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MARSH INSIGHTS:

PROPERTY

CAPTIVE USAGE IN A TRANSITIONING PROPERTY MARKET

BY BEN TUCKER, PROPERTY SPECIALIZED RISK GROUP LEADER

Captives have played an important role in risk financing for clients in a number of industries, of different sizes, and of varying degrees of sophistication. They offer clients an alternative suite of tools to help address certain limitations in property risk transfer programs from commercial insurers.

In a study conducted by Marsh's Global Captive Solutions Group titled, "Trends and Performance 2011 Captive Benchmarking," 20 percent of the clients sampled used their captives for property risk transfer, the largest percentage when compared to the other lines of insurance.

(Re)Insurance Lines Underwritten by Captives in 2010

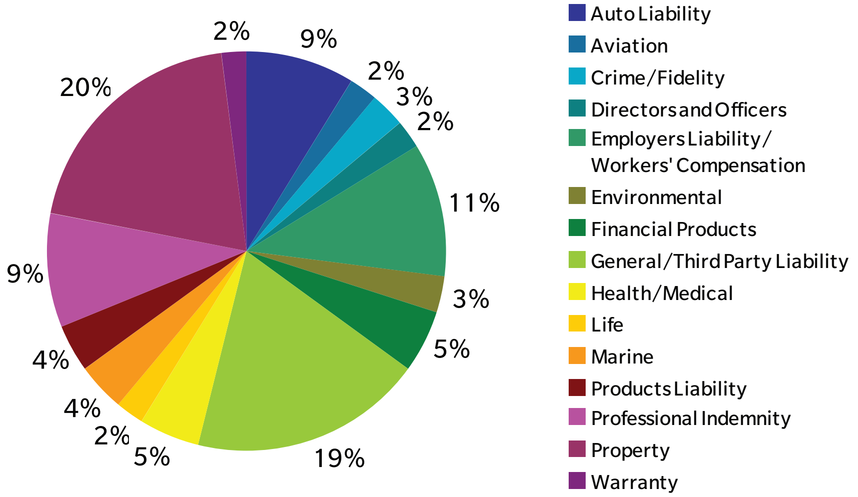


Table of Contents

The current property insurance market is in a transitional period. There are a number of indicators of a potential hardening market cycle including:

- newly imposed exclusions—whether with or without the ability to buy back the excluded coverage at an additional cost;
- newly increased deductible or retention thresholds—whether with or without the ability to buy down the deductible or retention;
- a requirement that the insured coinsure a layer or layers of coverage;
- non-concurrency of terms and conditions in layered and/or quota share programs;
- "best terms" required by certain carriers participating in a quota share program; and
- "Swiss cheese" program structures, such as towers of limits that feature layers or parts of layers where coverage was either not available or not available at rates deemed commercially viable by the client.

For more market insight, please read our new report, "Guide to Markets in Transition: Strategies and Tactics for Navigating a Hardening Insurance Market."

As a result of the changing property market conditions, the scenarios for using captives are likely to increase both in frequency and relative importance, when measured based on either limits required and/or premium associated with such captive program structures.

Captives are one tool to be considered when proactively developing alternative program designs as part of aligning the placement strategy with a client's culture, values, and strategic, operational, and risk management objectives.

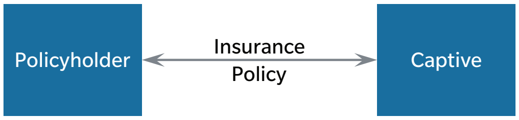
CAPTIVE STRUCTURES

The following are principal captive program structures that respond to the scenarios above:

1. ISSUE:

- Newly increased deductible or retention thresholds.

Potential solution: Direct reimbursement/deductible reimbursement by captive.



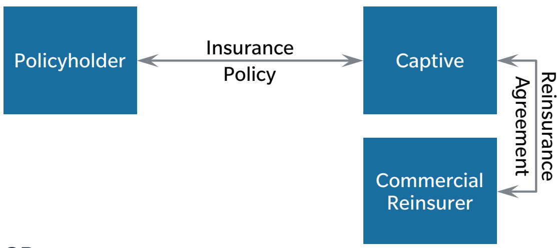
This structure is very common and involves a captive writing one or more layers directly. It functions well and may be the least expensive where there is no requirement for an admitted insurer. Typically, the captive provides reimbursement for the primary layer, e.g., the first $5 million, which would be retained by the original insured in the absence of a captive's involvement.

2. ISSUES:

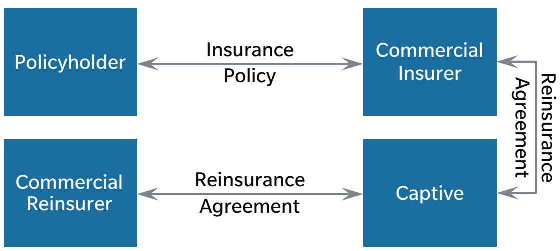
- Commercial carriers impose new restrictions in coverage or perils insured.
- The insured is required to co-insure a layer or layers of coverage.
- "Best terms" requirements result in increased program and/or layer costs.
- "Swiss cheese" program structures, such as towers of limits that feature layers or parts of layers where coverage was either not available or not available at rates deemed commercially viable by the client.

Potential solution: Reinsurance access

In many cases, such issues result in increasing premiums for coverage that is desired by the client. Captives can be a useful means of addressing these issues. Insureds that deploy their captives to address the above issues can choose to either retain all or a portion of the risk assumed within the captives (assuming adequate capitalization), and/or identify whether reinsuring the risk can result in improved costs or coverage of a program. If reinsuring the risk a couple of structures are typically used:



OR



In both structure options, the principal objective is to gain risk transfer to multiple commercial reinsurers that cannot otherwise be accessed directly. The benefits may vary, but typically include improved pricing and coverage because more carriers are available than through direct commercial insurance purchases. In certain cases the captive can retain a portion of the risk or insure specific perils that are otherwise complicating the direct placement—for example, the captive may retain all risks and then cede all but Puerto Rico windstorm to certain reinsurers.

It is often inferred that when carriers are aware of the existence of a captive they assume several things about the captive owner, including sophistication and a willingness to retain risk. This may translate into an improved bargaining position with certain insurers.

The issues and scenarios above are limited examples for captive utilization. The following are a number of other common approaches for using captives to address property program requirements:

- To reinsure fronting carriers.
- To access the U.S. Terrorism Risk Insurance Act (TRIA) for conventional and/or nuclear, biological, chemical, and radiological (NBCR) terrorism risks as well as other government-mandated pools where permitted.
- To provide "wrap around" coverage to address deficiencies in commercial coverage. This can be helpful to clients when seeking to address non-concurrency of terms and conditions in layered and/or quota-share programs. Captives have greater flexibility to address broader coverage through the manuscripting of policies.
- As a means to "right size" deductibles across an organization, and when different retention levels may be appropriate by subsidiary.
- As part of integrated risk transfer programs including property insurance.
- As fronting carriers; for example, as for admitted European freedom of services policies.

Captive structures may not always offer the ideal solution and there are a number of considerations insureds should take into account before using their captives:

- Captives do not always meet third party contractual requirements—such as lender requirements that participating insurers must meet and/or certain actions that must be undertaken to meet such requirements (e.g., the cost and effort in securing a required A.M. Best rating).
- Captives do not always meet admitted carrier requirements as they are typically only licensed in domiciliary state.
- In the event of a loss, reinsurance access via a captive can result in a more complex recovery process than a direct to market solution.

Overall, captives can offer a number of benefits for companies seeking to insulate themselves from adverse commercial insurance market conditions. Additionally, an indirect benefit may be the flexibility afforded by increased captive utilization. Marsh's dedicated property experts, in conjunction with our Global Captives Solutions Group, can provide insight and advice to companies considering creating or using a captive as an alternative to traditional property programs. Please contact your local Marsh representative to schedule an appointment to discuss your company's unique exposures and options.

CHANGING PROPERTY MARKET PLAYBOOK: ADVICE FOR INSUREDS

BY GREG MANN, MANAGING DIRECTOR, U.S. PROPERTY PRACTICE

The current property insurance market is in a state of transition. Underwriters are requiring more improved account information and are increasing their standards regarding the types of accounts they will consider underwriting. Clients that understand the needs and knowledge requirements of underwriters—and that work to overlay such requirements with their corporate strategies, direction, and objectives—are best positioned to achieve successful renewals in 2012.

Most importantly, insureds need to understand their risk. The following are six key aspects all clients should know about their risk to ensure an appropriate property insurance coverage is secured at renewal.

UNDERSTAND YOUR COMPANY'S EXPOSURES

- Clients should be prepared with a complete statement of values including construction data, fire protection, wind mitigation measures, flood zone, and elevation data. While underwriters have requested this information for some time, the majority of insureds—including many Fortune 500 companies—have yet to develop a credible statement of values.
- Know your company's process flow of operations, products, services, and revenue—including peak seasons of production/revenue—as well as the interdependency among owned locations and contingent locations of suppliers and customers. Understanding the worse case scenarios and the causes of loss that may contribute to a loss are key in determining limits to purchase.
- Perform catastrophic (CAT) modeling, preferably using both RMS and AIR if the exposure has any level of earthquake and/or named windstorm exposure. CAT modeling is a key driver of price, more so than any other factor within property insurance programs. Knowing and understanding the cost to cover risks, especially by layer (primary, excess), will assist in insureds' buying decisions to potentially maximize cost versus coverage. Moreover, performing the modeling acts as a credible tool as to worse case scenarios and catastrophic limits required to address such scenarios. This same limit data is useful in combating restrictive loan requirements as regards catastrophic limit requirements.
- Insureds should have full knowledge of flood zone determinations for all locations. Flood is one of the hardest perils to obtain adequate coverage for, in part due to a lack of credible modeling as well as the historical flood events in the United States, Japan, Australia, and Thailand over the past 36 months. Coverage offered through the National Flood Insurance Program (NFIP) provides a base level of insurance at a cost well below market. Even if your company's risk appetite is high, the NFIP should be considered due to its typically low cost.

KNOW YOUR RISK TOLERANCE

It is important to consider the minimum amount of loss that would impact your company, as well as the maximum amount of loss your company could retain and continue normal operations. To illustrate, a company determines that a loss of $2.5 million would be the minimum amount that would affect its operations and the maximum amount it could retain is $100 million. In this scenario, the insured may elect a higher deductible as it can absorb a small loss, forgoing the extra expense to buy down its deductible. Instead, it may elect to purchase additional excess limits for less than the cost of buying down the deductible, saving premium dollars and achieving more appropriate insurance coverage to match its risk tolerance.

While aggregation of values, business interruption, and amount subject (i.e., largest values at one single location) factor into decisions, insureds often push to negotiate deductibles more aggressively than they do their high excess limits—even though the limit decision most likely will have the greatest influence on the company if a catastrophic event were to occur.

BE AWARE OF YOUR LOSS HISTORY

A thorough understanding of your company's loss history—based on current and existing exposures at the time of loss—is key to a successful renewal. Questions risk managers should ask themselves include:

- What losses occurred?
- What property was damaged?
- Did outside influences increase or decrease the loss?
- Was the cause of loss operational, manmade, or natural?
- What were the lessons learned?
- What improvements/new procedures have been made to mitigate future losses and have they been shared with other locations?

Knowing little about your company's historical loss picture is often viewed negatively by insurers, that may believe you are using insurance only as a preventive maintenance budgetary tool. This may ultimately increase both the program's deductible and cost.

It is just as important for risk managers to understand the loss histories of both their peers/competitors and their industry sector. In most cases, insurers specialize in underwriting certain industries and often make decisions (e.g., appetite, capacity offering, etc.) based on an industry's portfolio loss history versus on an account-specific basis. Insurers want to know why their clients' specific loss history is above or below the industry norm.

KNOW THE INSURANCE MARKETPLACE

Understand which insurers write which coverage for specific risks and exposures. Even if long-term relationships exist, market conditions and insurers' appetites change. It is imperative that insureds are aware of the other insurers that write their risks and develop and foster relationships with those underwriters.

Insureds that seek to understand declinations are best positioned to take advantage. Why was your company's submission declined: was there not enough time?; were the underwriters' production goals already met?; was the underwriter out of available capacity?; was it engineering related?; was it driven by a small percentage of the portfolio exposure? Understanding the "true" reason for declinations allows insureds to address the issues over time and/or consider operational/procedural changes in order to maximize the available market appetite.

One of the best ways to get to know the insurer community is through face-to-face meetings. For a more detailed discussion please read, "Maximize Your Market Meetings: Tips to Getting the Most out of Underwriter Meetings."

UNDERSTAND YOUR RISK REQUIREMENTS AND HOW THEY MAY CHANGE

Insurance evolves—new products are introduced, risks and exposures change, and both insureds' and insurers' risk appetites adapt. Insureds may purchase more or less protection than they really need, and/or they may retain existing limits, deductibles, and coverages rather than researching and understanding their current exposures. Likewise, insurers often base their terms, conditions, and pricing on historical exposures and existing products versus factoring in exposure and risk that are projected to exist in the near future. All of these can greatly influence the adequacy of existing coverage. An accurate assessment of your company's insurance program should be undertaken to ensure risks are properly addressed.

DETERMINE YOUR CORPORATE RISK LIMITS AND EXPECTATIONS

When purchasing insurance products, most risk managers must meet a set of parameters defined by their superiors and/or board of directors. While buyers have goals for a successful renewal, it is important to be aware of additional limitations and/or expectations that may affect the renewal process. These limitations and/or expectations may include: the elimination of certain insurers due to current or past experiences (e.g., claims, losses, or a lawsuit) or the addition of certain unusual exposures within the portfolio due to a past corporate agreement/relationship, for example.

While some unexpected limitations may be trivial, these factors drive buying decisions in a significant amount of cases. Sometimes, they may negatively affect the competitiveness or coverage terms of the program; other times they may result in higher prices than anticipated. Thoroughly understanding the macro factors that may affect the renewal—and, more importantly being prepared for such issues—will benefit risk managers.

Your Marsh property broker is available to help every step of the way and is your advocate in the property insurance marketplace. We help you navigate this changing landscape and ensure you have customized, well-designed property insurance programs that suit the unique needs and exposures of your organization.

THE REAL ESTATE INDUSTRY: PROPERTY INSURANCE INSIGHTS FOR MULTIFAMILY INSUREDS

BY RYAN BARBER, MANAGING DIRECTOR, U.S. PROPERTY PRACTICE

Tepid home buyers and conservative loan underwriting by lenders are expected to prolong favorable market conditions for the multifamily sector. Increased demand for multifamily properties—coupled with a limited supply—is fueling an expansion of investment into multifamily housing by the real estate community. Unfortunately this sanguine outlook by real estate investors is not shared by the insurance market as evidenced by the recent acceleration of premium increases being seen by owners and/or managers of multifamily properties.

2011 was an unusually active year for the insurance and reinsurance industries, characterized by an increased frequency of high severity events. In addition to the challenging economic environment and major updates to catastrophe models, (re)insurers were hit by a number of significant natural catastrophes: Insured losses for the year are estimated to exceed $100 billion, according to Swiss Re.

The multifamily real estate sector in particular has been a very challenging class of business for the commercial insurance market. A significant portion of multifamily properties are located in high hazard wind and earthquake zones (where insurers' cost of capital has increased due to modeling changes and reinsurance costs). Additionally, many insurers suffer from a high frequency of low severity claims, such as small kitchen fires or burst pipes, which erodes the premium needed to fund long term expected catastrophe (CAT) losses. Attritional losses—losses other than those related to major CAT events or exposures—have been exacerbated by low policy deductibles (e.g., $5,000, $10,000, or $25,000), which are often stipulated in the insurance provisions outlined by lenders in loan documents. As a result, a number of mainstream retail insurers have ceased writing this class of business, or, at a minimum, significantly tightened their underwriting guidelines (terms, conditions, minimum deductible requirements, pricing, etc.). This has brought about a resurgence in the excess and surplus (E&S) market to fill the void, but new entrants in this space are looking for higher returns, thus pushing prices higher.

As owners and investors know, not all multifamily properties are created equal nor are their associated insurance risks. Assets can range from non-sprinklered, wood frame, class D or C housing to high end, fully sprinklered, fire resistive, class A properties. An unprecedented year of losses for the insurance industry, however, and the poor performance of certain multifamily properties have unfortunately jaded a number of carriers. Some insurers have preconceived notions about multifamily dwellings, including the following:

- They are often garden style apartments.
- Properties are typically made from wood frame or joisted masonry construction.
- Most locations traditionally do not have sprinkler systems.
- Replacement cost values are often under reported.
- The industry sector performs poorly during natural catastrophe events.
- Insurance policies include low deductibles and a high frequency of attritional losses.
- The actions of the tenants themselves, which may contribute to losses, cannot be controlled or underwritten.

MARKET PRESENTATION

Multifamily owners and managers must differentiate their risk from the "perception" of the sector in order to successfully navigate the current property insurance market. At no other time has it been more important for clients to know their underwriters; therefore, insureds should participate in face-to-face meetings with insurers to present their risk directly to underwriters. Be prepared to address the following with underwriters:

- **Replacement cost values.** Substantiate your company's reported insurable values either via appraisal reports, construction contracts, or another report by a qualified entity.

Note that insurers are typically looking for a minimum replacement cost value (RCV) of $70 to $80 per square foot for wood frame, garden-style apartments; higher RCVs for Class A properties are likely to be required, especially if the properties are located in high hazard CAT zones. In addition, rental income should be updated annually as underwriters are more regularly checking advertised rents. If an insurer believes values are undervalued, it may place restrictive terms on the policy, such as scheduled limits or coinsurance penalty clauses.

- **Break down the replacement cost values and rental income by individual building.** Providing information regarding the distance that separates each building in a complex enables underwriters to evaluate the maximum amount subject from a fire loss. Such information can potentially reduce the minimum attachment point of excess layers, fuel competition among insurers by reducing the necessary size of the primary layer, and may aid in securing a lower premium. Reporting individual building values is also critical in the calculation of percentage deductibles, which are often applicable to assets located in high hazard earthquake and windstorm zones.
- **Historical loss information.** Underwriters are increasingly reluctant to quote without credible historical loss data; therefore, be prepared to provide at least five years of hard loss runs. Losses should be presented both "ground up" and net of the proposed deductible/retention structure. If properties have been recently purchased, buyers should endeavor to collect historical loss data as part of their acquisition due diligence. In the absence of credible historical loss data underwriters may add a surcharge to their premium to account for unknown loss potential in the submission data. Evaluating the loss history by "insured peril" can help structure creative deductible options—be sure to include a description of loss.
- **Construction information.** Quality data has never been more critical in the underwriting process. Carriers are increasingly reliant upon the use of natural catastrophe modeling (i.e., RMS, AIR) to evaluate the loss potential from earthquake and windstorm events, to monitor their portfolio accumulations, and to guide them in the purchasing of reinsurance protection. The output of these models is highly dependent upon the quality of data input. In the absence of complete and/or accurate data, these models will contain more volatility in the results and will default to more conservative assumptions, potentially resulting in inflated loss projections and premium charges. Insureds should be prepared to provide not only the primary construction characteristics of their assets (exterior construction, occupancy description, year built, number of floors, etc.), but also secondary characteristics such as information on roofing systems, dates of roof replacements, window descriptions, seismic bracing, flood walls, and any other mitigation features that reduce the assets' loss potential due to CAT events. The inclusion of secondary modifiers not only results in a more accurate output from the model, but has the potential (albeit not always) to reduce the probable maximum loss (PML) and average annual loss (AAL) expectancies, which have a direct correlation to capacity and premium. Given that underwriters typically price CAT risk as some multiple of the AAL, reducing this number can have a direct impact on the premium.
- **Maintenance, inspection, and loss control programs.** Proactive maintenance, inspection, and loss control programs facilitate the identification and correction of hazardous conditions before they develop into losses. Insureds should clearly demonstrate measures taken to control attritional losses and to educate their tenants, onsite property managers, and security personnel about fire safety and other loss control initiatives.

  Insureds should discuss with underwriters how their inspection programs identify common causes of loss and the actions that can be taken to remedy a hazardous condition. The following are among the most common causes of loss in multifamily dwellings:

  - **Fires**—inspections identify potential fire hazards: are operable smoke detectors in place; are fire extinguishers located in key areas (e.g., kitchens and laundry rooms); are electrical outlets overloaded; are there grills on wood decks, etc. Validate for insurers that the buildings' electrical systems have been inspected by a licensed electrical contractor. Where applicable, document that wiring has been upgraded to new technology—old wiring (aluminum) can create a significant fire risk—or that the risk has been otherwise mitigated.
  - **Water Damage**—inspect roofs, plumbing, and appliances to identify and correct leaks before they cause damage. An effective maintenance program will trigger repair or replacement of worn or aging hoses and pipes, a common cause of loss (bursting pipes). Flooding is the number one natural disaster in the United States: Approximately 97 percent of the U.S. population lives in a county that has experienced a flood in the past 30 years. A comprehensive flood insurance program through the National Flood Insurance Program (NFIP) can help companies mitigate their exposure to this costly peril.
  - **Roofing**—keep a schedule of roof maintenance activities, including which properties have had roof replacements, when they occurred, and which properties are scheduled for future roof replacements. This is especially important

for properties located in high hazard wind zones as the date of roof replacements is a critical input into the natural catastrophe models.

PROGRAM DESIGN

With a transitioning property market and insurance rates on the rise, now is the time for an insured to conduct an in-depth review of its insurance coverage and tailor a program based upon its unique risk profile, risk appetite, and risk bearing capacity (RBC). As a means to control pricing in the current market, insureds should understand what insurance they "need to have" versus what may have been "nice to have" during a soft market.

Insureds should make use of all available analytical tools to measure and define their risk profile including:

- Marsh's Global Benchmarking Portal allows clients to compare key features in their insurance programs with those same elements in placements of peer companies.
- RMS and AIR natural catastrophe modeling analyzes PML and maximum foreseeable loss (MFL) estimates, essential tools in establishing appropriate limits of insurance. In addition, analyzing AAL expectancies can help identify key loss driver locations and prioritize where the collection of additional modeling data and/or risk improvements may potentially drive down loss cost and premium.
- Marsh Business Analytics team measures the risk bearing capacity of an organization, which generates a 12 month quantitative view of risk tolerance. This RBC analysis helps clients draw a "line in the sand" where adverse events have substantial financial impact on company valuation. The optimal insurance program will balance risk retention and risk transfer. Knowing the RBC of your organization is highly valuable when evaluating alternative deductible and retention strategies.

With an in-depth understanding of its risk profile and RBC, an organization is better positioned to work with its broker to customize an efficient insurance program that meets its specific needs. Consider the following:

- Delete or minimize unneeded coverage(s) to reduce cost, especially coverage that often carries hidden reinsurance costs, such as flood, earthquake, and wind.
- Consider reducing the overall policy limit. While there may be only modest cost reduction from an incumbent insurer, this change often creates more competition from other carriers since less capacity is needed. This second cost savings dynamic is often overlooked.
- Design a deductible structure/retention strategy that eliminates attritional losses from being passed back to the carrier and avoids dollar trading with insurers. Instead, evaluate alternative funding strategies for expected losses (e.g., aggregate deductibles, deductible funding program (DFP), captive usage, etc.).
- Consider purchasing a flood insurance policy to provide protection in the event of a flood. Marsh's Flood Service Center (FSC) can help clients analyze their exposures and design a program that fits their unique needs. Primary flood programs are offered through the NFIP, a federally-funded program; additionally, the FSC can place up to $30 million in excess limits, which can include coverage for business interruption losses.
- Create competition and seek potential market alternatives by engaging with global insurers and soliciting proposals from key insurance centers outside the United States, including Bermuda, London, and Zurich.
- Produce a comprehensive but brief presentation to underwriters showcasing key risk management initiatives, risk improvement activities, planned loss control improvement projects, the capital expense budgeted, and the effect the improvements will have on loss potential.

Marsh's Property Practice is available to help our clients and prospects navigate this changing real estate insurance marketplace. For fresh ideas on how to control costs, please contact your local Marsh representative or a member of our property team.

BUSINESS INTERRUPTION INSURANCE AND THE FORENSIC ACCOUNTANT

BY STEVEN LIGUORI, VICE PRESIDENT, U.S. PROPERTY PRACTICE

Forensic accounting is the use of professional accounting skills in matters involving potential or actual civil litigation. In the insurance claims world, a forensic accountant is typically engaged by an adjuster or an attorney to audit an insured's books and record whether the policyholder has sustained a loss, as defined in its insurance policy.

THE ROLE OF THE FORENSIC ACCOUNTANT WHEN A BUSINESS INTERRUPTION CLAIM ARISES

Determined by the size and complexity of the policyholder's business operations and the claim in question, a team of adjusters and consultants may be assembled to analyze many of the issues that arise during the claims process, including building and construction, production, sales and marketing, advertising, and accounting. Both the insured and the insurer may assemble their own teams to support their respective positions.

The insurer's team may likely include a field adjuster, claims manager, underwriting department, in-house legal staff, and other experts such as engineers, salvors, outside legal resources, and forensic accountants. The insured's team often includes a public adjuster, in-house accounting department, external certified public accountant (CPA) or accounting firm, production managers, sales and marketing departments, and in-house legal department. It may also employ outside consultants, including engineers, salvors, outside legal counsel, and forensic accountants.

Business interruption (BI) claims are often complex and difficult. Consequently, many adjusters do not have the time or expertise to fully understand both direct property and business interruption issues. A competent forensic accountant will provide an adjuster, policyholder, or legal counsel with his/her knowledge and experience in matters, such as the technical aspects of accounting rules and procedures and other related data and the ability to translate accounting data to conform to insurance policy coverage language. A forensic accountant does not provide coverage interpretation. This is the responsibility of the adjuster or legal counsel.

A LOSS OCCURRENCE

The forensic accountant will review applicable BI coverage and familiarize himself/herself with both macro- and micro-economic trends of the insured's industry. Next, the forensic accountant will contact the appropriate representative(s) of the insured to discuss the loss occurrence and how the damage may have affected business operations, as well as to access business/accounting records maintained in the normal course of business. The forensic accountant may also possibly suggest integrating additional accounting procedures to expedite the claim process.

One of the critical factors in determining the value of a BI loss is the "time element" or time continuum. In other words, what will be the dollar value from the time of the occurrence to the time when the business has been restored to the same place it was before the loss occurred. A claims adjuster may make a determination of the time continuum by melding his or her knowledge of BI coverage with assistance from knowledgeable consultants (e.g., construction, electrical, legal).

Once the time continuum has been established, it is forwarded to the forensic accountant to include in his/her computation. The time continuum is typically referred to as the period of restoration and may include an extended period of indemnity.

Next, the forensic accountant prepares a list of relevant financial and other related documents needed to calculate the actual loss sustained, if any, during the measurement period. The documents requested may include but are not limited to: income tax returns, income statements, budget to actual variance reports, sales tax returns, equipment and office leases, general ledgers, and payroll figures.

Whichever method of calculating BI is used—gross earnings or gross profits—the BI value and analyses of sales, costs, and expenses are necessary. Normally, a forensic accountant projects what the sales level should have been during the loss measurement period if the loss never occurred. Some potential factors the forensic accountant will consider include:

- seasonal or long-term sales trends;
- recent expansion or reduction in operating capacity;
- recent increase or decrease in competition;
- recent sales contracts; and/or
- possible mitigation of loss.

Once the period of restoration is established, the sales trend determined, and pre- and post-lost costs and expenses analyzed, a business interruption calculation is prepared. A BI calculation is the sum of many components. Some of the components are objective while others are more "grey" in nature. The "grey" components may result in a difference of business interruption value between the teams. If the differences can be resolved, then the claim will get paid and closed. If not, then a forensic accountant may be engaged to take on a new role as an appraiser in the appraisal process found in many insurance policies, or as a consultant or expert witness if the claim ends up in litigation.

Marsh's Forensic Accounting and Claims Services (FACS) Practice provides expert assistance in the quantification and measurement of damages, economic claims, and losses that can help companies achieve a superior recovery and/or minimize losses resulting from catastrophic events, litigation, or disputes. Our experts deliver world class forensic accounting, investigative, construction, product recall and liability, dispute advisory, and insurance claim preparation and advisory services. We are able to respond and react anywhere in the world, providing assistance with large and complex investigations and damage assessments, as well as advisory services to minimize the impact of claims on a company's business. To learn more about Marsh's forensic accounting services, please contact your local Marsh representative or visit www.marshriskconsulting.com.

SPOTLIGHT: THE STOCK THROUGHPUT POLICY

BY STEVEN LIGUORI, VICE PRESIDENT, U.S. PROPERTY PRACTICE

Stock throughput (STP) policies are designed for companies that import, distribute, or export merchandise. The policy provides coverage for all moveable goods (inventory) that are the subject of the insured's trade, including raw materials, semi-finished, and finished products. The goods are covered at all times whether in transit, undergoing process (although damage caused by the manufacturing process is excluded), or in storage at owned or third party premises.

Purchasing a separate stock throughput policy rather than basic transit coverage in a property "all risk" insurance policy can provide seamless coverage of goods and more control of inventory risks throughout the entire supply chain, from the supplier or point of origin through the goods' final destination.

Traditionally, freight forwarders would handle the insurance for transporting the insured's goods across the sea while local insurers would underwrite transit insurance within the country's borders and provide coverage while the insured's goods were in storage. However, one of the highest risks associated with cargo actually occurs between these two sections—when the cargo is being loaded, offloaded, or moved from storage to transit. This loss scenario typically results in an argument amongst insurers as to which carrier is responsible at the moment the merchandise is damaged or stolen. This often stalls or complicates claims payments.

The transfer of materials and goods through supply chains has never been more fragile. Global outsourcing, economic impairments, government regulations, and bills of material with countless suppliers compound the volatility of supply chains. Thus, companies should make every effort to command control of the goods in transit to and from their operations. The flexibility provided to the insureds via STP policies can assist them in managing their insurance premium expense by allowing insureds to choose between different distribution channels. This flexibility is the key driver for creating a strong, cost-effective supply chain model. Options for distribution channels include:

- full container loads;
- consolidation;
- special handling services;
- less than container loads and multi-country consolidation programs;
- sea/air and air/sea;
- sea to air conversions; and
- export and import distribution centers.

By using this flexibility of choice the insured can control the volume of shipments and loss experience. This can lead to controlling more of the supply chain and increasing purchasing volume, potentially resulting in a better rate on the premium.

WHAT IS A STOCK THROUGHPUT POLICY?

An STP is a marine policy that insures a company's inventory and the flow of goods from the source of production to its final destination, whether at a place of storage or a retail store. An STP policy has three components:

1. ocean cargo insurance;
2. inland transit; and
3. property/storage.

STP policies integrate transportation, inventory storage, material handling, and packaging as they are designed to cover the repositioning of:

- raw materials;
- works in progress; and
- finished goods.

The focus is on global infrastructure and local presence from beginning to end. Coverage terms typically include all goods in transit globally as well as all stock/inventory (works in progress and finished goods). Such goods are covered at the insured's location(s) as well as its subcontractors, consolidators, and warehouse locations. The policies typically include coverage at manufacturing locations, often subject to a process clause, which provides the insured with coverage for loss or damage occurring during the manufacturing process. However, it does not provide coverage for any errors in processing the insured's raw materials into finished products.

The use of STP policies has grown recently, as the marine carriers remain soft in their pricing versus property "all risk" carriers, whose rates are currently transitioning upward. An STP allows for the removal of the inventory from a property policy; in many cases, this may subject the inventory to a lower rate, thus saving premium dollars. Further, separate aggregates for CAT coverages can be achieved for the property versus the STP, boosting available catastrophe cover.

Insureds in industry sectors that have significant inventory and/or transit exposures may want to consider purchasing STP policies. Clients in the retail, wholesale, food and beverage arenas have historically benefited the most from STPs. In the changing market landscape, this is a program alternative worth investigating.