

ARE MULTINATIONAL CORPORATIONS UNDERESTIMATING EVOLVING TERRORIST THREATS?

BY GREGORY RANC

A decade after the attacks of September 11, 2001, terrorism remains a significant risk for corporations throughout the world. To address the financial and operational fallout from an attack, multinational corporations can mitigate loss through insurance, reinsurance, and risk management tools. Over the years since the 9/11 attacks the terrorist threat has evolved, leaving many multinational firms unaware of new or changing exposures. These firms need to ensure that adequate procedures and resources are in place while securing the insurance and reinsurance solutions that are appropriate for their specific risk profile.

There are three categories of risk to be considered when managing these threats; political risk, terrorism, and political violence. Consequences and losses due to these risks can arise following a single catastrophic event or through a chain of events that build slowly.

Political Risk

It is important to note the distinction between political risks specific to business and the political risks regarding operations specific to the business' host country¹. Political risks specific to business are those risks that target a business's operations based on discriminatory political differences and agendas. For example, the risk of a host country's government cancelling its contract with a business as opposed to a terrorist group that targets the physical operations of the company.

There can be political risks specific to a country that, while not directed against a particular company in the private

sector, target the whole country and can, thus, affect the functioning of the business operating there. Examples include a government's decision to forbid the transfer of currencies or the outbreak of civil war.

Government instability can be identified as political risk when governmental authority is exercised legally or illegally. Many government risks, notably those that are specific to business, contain an ambiguous mixture of legal and illegal elements. Actions ranging from a legitimately enacted tax hike to an extortion ring that is authorized to operate (e.g. directed and supported by a corrupt local police force) can be considered as risks linked to government. The danger of government instability can result in political unrest, for example when conflicts arise between distinct members of a government fighting for succession or from responses to the deterioration of social conditions, such as massive and wide scale riots. Political violence is therefore part of political risk. In addition to strikes, urban riots, and civil wars, the following events can be included when defining political violence exposures: wars, social disorders, insurrections, rebellions, and revolutions.

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Terrorism

Terrorist risk can generally be defined in four categories; Islamic extremist terrorism (Al-Qaeda); Separatist terrorism (ETA – Euskadi Ta Askatasuna/ Basque Fatherland and Liberty in Spain); Anarchist terrorism described as “left” (A Exarhia in Greece); Terrorism described as “right” (Anders Behring Breivik in Norway)².

Due to international interpretations and complex characteristics, there is no unique or unified definition of terrorism. For companies buying insurance, its meaning depends on the country in which a business is based. For example, the government of Canada or Switzerland does not have the same experience addressing terrorism as does Spain or the United Kingdom. The United Nations attempted to develop a common definition but were unsuccessful. The different interpretations that exist throughout the world converge towards describing an act of terrorism as “an action perpetrated by an effective person in the name of, or in relation with, an organization that exercises coordinated activities towards the overthrow, or the influence of a sovereign government by force, violence, or fear”³.

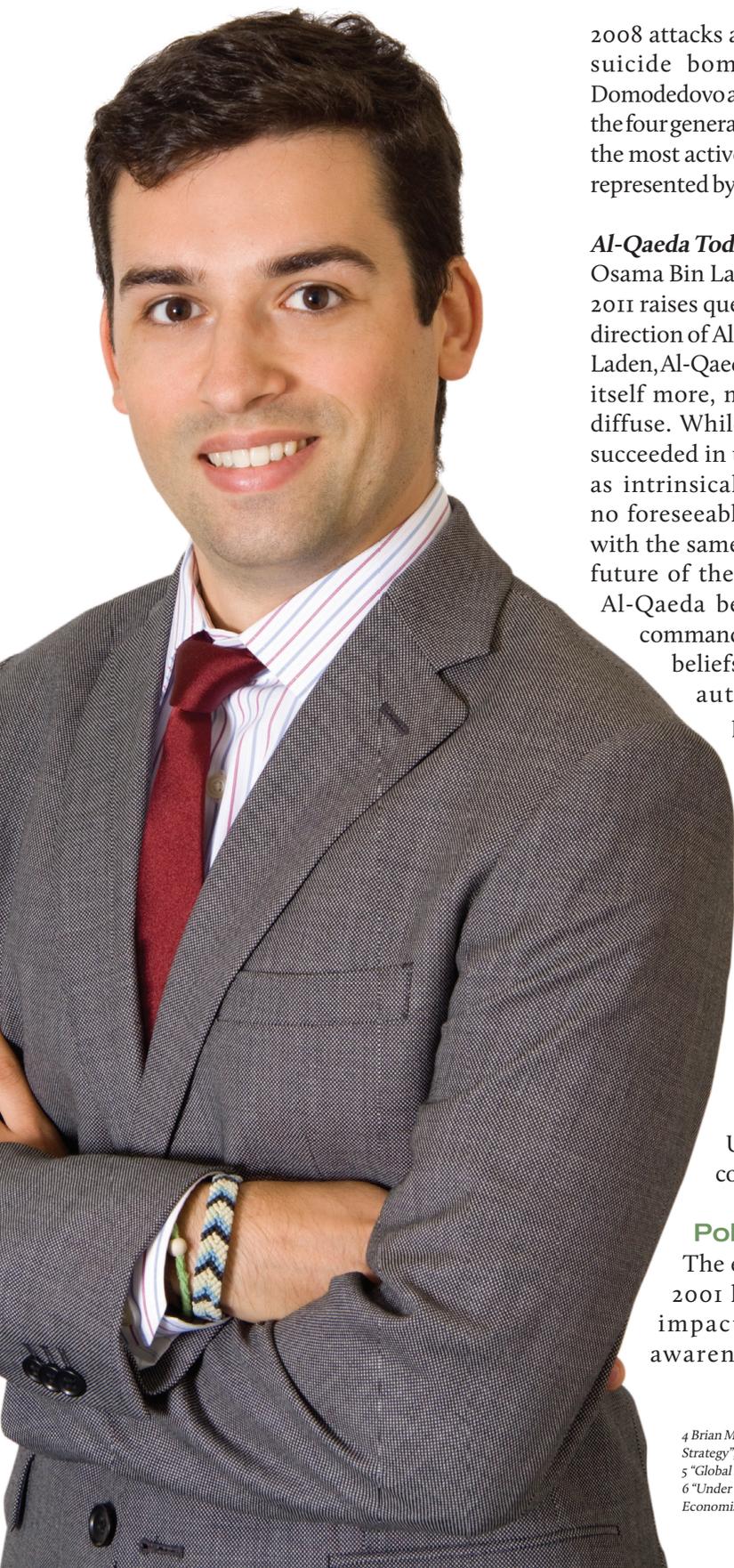
Although no comparable attacks to the World Trade Center in 2001 have been repeated, the threat has always been present and has since taken new forms. International terrorism continued after 2001, most notably with the 2002 Bali nightclub bombing, the 2004 train station bombings in Madrid, the 2005 public transportation bombings in London, the

¹ Daniel Wagner, CEO of Country Risk Solutions (CRS).

² “Te-Sat 2011 – EU Terrorism Position and Trend Continuation”, Europol, 2011.

³ Christiane De Bondy, GAREAT's General Secretary, June 27-28 2011, 3RD Asian Risk Management Conference, Singapore.

MANY MULTINATIONALS REALIZE THAT TERRORISM THREATS CONSTITUTE REAL RISK -BUT ARE THEY RESPONDING EFFECTIVELY?



2008 attacks across Mumbai, and the suicide bombing in 2011 at the Domodedovo airport in Moscow. Within the four general definitions of terrorism, the most active and organized group is represented by Al-Qaeda.

Al-Qaeda Today

Osama Bin Laden's death on May 2nd 2011 raises questions about the future direction of Al-Qaeda. Firstly, after Bin Laden, Al-Qaeda is likely to decentralize itself more, making its threat more diffuse. While still alive, Bin Laden succeeded in unifying his operations as intrinsically anti-American but no foreseeable successor can speak with the same authority as him. The future of the organization may see Al-Qaeda become a collection of commanders only united by their beliefs while divided up in autonomous territories presided over by a central governing body.

Secondly, the death of Bin Laden does not mean the end of the worldwide terrorist objectives of Al-Qaeda. The declared elevation of Ayman Al Zawahiri as the organization's leader suggests Bin Laden's insistence to attack Western interests, and in particular the United States, will continue after his death⁴.

Political Violence

The events of September 11, 2001 had an unprecedented impact by raising global awareness that a terrorist

organization could plan attacks of large scale and opt for financial targets as well as political targets. The terrorist threat has since continued to develop on a smaller scale while social and political events shaped by political violence are emerging.

The results of the Global Risk report 2011⁵ illustrates the fact that multinational corporations perceive political violence as a high probable risk. The factors that are of particular concern are political radicalization, religious radicalization, social fragmentation, economic disparity, geopolitical tensions, and the existence of fragile States. Multinational corporations are aware of threats due to social change and wealth disparity, as supported by the following statistic: 63 percent believe that their businesses face political violence due to their relationship with and role in the capitalist system. Additionally, three out of five business leaders predict that the operational risks associated with political violence will increase during the five next years. The Middle East and the United States are considered the two main regions exposed to these threats⁶.

In 2011, this risk was at the heart of a movement called the "Arab Spring", which unleashed a wave of peaceful demonstrations through Tunisia, resulting in the ousting of president Zine el-Abidine Ben Ali. After the uprising in Tunisia, protests in Egypt in January and February 2011 forced president Hosni Mubarak to resign. Nevertheless, the quick overthrow of the Presidents of Tunisia and Egypt did not yield the same results elsewhere in the region. While other small scale demonstrations took place in almost every other Arabic country in the region, the governments of Bahrain, Libya, Syria, and Yemen deployed troops to withstand the call for change. In some countries civil war was declared. In Libya, civil revolt culminated with the capture and death of Colonel Kadhafi. In Yemen, President Ali Saleh stepped down and ceded power to his deputy and in Syria civil unrest currently rages on without an end in sight.

4 Brian Michael Jenkins, "Al-Qaeda after Bin Laden Implications for American Strategy", The RAND corporate Body, June 22 2011.

5 "Global Risks 2011 6TH Edition", World Economic Forum, January 2011.

6 "Under attack? Global business and the threat of political violence", The Economist Intelligence Unites Ltd and Lloyd's, 2008.



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Managing Evolving Risk

Overall, the level of preparedness of multinational corporations to protect themselves from terrorist threats is favorable, but that distinction depends on the criteria that is chosen to measure the level of preparedness. Awareness is growing and these threats seem well integrated in most risk management approaches. Although, as risk awareness is a necessary component of risk management, most firms do not have sufficient safeguards in place.

Establishing performance tools and procedures to assure the continuity of operations and crisis management is essential. On this particular point, many multinational corporations do not have policies in place to avoid delays in recovery if any of these types of events occur.

The reinforcement of multinational businesses’ information on terrorism and political violence risks is a major aspect to ensure proper risk management. It requires a deeper understanding of the financial, social, political and humanitarian situations of the respective countries in which they operate. Collaboration with local authorities and other local decision makers help address these factors. In countries with fragile security and political environments, local commitment is a significant advantage for international corporations. Indeed, a multinational business’s involvement in the local economic and social life (financial development and humanitarian initiatives) contributes to the strengthening of a positive corporate image of the company.

Solutions

The definition of “terrorist threats” covers a wider spectrum than ten years ago, and the risks linked to these threats logically follow. Multinational corporations are therefore concerned about insuring several aspects of their operations and the levels of consequence each loss would

present. Three specific categories to be considered when insuring against assets targeted by terrorism; human resources (employees); physical resources (buildings, machinery); and intangible resources (the business’ reputation and/or its computer data).

Because multinationals operate in several countries, they are more likely to be exposed to terrorist and political violence risks than a business located in one nation. This risk is diverse and can be a destabilizing force for both their financial health and operations, should an act occur.

In the aftermath of September 11, 2001, many countries, starting with the United States and France, established programs with insurance and reinsurance companies to allow coverage against terrorist risks to become readily available. Before the September 11 attack, other countries like Spain and the UK, having already experienced terrorist attacks of their own, had established similar compensation strategies. In 1986, France created a compensation fund for victims of attacks within its borders and for French nationals who are victims of terrorism abroad. In 1990, the compensation for victims of terrorism, previously managed by the State, were reserved to a new fund, the FGTI⁷. Multinational corporations must rely on the local regulations in the countries where they operate to determine exposures. The terms and conditions that frame these local programs vary from one country to another but it is a non negligible element that must be considered by corporations when creating global terrorism insurance programs.

Today, 12 of the 34 countries that make up the Organization for Economic Cooperation and Development possess insurance and reinsurance programs for the compensation of victims following a terrorist attack. Altogether, 20 different models are in place around the world, as

a whole they manage the same risks. Some exceptions, such as France, offer a wider cover.

Various approaches to provide solutions are being created and financed by private insurance companies. Their intervention is fueled by the retention that is imposed on them (or threshold from which the State intervenes), by the financial contribution linked to the reinsurance cost, and to bolster their corporate responsibility by offering this coverage to employees. Regardless of private sector solutions, the total withdrawal of any financial support from the State is not probable, even in the current situation of excessive debt that most of the governments (guarantors of these funds) are experiencing.

Limited Capacity of the National Programs

From an ethical point of view, government intervention is a necessary function. Terrorism affects several public issues such as national security, national interest, compensation for domestic victims, and the overall economy of the country. All forms of political organization (republic, federal, state, monarchy) are concerned about terrorism and are facing its challenges.

Government programs provide limited coverage in terms of value, including such limitations as restrictive conditions on covered perils. As this coverage is usually insufficient, the market has a fundamental role to provide additional coverage or a more appropriate solution for corporations and insurance firms.

The coverages available on the private insurance and reinsurance markets offer the following advantages:

- Ability to extend coverage to include perils otherwise unavailable such as nuclear, biological, chemical, and radiological attacks; war; and civil authority exposures
- Broader coverage in more territories

- Certification of an act of terrorism by the government is not required (for example the United States requires governmental certification before compensation is paid)
- No minimal loss requirement to reach the intervention threshold above an agreed deductible
- Fire damage and loss as a result of a terrorist act is included in the coverage
- Coverage can be extended beyond the expiration of national programs (2014 for the United States)

Originally, the capacities of the terrorism insurance market offset the exclusion of terrorist risk from property policies added after September 11, 2001. The absorption potential of the losses has increased significantly in the last 10 years, from a few hundred million to over \$2 billion today.

This significant increase underscores two major points:

- Demand for terrorism insurance

products available in the market is strong and growing.

- The largest markets with capacity for solutions are Chartis and Lloyd's of London
- Underwriting capabilities and stand-alone terrorism forms have been developed over the past decades as the private market has grown.

Insurance Markets Evolving to Meet New Risks

The risks linked to terrorist threats are increasingly sophisticated and wider in scope. This evolution tends to ensure that the development of the stand-alone market in this space will continue. With regard to insurance products, terrorism and political violence risks are more likely to be covered by a single contract. For example, Hiscox is one of the pioneers on this type of coverage. Recently, Bermuda-Hiscox Ltd. developed an insurance product designed specifically for U.S. hospitals to deal with terrorist threats. This new product offers up to \$50 million for full coverage against liability related to terrorism, the risks of nuclear, chemical, and radioactive terrorism, compensation for the security and evacuation of victims, and casualty triage expenses⁸.

Reaching appropriate levels of protection and optimum preparation to address terrorism and political violence risks lead to substantial financial investments for any company. In today's current period of economic crisis, multinational corporations often decide to cut these expenditures in efforts to post profits and allot funds to expenses deemed more essential for

revenue producing operations. The crisis that Europe and other western economies face is becoming a spark for political violence (for example, Greece or Great Britain), which can in turn become a potential generator of terrorist acts.

Moreover, multinational corporations must deal with other catastrophic risks such as natural events like earthquake, flood, tsunami, volcanic eruption, and hurricane exposures. Natural disaster risks are defined and covered separately from terrorism and political violence risks, as the latter are man made catastrophes. These risks can be just as destructive with serious implications for the financial accounts of companies, especially as the frequency of recorded disasters during the last decade has increased compared to previous years. This leads reinsurers to make estimates in terms of insured losses. Today, the black swan theory⁹ plays an increasingly significant role in risk managers' reflection and strategy.

Multinational corporations are intelligently run organizations that have proven in the past to be appropriately flexible when facing changes in their industries as well as emerging global challenges. They can count on their internal strengths. Crisis Management and Business Continuity plans are efficient tools to reinforce their capacity to proactively respond to Natural Disasters, Terrorism or Political Violence perils. The hypothesis is thus formulated that these businesses will adapt themselves through public, private and internal solutions to meet the challenges of prevention and coverage of terrorism and political violence risks.



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