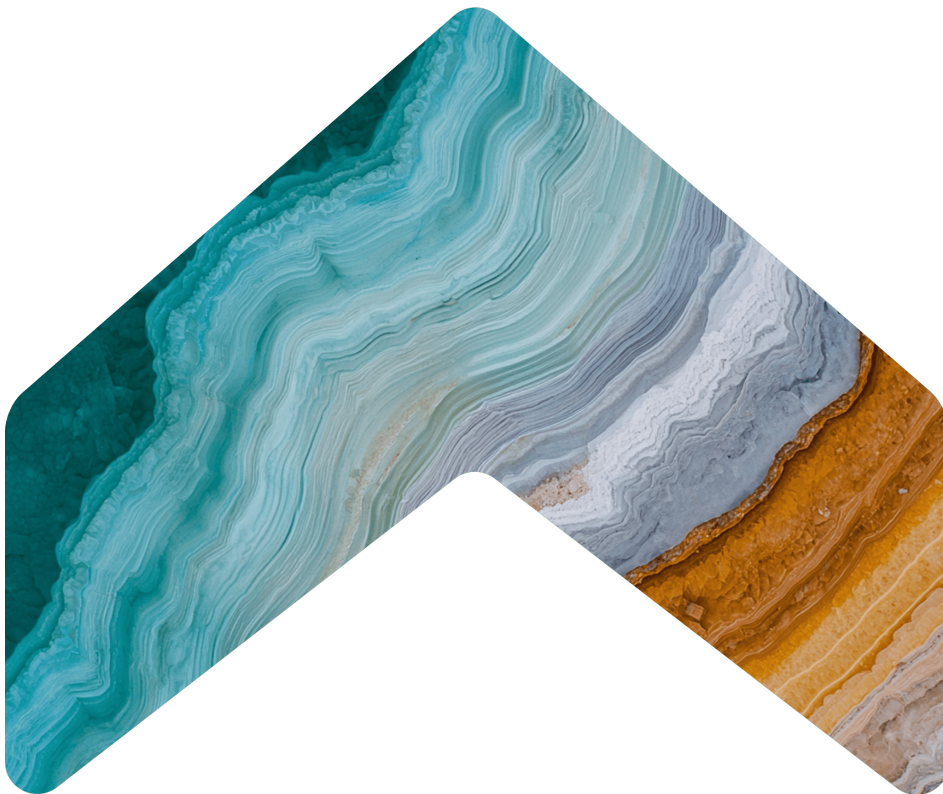


# Rethinking the Approach to SRCC and Political Violence in the Global Environment of Rising Geopolitical Uncertainty – the Reinsurance Perspective

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In this paper, we consider the following question: is it time for insurers and reinsurers to rethink the current approach to first party property cover for strikes, riots and civil commotion (**SRCC**) and political violence, particularly in the face of the global environment of rising geopolitical uncertainty (**the Question**).

To facilitate the informed consideration of this Question, this paper addresses the necessary context in which this issue arises by providing an overview on the following matters:

- Firstly, a brief historical overview about the evolution of political violence exclusions in first party property insurance. The short point here is that as geo-political threats have evolved over centuries, insurers and reinsurers have responded by steadily expanding the scope of exclusions for political violence and political risk, however, the evolution of the exclusions has lagged behind the evolution of the political risks.
- Secondly, a brief overview about the development of a global war, terrorism and political violence (**WTPV**) insurance market to provide cover for the political violence risks that are typically excluded under standard first party property policies.
- Thirdly, a brief overview of the current approach to political violence risks and SRCC. The short point here is that most current first party property policies contain express exclusions for various forms of political violence, which do not include SRCC. As most first party property policies these days provide cover for “all risks” except as excluded, it follows that damage caused by SRCC is generally covered.

It is against this context that the authors pose the Question and posit that a re-think to the current approach to SRCC may be in order.

## 1. The historical evolution of political violence exclusions

The modern standard clauses excluding political violence have evolved against the backdrop of history. As geo-political threats have evolved over the centuries, insurers have responded by steadily expanding the scope of exclusions for political violence and political risk, first in the marine market, and more recently in the non-marine market.

In the marine context, a pivotal moment occurred in 1898, when a colonial spat in Sudan (the Fashoda Incident) very nearly triggered a full-scale war between Britain and France. This seriously rattled the marine underwriters at Lloyd’s. At a general meeting of Lloyd’s that year it was decided that marine risks and war risks would be insured by separate policies. This was the catalyst for the development of the WTPV insurance market. In 1899 it was further resolved that all marine policies at Lloyd’s should include a Free of Capture & Seizure (**FC&S**) clause excluding war risk perils unless otherwise specifically agreed. The London insurance companies outside of Lloyd’s followed suit.

Likewise, for non-marine risks, the nature of cover for political violence risks also underwent a period of significant evolution, particularly from the early twentieth century onwards. Specifically, in the early twentieth century property damage due to war or other political violence was generally considered a relatively localised risk that did not pose a systemic risk to the business of property insurance. That all changed with the advent of the airplane and its use in warfare.

While airplanes were used in World War 1, mostly for reconnaissance, the Spanish Civil War in July of 1936 saw the emergence of a new feature of warfare that drastically increased the potential exposure of the non-marine property insurance market to war risks – the use of mass aerial bombardment of large, densely insured, cities and other urban areas.

Prior to July of 1936 non-marine underwriters were writing bomb risks freely. However, following the start of the Spanish Civil War, the Chairman of Lloyd's at that time, Neville Dixey, saw that the continued writing of "war on land" risks threatened the security of the entire Lloyd's and other markets and needed to be stopped. With the agreement of Lloyd's, a new war on land exclusion was drafted, and Dixey was authorised to negotiate with British and foreign insurers to secure their agreement to it. That exclusion was NMA464 which provided that a policy does not cover loss or damage "*directly or indirectly occasioned by, happening through or in consequence of war, invasion, acts of foreign enemies, hostilities (whether declared or not), civil war, rebellion, revolution, insurrection, military or usurped power or confiscation or nationalisation or requisition or destruction of or damage to property by or under the order of any government or public or local authority*".

NMA464 became the global standard war risks exclusion from 1938 to about 2001, when the terrorism-related events of September 11<sup>th</sup> (9/11) caused a re-think.

While 9/11 was no doubt a pivotal event in the history of both terrorism and terrorism insurance, it was not the first such event. On 19 July 1946, the King David Hotel in Jerusalem (which housed the headquarters for the British military) was reduced to rubble by a Jewish underground organisation who had placed 500 pounds of TNT in the basement, leading to a large insurance claim. That attack was a wakeup call for the London Market, who realised that the NMA464 did not clearly describe or exclude terrorist acts.

Over the ensuing years, various iterations of terrorism exclusions were drafted. The earliest terrorism exclusions which only excluded terrorist acts aimed at overthrowing governments proved to be inadequate for the evolving terrorism threat which included acts that were aimed at "influencing" governments.

Through the 1990s there was much debate about the extent to which terrorism should or should not be excluded. At that time, many reinsurers still saw terrorism as a relatively insignificant risk in insurance terms as most terrorist attacks remained local, limited, and sporadic.

That all changed with the events of 9/11. Although that attack followed a trend of increasing violence and the globalisation of terror organisations, it was of a different order of magnitude to anything previously experienced.

Reinsurers immediately realised the massive accumulation problem posed by this new form of 'mega terrorism'. As a result, all reinsurers began to add new broad terrorism exclusions to policies at the earliest possible opportunity, thus compelling primary insurers worldwide to follow suit.

The NMA2918 and NMA2919 clauses (or slight variations) soon gained traction in international markets and are now generally considered to be the modern 'standard' form of non-marine political violence exclusion appearing in insurance and reinsurances globally.

NMA2918, for example, not only excludes many of the same political violence terms set out in NMA464, it adds the following to the list of excluded acts of political violence: terrorism (which is broadly defined by the endorsement to include acts committed for political, religious, ideological or similar purposes including the intention to influence any government and/or to put the public, or any section of the public, in fear) and "*civil commotion assuming the proportions of or amounting to an uprising*".

Like NMA464 before it, NMA2918 applies where damage is either directly or indirectly caused by any of the excluded acts of political violence. Significantly, however, NMA2918 includes another significant feature which greatly expands its efficacy beyond that of its predecessor, NMA464 – that is, it provides for a reversal of the normal burden of proof. Specifically, Insurers generally have the burden of proving facts necessary to engage the application of an exclusion to a claim. For political violence claims, however, the necessary facts, particularly in respect of the motivation for a perpetrator's acts of violence can be difficult to prove. To address this problem, NMA2918 contains the following express wording which reverses the burden of proof: "*If the Underwriters allege that by reason of this exclusion, any loss, damage, cost or expense is not covered by this insurance the burden of proving the contrary shall be upon the Assured*".

## 2. The development of a WTPV insurance market

A specialty WTPV market has developed to provide cover for the political violence risks typically excluded by endorsements such as NMA464 or NMA2918 in standard first party property policies.

Political violence policies in this specialty market are not only carefully underwritten for each insured and priced to reflect the unique risk exposures faced by each insured but also are written to provide cover for specific perils, all of which are expressly defined. This represents a stark departure of the practice in the first party property insurance market where the political violence exclusions do not define any of the terms, save for "terrorism".

## 3. The current approach to political violence and SRCC risks

Strikes, riots and civil commotion may often involve violence that can lead to damage to property, however, that violence may not necessarily involve the requisite political element necessary to engage any of the terms of the standard political violence exclusions such as the NMA2918 endorsement. As a result, because most first party property policies cover all risks except as excluded, damage caused by SRCC events are typically covered.

It is not uncommon for an Insured in Australia to have first party property insurance through an ISR policy (written on a Mark IV ISR wording) which contains both Perils Exclusion 1 and NMA2918, which exclude the following perils:

Perils Exclusion 1 in Mark IV ISR wording	NMA2918
<p><i>The Insurer(s) shall not be liable under Sections 1 and/or 2 in respect of:</i></p> <ol style="list-style-type: none"> <li>1. <i>physical loss, destruction of or damage to the Property Insured</i> <ol style="list-style-type: none"> <li>(a) <i>directly or indirectly occasioned by or happening through or connected with war, invasion, act of foreign enemy, hostilities (whether war be declared or not), civil war, rebellion, revolution, insurrection, military or usurped power</i></li> <li>(b) <i>resulting from confiscation, nationalisation, requisition or damage to property by or under the order of any Government or Public or Local Authority</i></li> </ol> </li> <li>...</li> </ol>	<p><b>NMA2918 War and Terrorism Endorsement</b></p> <p><i>Notwithstanding any provisions to the contrary... this insurance excludes loss, damage...directly or indirectly caused by...</i></p> <ol style="list-style-type: none"> <li>1. <i>war, invasion, acts of foreign enemies, hostilities or warlike operations (whether war be declared or not), civil war, rebellion, revolution, insurrection, civil commotion assuming the proportions of or amounting to an uprising, military or usurped power; or</i></li> <li>2. <i>any act of terrorism [as expressly defined in the endorsement]</i></li> </ol> <p>...</p> <p><i>If the Underwriters allege that by reason of this exclusion, any loss, damage cost or expense is not covered by this insurance the burden of proving the contrary shall be upon the Assured.</i></p>

It will be readily apparent that there is significant overlap between Perils Exclusion 1(a) and subparagraph 1 of the NMA2918 Endorsement, as both clauses exclude many of the same things using the same

undefined terms. There is, however, a very significant difference between the two exclusions – that is, the Insurer bears the burden of proof to engage Perils Exclusion 1. In contrast, NMA2918 places the burden on the Insured to prove that the exclusion is not engaged.

This has the potential to create significant coverage disputes (and therefore uncertainty) about the extent to which claims for damage caused by strikes, riots and/or civil commotion are covered by the Policy. Such claims would not be excluded by Perils Exclusion 1. However, such claims could engage the exclusion of NMA2918 in respect of “*civil commotion assuming the proportions of or amounting to an uprising*”, particularly if the Underwriters so allege – as it is the Insured who has the burden to prove the exclusion is not engaged. Leaving aside the burden of proof issues, there is an obvious issue about where to draw the line between “*civil commotion*” which is not excluded and “*civil commotion assuming the proportions of or amounting to an uprising*” which is excluded.

## 4. Revisiting the question

This brings us back to the Question posed at the outset of this paper. The undefined SRCC perils are currently insured under first party property “all risks” policies. The authors suggest that it may be time to re-think that status quo and to move coverage for those SRCC perils to the specialist WTPV insurance market instead for the following reasons:

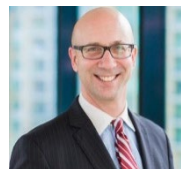
- Firstly, the lack of clarity about where to draw the line between covered civil commotion and excluded civil commotion as described above.
- Secondly, there is an increased frequency and severity in the R and CC components of SRCC due to factors such as a sense of injustice based on economic, racial, political or religious issues around the globe, which are amplified and spread over the internet and social media, thereby exponentially increasing the severity of such risks. This is posing a risk to the sustainable provision of SRCC capacity in the conventional first party property market as insurers and reinsurers will invariably look to manage and/or limit their exposures through various policy mechanisms (e.g. sub-limits, deductibles, restrictions based on type of occupancy, temporal and spatial limitations, country-specific exclusions, etc.).
- Thirdly, there will be an inevitable tension between an Insured’s need for adequate insurance cover for its SRCC risks and the decreasing appetite of insurers and reinsurers to provide such cover as part of their first party property policies.

It seems to the authors that the future of SRCC cover is for it to be shifted out of the first party property insurance market and into the specialist WTPV market where it can be specifically underwritten, priced and more clearly articulated by wordings that provide cover on a defined perils basis, thus providing greater certainty for all stakeholders.

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