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MARSH INSIGHTS: PROPERTY

TERRORISM RISK INSURANCE UPDATE

By Tarique Nageer, Senior Vice President, Global Risk Management, Marsh's Property Practice

The Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA) — the federal terrorism insurance backstop program — is scheduled to expire on December 31, 2014, unless it is reauthorized by Congress. For organizations that rely heavily on TRIPRA for terrorism insurance coverage, the current period of uncertainty can be unsettling. As they plan ahead, it can be useful for them to begin considering alternative ways of insuring terrorism risk.

POTENTIAL RAMIFICATIONS IF TRIA IS NOT REAUTHORIZED

Originally enacted as the Terrorism Risk Insurance Act (TRIA), the law was reauthorized in 2005 and more recently in 2007 as TRIPRA. If the government does not renew this reinsurance backstop, the market dynamics for terrorism insurance will be disrupted and will likely result in increased pricing and capacity shrinkage, especially for risks in the central business districts of major cities. Commercial property lines are especially sensitive.

A handful of bills have been introduced in the US House of Representatives to extend TRIPRA (see Figure 1); however, to date there has been little substantive action on the legislation in the House Financial Services Committee. Congress this year is expected to study the issue before any legislative steps are taken, with hearings possible later in the year. In the event that TRIPRA is not reauthorized, property insurers will likely exclude or dramatically reduce terrorism coverage from policies. The private insurance market is unlikely to be an adequate substitute to TRIPRA; what limited coverage is available will be met with increased pricing.

Before TRIPRA's 2005 extension, Marsh's property and terrorism experts conducted 50 interviews with commercial property insurers. Of those interviewed, 34 (68%) said they would have excluded terrorism coverage if the law was not extended at that date.

ALTERNATIVE APPROACHES

Clients that rely on TRIPRA can develop a number of risk transfer approaches should the Act be changed or not extended. It is important to note that program structures are contingent upon an insured's specific needs. Also, buyers of TRIPRA coverage in high-demand areas are unlikely to be able to replicate their current level of coverages and limits provided by TRIPRA as part of their property and captive programs.

Property Programs: If TRIPRA is 100% embedded as part of an "all risk" property insurance program, organizations should determine which property insurers are likely to continue to offer terrorism coverage

Table of Contents

regardless of the law's extension. If gaps in capacity are identified, insureds may want to consider:

- Standalone capacity.
- Standalone capacity commitment contracts.
- Excess standalone contracts with the option to drop down and fill gaps in capacity where property carriers cannot continue to offer terrorism coverage in the Act's absence.

Marsh experts can also assist clients that currently access standalone terrorism insurance markets for either US noncertified or international terrorism coverage in engaging insurers and discussing options and terms for converting capacity to cover full terrorism risk in the US.

Captives: Organizations that access TRIPRA coverage via a captive property program or a standalone captive policy can consider securing standalone terrorism reinsurance for the captive's liabilities. This standalone capacity can then be accessed directly should TRIPRA not be extended.

Captives that already purchase standalone terrorism reinsurance as part of their property terrorism coverage can consider identifying standalone terrorism insurers to increase their capacity to cover potential changes in TRIPRA. If the law is not extended, captives can consider converting the standalone terrorism reinsurance limits to primary coverage and seek additional limits in the standalone terrorism insurance market.

DATA AND ANALYTICS

It is critical for clients to provide insurers and reinsurers with the highest-quality data to receive the most accurate terms, conditions, and pricing based on their actual exposures. Data related to property and employee accumulation, for example, can affect a carrier's view of terrorism loss and, in some cases, can help minimize the impact that default assumptions have on expected modeled losses. Examples include:

- Location and property/building information, including COPE (construction, occupancy, protection, and exposure) data.
- Total number of employees by location, at the address level.
- Shift information or maximum employees at each location at any one time.
- Whether the property is a single location or multiple-building campus setting.
- Building construction type.
- Floor where employees are located.

Providing complete data can ultimately reduce the volatility and uncertainty of terrorism risk from an underwriter's perspective, allowing more accurate pricing and coverage. For an insured, it can lead to better understanding of exposures. Thus, an organization can be better positioned to purchase adequate coverage limits with appropriate terms and conditions in the event that TRIPRA legislation is changed or not extended.

TERRORISM RISK MODELING

Terrorism risk models can help organizations make informed risk financing decisions in the event that TRIPRA is changed or not extended. The terrorism modeling process follows techniques that are similar to earthquake and windstorm models and are based on engineering outcomes calculated from event modeling and building response databases. These models are constantly refined by the insurance industry.

Individual companies are increasingly using data management systems and modeling tools to understand the relationship between vulnerable sites and the likelihood of impact from terrorist acts — or other risks — on their operations and profitability. These models aim to calculate the potential economic losses stemming from a terrorist event and support financial quantification of these risks to help companies:

- Achieve greater understanding of their financial exposures, insurance program design, and risk financing options.
- Assess the appropriateness of insurance deductibles and limits.
- Rate their terrorism risk to negotiate adequate insurance premiums.
- Prioritize risk mitigation strategies.
- Develop an efficient business continuity plan.
- Understand the correlation and potential benefits of diversification among sites, locations, and regions.

MARSH URGES LAWMAKERS TO REAUTHORIZE TRIPRA

Marsh has been heavily involved in providing the US government feedback regarding TRIPRA, and remains steadfast in advocating for clients in support of the program. On September 19, Peter J. Beshar, Executive Vice President and General Counsel of Marsh & McLennan Companies, testified before the US House of Representatives Committee on Financial Services on the future of TRIPRA. Mr. Beshar, who also presented on the same subject before the Senate Banking Committee on September 25, testified that TRIPRA is needed; that the program is a model of public-private partnerships; and that TRIPRA also serves to protect the government and taxpayers. Mr. Beshar's testimony is available here.

In addition to Mr. Beshar's testimony, Marsh representatives responded to the President's Working Group on Financial Markets on the long-term availability and affordability of insurance for terrorism risk in the US. The response is available here.

For an in-depth discussion on terrorism risks, including terrorism risk modeling, explore Marsh's Terrorism Risk Insurance Report.

HOW MARSH CAN HELP

Marsh's Property Practice is well-positioned to advise our clients on the latest issues surrounding TRIPRA legislation, to best prepare for alternative terrorism insurance programs should TRIPRA not be reauthorized, and to gather and present complete data that may affect terrorism risk insurance pricing and coverage.

For more information, contact your Marsh representative or visit us at marsh.com.

FIGURE 1: SUMMARY OF PROPOSED TRIA REAUTHORIZATION LEGISLATION (AS OF SEPTEMBER 10, 2013)

Stipulations	Terrorism Risk Insurance Act of 2002 Reauthorization Act of 2013 (H.R. 508)	Terrorism Risk Insurance Program Reauthorization Act of 2013 (H.R. 2146)	Fostering Resilience to Terrorism Act of 2013 (H.R. 1945)
Sponsorship	75 cosponsors, 35 Republicans and 40 Democrats	31 cosponsors, 30 Democrats and 1 Republican	6 Democrat cosponsors
Term (Expiration)	December 31, 2019	December 31, 2024	December 31, 2024
Recoupment Deadline	September 30, 2024	September 30, 2027	September 30, 2024
Reporting Requirements	None	2013, 2017, 2020, and 2023 on the findings of the President's Working Group on Financial Markets to determine long term affordability/availability of terrorism insurance.	2013, 2017, 2020, and 2023 on the findings of the President's Working Group on Financial Markets to determine long term affordability/availability of terrorism insurance.

RISING FLOOD INSURANCE PREMIUM LEVELS

By Patrice A. Collingwood, Marsh's Flood Service Center Practice Leader

The Biggert-Waters Flood Insurance Reform Act of 2012 requires the Federal Emergency Management Agency (FEMA) to adjust the way it manages the National Flood Insurance Program (NFIP). The law extends the NFIP through September 2017 with significant program reforms and aims to eliminate subsidies and discounts on flood insurance premiums.

Key provisions of the law require the NFIP to:

- Increase rates to reflect the actual flood risk, subject to a maximum of 20%.
- Create a financially stable insurance program.
- Eliminate subsidies that prevent rates from accurately reflecting the associated risk.
- Change how updates to Flood Insurance Rate Maps (FIRMs) affect policyholders.

CHANGES EFFECTIVE OCTOBER 1, 2013

The changes that took effect October 1, 2013, represent only one section (205) of many in the Act and include:

- A 25% premium rate increase that applies annually to coverage already placed for:
  - o Pre-FIRM (built before 1974 or the date of the initial FIRM) commercial properties located in a Special Flood Hazard Area (SFHA) that are not currently rated using an Elevation Certificate (EC).
  - o Properties having incurred flood-related damages in which the cumulative amount of the NFIP claim payments exceeds the property's fair market value.
- A 20% premium rate increase that applies to new and renewal policies issued under the Preferred Risk Policy Eligibility Extension.
- Elimination of rate subsidies for:
  - o New coverage placed on or after July 6, 2012, on a pre-FIRM SFHA-located structure or for any policy that has been allowed to lapse. These properties will require an EC as well as photos showing the distinguishing characteristics of the insured structure in order to place, renew, and/or reinstate coverage and to determine a risk-based premium.
  - o Situations in which there is a change in ownership, title, and/or deed on any pre-FIRM SFHA-located structure. This applies even if the current owner has an in-force NFIP policy.
- Creation of a reserve fund to meet the program's future loss obligations. This fund will be built by adding to the overall premium calculation a charge of 5% of the total annual premium for all policies except those placed in the Preferred Risk Program.
- An annual federal policy fee change:
  - o A Preferred Risk Program will increase to $22 from $20.
  - o All other programs will increase from $4 to $40.
- Applications have been expanded to include questions/elements required to implement the law's provisions. Examples include questions/elements pertaining to date of purchase, the use of the property, any elevators in the building, and any machinery and equipment servicing the building and located within its footprint.

CONTINUING CHANGES

As Biggert-Waters implementation continues, Marsh will keep clients aware of the additional changes. For example, Provision 207 — to be implemented in 2014 — will phase out rates based upon an older FIRM as a community adopts new ones. Premiums will increase 20% each year for the next five years.

Additionally, we will keep you informed about several pieces of legislation currently before Congress that would amend and potentially discontinue aspects of Biggert-Waters.

MANAGING YOUR RISK

Marsh's team of experts can work with property owners to address NFIP premium increases and manage their flood insurance costs.

For coverage to be properly rated and placed, Marsh can help insureds to manage and present to insurers crucial information such as the purchase date of the building, description of any building additions or extensions, and additional information regarding tenants' coverage. Also, Marsh's Flood Service Center will analyze a client's elevation certificate to determine which rates are more beneficial, the EC-produced rates or the NFIP set increase.

To make informed insurance and risk management decisions, property owners can first obtain an EC to determine the organization's true risk premium. Using this information, risk professionals may structure their flood insurance programs with higher deductibles, which may lower overall premium rates.

Incorporating flood mitigation during any remodeling and rebuilding processes as well as participating in community efforts that reduce overall flood risks could reduce premium.

For more information on changes to the NFIP and flood risks, contact your Marsh representative or visit us at marsh.com.

KNOW YOUR BUSINESS INTERRUPTION VALUES AT RISK

By Brian E. Hudecek, Senior Vice President, Forensic Accounting and Claims Services, Marsh Risk Consulting

Understanding the values at risk and overall loss of income exposures can be critical to an organization's finances, operations, and overall success. Companies affected by Superstorm Sandy experienced significant interruptions to their operations, affecting financial returns and exposing business interruption (BI) insurance coverage limits during the adjustment process. These limits often resulted in complicated and protracted insurance claims, some of which have yet to be paid.

This experience reinforced the importance of thoroughly understanding an organization's income exposures. As Marsh clients and prospects work to renew their property programs, they are now faced with uncertainties regarding the need for BI insurance and the amount of coverage that is necessary to indemnify their businesses in the event of a loss. Understanding BI values can help organizations determine:

- The amount of coverage needed.
- Risk retention and transfer options, including captive solutions.
- Appropriate limits.

Marsh Risk Consulting's Financial Advisory Services (FAS) Practice supports organizations' efforts to provide accurate financial data for insurance coverage purposes. Our cross-company, multidisciplinary team of forensic accountants, policy experts, risk engineers, and supply chain and resiliency professionals can analyze an organization's risk to provide a comprehensive evaluation of BI exposures. This understanding of values at risk offers significant insight so that an organization and its broker can make informed decisions about which policy best protects the business.

FAS provides three levels of company- and industry-specific analyses — a basic 12-month valuation required by underwriters, an anticipated maximum business interruption loss (AMBIL) calculation, and a contingent business interruption (CBI) exposure study – all of which provide important information for internal decision making.

BASIC 12-MONTH BI VALUE CALCULATION

To get started and to satisfy underwriters' demands, a basic 12-month valuation is necessary. FAS often assists Marsh clients with this basic valuation, as both clients and underwriters feel more confident with a financial statement-based study provided by an independent party. This approach provides transparency into which operating costs and expenses an organization intends to insure along with the profits of the business. The resulting BI value percentage — the product of dividing the calculated value by the annual net sales — gives an organization a quick metric to determine the estimated loss that would be sustained per dollar of lost net sales, a powerful tool when considering the costs and potential mitigations of business continuities.

Although most organizations go through some process to present their BI values to underwriters, it is by no means the same exercise for each. The industry, complexity of the organization, and existence of transfer pricing between domestic and/or foreign affiliates, among other issues, can complicate the process. Another complicating factor is that formal accounting may be misaligned with an organization's risk. This is often deceiving, as the risk to the organization rests predominantly at the physical location where business activities occur, which is not necessarily the same as the operating location or segment where income is booked.

In conducting past studies, FAS experience is mixed as to whether the calculated BI value is greater or less than the amount previously reported by a client. However, a constant benefit for risk professionals of knowing their values is being an informed decision maker and purchaser in the insurance marketplace. For example:

- If an organization is overinsured based on the results of the study, the reduction in necessary BI limits should result in premium savings.
- If an organization is underinsured based on the result of the study, it now has the information necessary to avoid or mitigate the experience and consequences of a financial loss far in excess of purchased limits through the purchase of additional insurance or an expanded risk management program.

ANTICIPATED MAXIMUM BUSINESS INTERRUPTION LOSS (AMBIL) CALCULATION

The next level of analysis involves the preparation of an anticipated maximum business interruption loss (AMBIL) calculation. An AMBIL calculation is a values reporting tool, which considers realistic repair/replace timelines and existing capabilities to mitigate the maximum potential losses to an organization's supply chains by utilizing inventory, redirection of product, and outsourcing, among others. As such, the AMBIL calculation presents a realistic measure of an organization's values at risk.

There are many reasons why an AMBIL calculation, which considers the unique characteristics of a company, might differ from the traditional 12-month BI valuation. The most easily understood difference involves geographic spread of risk. With a traditional BI values presentation, the addition of each location's calculated value would be presented to the underwriters. But, the AMBIL calculation considers events that would have a wide regional impact, possibly affecting multiple operating locations, and focuses on only those locations in the affected region as outlined by the loss scenario. An AMBIL calculation also:

- Quantifies the expected reduction in potential BI from existing business continuities and reduces the reported value accordingly.
- Considers realistic repair and/or replacement timelines.

A recent engagement highlights how each aspect of an AMBIL calculation assisted a hospital group in purchasing the proper amount of property insurance. The hospital group operated a main campus and remote health centers. Marsh Risk Consulting's engineers determined that the replacement timeline for the main hospital property was approximately 2 ½ years. However, based on the hospital group's geographic spread of risk and its ability to set up temporary operations for certain medical services, business could continue, in part, during reconstruction. Therefore the potential maximum loss to the main campus was only slightly higher than the 12-month BI value despite the elongated repair period.

CONTINGENT BUSINESS INTERRUPTION (CBI) EXPOSURE STUDY

The AMBIL calculation does not necessarily account for the potential impact on an organization's business from the suppliers and customers on which it depends. Expanding the BI analysis to the next level to include contingent business interruption (CBI) exposures is a smart and often necessary step.

Recent CBI events, notably the Japan earthquake and Thailand floods, highlight the need for increased visibility into the supply chain and understanding of key vulnerabilities so that appropriate coverage can be obtained and any potential outages or shortages are reacted to quickly and appropriately. Some of the CBI vulnerabilities have included:

- Insufficient CBI limits.
- Little or no indirect CBI coverage.
- Coverage provided for only the location where the loss occurred, leaving other global losses without coverage.
- Frequently inaccessible causation and other claim information required by the insurance adjusters, since the physical damage or other causes of loss did not occur at the policyholders' operating locations.

Underwriters have responded to these recent, unprecedented CBI events by demanding detailed CBI exposure information prior to providing increased or equivalent levels of coverage. CBI coverage can no longer be a simple add-on to the insurance policy. Assessment and quantification of an organization's direct and indirect exposures must be part of the process when establishing CBI limits and securing adequate coverage from the markets. This analysis provides insight into customers' and suppliers' risks to enable the creation of continuity strategies, a competitive advantage especially when there may be limited options in the marketplace. When quantifying CBI exposures, it is important to remember that:

- The sum of the parts can be greater than the whole, since two different suppliers can put the same dollar at risk.
- To avoid duplication and the overreporting of values, the focus should be on the maximum contingent exposures, usually from key suppliers and customers.
- CBI exposures can never exceed the BI value of a total shutdown over the same time period.
- Supply chain mapping and natural hazard exposure analyses help to support CBI quantifications.

Using a pre-loss exposure analysis — whether at a basic, AMBIL, or CBI exposure study level — to understand your values at risk provides the certainty needed as a buyer of property insurance and a manager of risk. These calculations are often an eye-opening experience, bringing new insight to the local and global risks inherent in your business.

For more information on Marsh's pre-loss exposure analysis capabilities, contact your Marsh representative or visit marsh.com.

AVOID THE COMPLACENCY TRAP WITH A STRATEGIC REVIEW

By Duncan Ellis, Marsh's US Property Practice Leader

The seemingly straightforward task of insuring and mitigating property exposures in a flat rate environment or a softening market can lead to program complacency and leave complex risks inefficiently managed. This may be especially true when the hurricane season is less active than anticipated, as is the case to date in 2013. To avoid the complacency trap, companies can undertake a strategic review of their insurance program, seeking new, more efficient ways of transferring and managing their risks.

Risk professionals must manage their full spectrum of exposures — from builders risk and business interruption to inland marine and terrorism — to avoid, mitigate, or transfer the risk. At the same time, cost-effective program structures and innovative risk solutions can be critical to the organization's bottom line.

SLOW START TO HURRICANE SEASON

Heading into the fourth quarter of 2013, property insurance market capacity was abundant and pricing remained stable — and in some cases was trending downward. To date, 2013 has been a fairly mild windstorm season, with only two North Atlantic hurricanes, neither of which made US landfall. Mexico has received the brunt of the damage thus far, with Hurricane Ingrid and Topical Storm Manuel causing upwards of 60 deaths.

The first hurricane of the season, Humberto, did not form until September 11. Typically, hurricanes have formed by early August, according to catastrophe (CAT) modeling firm EQECAT. In fact, had Humberto formed just three hours later, it would have tied 2002's Hurricane Gustav as the latest-forming first hurricane of a season, EQECAT said.

Not that the US has been completely spared damage from storms and flooding this year. The September floods in Colorado are likely to result in more than $2 billion in economic losses, with significant damage to residential and commercial properties, roads, and bridges.

If the wind season, which ends officially on November 30, remains mild, property insurance markets may soften further and competition among underwriters may increase, which could yield better rates for insureds at renewal time.

TIME FOR A STRATEGIC REVIEW – GET A SECOND OPINION

Organizations can prepare renewals now with an eye to more favorable outcomes in terms and conditions, rates, and limits. For example, risk managers and insurance buyers can:

- Conduct a technical analysis of operational risk exposures.
    - Align and optimize terms, conditions, limits, and sublimits.
- Consider alternative risk financing products, such as:
    - Parametric CAT coverage around wind and earthquake.
    - Multiyear, single limit programs.
    - Loss sensitive programs.
    - Risk incentive sharing programs.
    - Integrated risk programs.
- Review coverage, limits, and values.
- Ensure that all data is in optimal modeling format and as accurate as possible.

An organization can also gauge whether it is getting the most out of its property program by seeking a second opinion from brokers and advisors. A thorough insurance program review can uncover potential inefficiencies, missed opportunities, and substantial cost savings.

For example, Marsh's strategic review process aims to identify coverage enhancements and premium savings by examining an organization's current risk analysis, risk transfer, and risk management processes.

Even if another broker represents your company, our review provides an objective, no-cost second opinion that offers risk managers key recommendations on policy limits, program structure, alternative risk transfer options, and market negotiations.

Marsh's review team digs deep into a company's operations to provide a comprehensive review of their property insurance program, including:

- Actuarial analyses.
- Captives.
- Loss modeling.
- Policy wording.
- Rate analyses.
- Structure options.

- Policy limits reviews.
- Deductible assessments.

The review first defines an organization's risk by examining reported loss values, natural catastrophe models, loss probabilities, risk bearing capacity, and insurance policies. The process includes industry benchmarking and peer review. Marsh's review team also works to identify insurers with the best program features to compete for the organization's business.

Such a review can help risk practitioners and insurance buyers properly peg their property program within current market conditions. With the benefit of a fresh set of eyes, organizations can better identify optimal insurance structures, terms, and rates, while discovering potential program innovations and best practices.

For more information about the Strategic Review Process, contact your Marsh representative or visit us at marsh.com.