

MARKET UPDATE

2013 TERRORISM RISK INSURANCE REPORT



MAY 2013

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INTRODUCTION

The September 11, 2001, terrorist attacks created a severe market shortage for terrorism insurance. As a result, the US Congress passed legislation — the Terrorism Risk Insurance Act (TRIA) — that created a federal “backstop” for insurance claims related to terrorism events in the US as defined by TRIA. The Act became law on November 26, 2002, and has since been extended and modified twice: in December 2005 and again in December 2007, when it was renamed the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA).¹ The Act is scheduled to expire on December 31, 2014, if it is not renewed.

TRIA provides reinsurance coverage to insurers in the event of a certified terrorist act. The upcoming decision to extend TRIA as is, extend it with modifications, or allow it to expire will affect the property and casualty (P/C) insurance industry and organizations that buy terrorism insurance. As of the spring of 2013, there has been limited action in Washington, D.C., regarding TRIA’s expiration, and Congress may wait until closer to the end of 2014 to determine its future.

If TRIA is not reauthorized, the number of property insurers willing to continue offering terrorism insurance is likely to decrease. According to interviews conducted by Marsh’s property and terrorism experts before the 2005 extension, of 50 commercial property insurers polled, 34 (68%) confirmed they would have excluded terrorism coverage after December 31, 2005, if TRIA was not extended at that date.

With expiration less than two years away, supporters of an extension are gathering information, preparing for the possible outcomes, and asking Congress to take action. This report summarizes TRIA’s history, provides benchmarking related to terrorism insurance take-up rates and pricing, and considers various scenarios regarding the future of the terrorism insurance market.

Note: Shortly before this report went to press, two bombs exploded at the Boston Marathon. As of this date, the event has not been classified as an act of terrorism under TRIPRA requirements. How and whether that event impacts the insurance markets in any way remains to be seen. But the bombing certainly raised yet again the ever-present possibility of mass violence.

¹ In this report, the law will be referred to as TRIA or the Act, except where it is necessary to highlight specific distinctions of TRIPRA.

EXECUTIVE SUMMARY

A key issue facing the insurance industry and insureds is the pending December 31, 2014, expiration of the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA), commonly known as TRIA. Enacted after the September 11, 2001, terrorist events, TRIA has been reauthorized twice before, both times with modifications. This report looks at the Act's history and uses Marsh benchmarking data to show trends in take-up rates, pricing, and other relevant issues.

Among the key findings:

- Congress may not fully address TRIA before the scheduled expiration at the end of 2014. If TRIA is allowed to expire or is substantially changed and the mandatory make-available provision is removed, insurers would not be obliged to offer terrorism coverage, which would affect its availability and price.
- TRIA was originally viewed as temporary and as a result, apart from the elimination in TRIPRA 2007 of the distinction between foreign and domestic acts, extensions consistently reduced government participation.
- TRIA's expiration or substantial modification at extension will almost certainly affect embedded TRIA coverage, standalone terrorism pricing/demand for capacity, and TRIA captive programs. Terrorism insurance capacity may be difficult to acquire at reasonable cost for insureds with significant exposures in a central business district of a major (Tier 1) city, or if the properties are perceived as potential targets for terrorism attacks, and/or where there have been instances of foiled plots.
- Available aggregate/terms and conditions can be restrictive in regions with past, present, or future trending terrorist activity.
- The Northeast US had the highest terrorism insurance take-up rates on average, likely due to the concentration of population centers, perceived potential for terrorist attacks, and the fact that the region was targeted in the 2001 and other attacks.
- The percentage of companies buying property terrorism insurance — the terrorism insurance take-up rate — has remained fairly constant since 2005 and has been in the low 60% range since 2009.
- Larger companies are more likely to purchase property terrorism insurance, and also to see the lowest cost as a percentage of overall property premiums.
- Among industry sectors, media companies were the most likely to purchase property terrorism insurance.
- Two likely impacts that the absence of or a serious modification of TRIA could have on the workers' compensation market are in the areas of pricing and capacity.
- Among US captive insurers managed by Marsh, 25% underwrite at least one TRIA-specific (standalone) program. Additionally, hundreds of owners use their captives to provide some element of terrorism coverage, thereby participating in TRIA.
- Global unrest has begun to affect the terror reinsurance market, not only with regard to supply and demand but in terms of how risks and coverages are defined.
- The recent bombing at the Boston Marathon had not been classified as an act of terrorism under TRIPRA requirements as of the date of this report. How and whether that event impacts the insurance markets remains to be seen. Regardless of the event being certified under TRIPRA or not, coverage for losses arising from the event will depend on clients' specific insurance contract language.

THE US TERRORISM RISK INSURANCE ACT AND ITS MODIFICATIONS

TRIA requires insurers to make terrorism insurance coverage available to their policyholders when offering to underwrite an accompanying line of business. The definition of insurer covers several categories, but the segment with the broadest reach is carriers licensed or admitted to engage in the business of providing primary or excess insurance in any state, which includes US-licensed captive insurers.

Although insurers must offer terrorism coverage, it is not mandatory for insureds to purchase the coverage, except for workers' compensation, which is defined by state statutes and compensates employees in the event of on-the-job injuries regardless of fault. Specific perils, including terrorism, cannot be declined or excluded from individual workers' compensation policies.

TRIA and its first extension required that an act be committed by an individual on behalf of any foreign person or foreign interest in order for it to be certified as an "act of terrorism" for purposes of reimbursement. This provision was removed in TRIPRA (see Figure 1). The 2007 reauthorization also provided coverage for domestic terrorism, which had previously been excluded.

CERTIFIED AND NONCERTIFIED ACTS

It is important to note that a distinction remains between acts of terrorism that are certified and those that are noncertified: Only certified acts are eligible for coverage through TRIA. An event can be certified if the Secretary of the Treasury, the Secretary of State, and the Attorney General of the United States determine the act meets all of the following criteria:

- It is considered an act of terrorism.
- It is violent or dangerous to human life, property, or infrastructure.
- It results in damage within the United States, (including US air carriers, vessels, and/or US missions, as described in the Act).

- It is committed by an individual or individuals as part of an effort to coerce the US civilian population or to influence the policy or affect the conduct of the US government by coercion.

An event cannot be certified if it does not cause property and casualty losses exceeding the \$5 million threshold in the aggregate or if the act is committed as part of the course of a war declared by Congress. (Note: This shall not apply with respect to any coverage for workers' compensation).

The distinction between a certified and noncertified act of terrorism remains an important consideration for insureds and insurers alike. Although the make-available provision requires insurers to offer TRIA coverage for certified terrorism acts, some exclude coverage for noncertified acts. Therefore, businesses may wish to consider purchasing noncertified terrorism insurance, which can provide protection for those events that do not qualify as certified per the criteria listed above.

Key issues under TRIA include:

- **Trigger and threshold:** Insured losses — aggregated across all coverage lines and insurers — must exceed \$5 million for an act to be considered for certification. However, there will not be any outlay of federal funds unless the event reaches the trigger of \$100 million in aggregate losses.
- **Cost of coverage:** Insurers may charge an additional premium for coverage provided under TRIA, as the Act does not provide specific guidance on pricing. Although TRIA preempts state regulations for prior approval of rates, it retains a state's right to invalidate a rate as excessive, inadequate, or unfairly discriminatory.
- **Terms and conditions:** As discussed, insurers are required to make coverage available for "certified acts" to their policyholders for all subject lines of coverage. Although TRIA does not require insurers to offer specific terms and conditions, they cannot materially differ from the policy's other property and/or casualty coverages. Additionally, insurers must offer the coverage at each renewal, regardless of whether the insured previously declined.

FIGURE 1: TRIA AND ITS EXTENSIONS

TERM	NOVEMBER 26, 2002 – DECEMBER 31, 2005	JANUARY 1, 2006 – DECEMBER 31, 2007	JANUARY 1, 2008 – DECEMBER 31, 2014
Official Legislative Name	Terrorism Risk Insurance Act of 2002 (TRIA).	Terrorism Risk Insurance Extension Act of 2005 (TRIEA).	Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA).
Coverage Summary	Covered acts committed by individual(s) acting on behalf of any foreign person or interest to coerce the civilian population of the US or to influence the policy or affect the conduct of the US government by coercion.	Covered acts committed by individual(s) acting on behalf of any foreign person or interest to coerce the civilian population of the US or to influence the policy or affect the conduct of the US government by coercion.	Eliminated the distinction between acts of foreign or domestic terrorism.
Territory	US only.	US only.	US only.
Certification Threshold	\$5 million	\$5 million	\$5 million
Federal Backstop Trigger	\$5 million	\$50 million in 2006, \$100 million in 2007	\$100 million
Insurer Retention	7% in 2003, 10% in 2004, 15% in 2005: Applied against prior-year direct earned premium.	17.5% in 2006, 20% in 2007: Applied against prior-year direct earned premium.	20%: Applied against prior-year direct subject earned premium. Subject to certain property and casualty insurance lines.
Government Share Excess of Retention	90%	90% in 2006, 85% in 2007	85%
Recoupment	Included with discretion on part of Secretary of Treasury — subject to maximum 3% per year applied to policyholders' premiums.	Included with discretion on part of Secretary of Treasury — subject to maximum 3% per year applied to policyholders' premiums.	Formula will be calculated using several factors: the size of the total loss, the amount of the industry aggregate retention as defined, the amount that the insurers actually retain, and the amount of the federal government reimbursement. There is no maximum on the amount that will be applied to future policyholders' premiums. For events that occur after 1/1/2012, the mandatory portion of any recoupment must be collected by 9/30/2017.

Source: Marsh's Property Practice

WORKERS' COMPENSATION COMPENSABILITY

The nature of a terrorist attack could have significant implications on whether injuries sustained are compensable under workers' compensation statutes. In many jurisdictions, any injuries sustained during the course and scope of employment are compensable under the statutes only if the injuries were caused by a risk specific to the employment. Simply being at work when injured is not sufficient to trigger a compensable event.

Most states focus the compensability determination on whether the employment put the employee at greater risk than that experienced by the general public. For example, with respect to acts of terrorism, employees at the World Trade Center during the terrorist attacks on September 11, 2001, were at greater risk than the general public, as those buildings were specifically targeted in the attacks. However, if the attack impacted several city blocks without targeting a specific building, then injured employees likely would not be deemed to be at a greater risk than the general public. This is essentially the same standard used to determine compensability in the event of a natural disaster such as a tornado or earthquake.

- **Adequate disclosure:** Insurers must provide policyholders with “clear and conspicuous” disclosure of both the TRIA premium being charged and the share of reinsurance provided by the federal government. If an insured rejects an offer to purchase terrorism coverage, the carrier is free to reinstate a terrorism exclusion clause (subject to state insurance regulations with standard fire policy (SFP) statutes, which in certain states do not permit the exclusion of terrorism).
- **Government participation:** The federal government will cover 85% of certified losses once insurers' deductibles have been reached. An insurer's deductible is calculated as 20% of its direct earned premium (DEP) for the prior year for the commercial P/C lines of coverage subject to TRIA.
- **Liability cap:** TRIA caps the total liability of the program and of insurers — including the insurers' participation and deductibles — at \$100 billion in any one program year. If insured losses exceed \$100 billion, then the allocation of loss compensation to insurers within the \$100 billion cap will be determined by Congress. Insurers would not be liable for certified losses in excess of this amount unless Congress were to pass legislation increasing the limit.
- **Government recoupment:** In the event the government makes payments following a certified loss, TRIA includes provisions for both mandatory and discretionary recoupment. The insurance marketplace aggregate retention amount is the lesser of \$27.5 billion and the aggregate amount, for all insurers, of insured losses from program trigger events during the program year.

TRIA AND WORKERS' COMPENSATION

TRIA's effect on workers' compensation coverage is somewhat different than it is on other lines due to the statutory nature of the coverage, which precludes the ability to limit exposure. In nearly all US states, employers are required to secure workers' compensation coverage to provide statutorily defined benefits for medical treatment and wage replacement. Exclusions and limitations to this coverage are not permitted. Because it is mandatory (via the state regulatory systems) for employers to purchase workers' compensation coverage, such coverage will always be available to employers either through private carriers, state funds, assigned risk pools, or by becoming a qualified self-insured.

After the September 11, 2001, attacks, workers' compensation insurers and reinsurers turned their focus to employee concentrations in geographic areas as a method of assessing their potential exposure to terrorist events. Computer models now allow insurers to gauge their potential exposures in a geographic area under different terrorism event scenarios, and insurers generally have adjusted their books of business accordingly in an effort to limit potential exposures.

Because TRIA provides protection for insurers, it effectively has helped a private market develop to fill in gaps in available coverage. For example, many carriers use reinsurance capacity to reduce their maximum exposure to terrorism losses and to help ensure their loss potential is within their predetermined risk tolerance.

TRIPRA's renewal, effective January 1, 2008, scaled down the protections afforded by TRIA via mechanisms such as larger deductibles and co-participations. As a result, many insurers became more vigilant in enforcing concentration guidelines. Uncertainty around TRIA's potential expiration or extension in 2014 has led some insurers to not renew certain programs for organizations with large employee concentrations in major cities. This trend could continue as TRIA's 2014 deadline draws closer.

TRIA AND CAPTIVE INSURERS

Guidance issued by the Department of Treasury affirmed that TRIA applies to captive insurers and risk retention groups that meet the definition of a qualified insurer, as set forth in Section 102 of the Act, "Definition of Insurer." Essentially, any entity that falls within the state licensed or admitted category and receives and reports direct earned premium is considered to be an insurer under TRIA. Captives are included to the extent they provide direct coverage only, and must be domiciled in the US to be eligible for inclusion under TRIA. (All references to "captives" in this report apply to US-domiciled captives only.)

To the extent the coverage is offered as part of an existing policy — embedded in the property program, for example — the terrorism coverage must not materially differ in the terms and conditions offered. This does not, however, prohibit an insured from seeking TRIA-specific coverage in a separate transaction. Captives also must comply with TRIA's disclosure requirements. The National Association of Insurance Commissioners (NAIC) has reporting forms that were approved by the Department of Treasury. The forms are available at http://www.naic.org/cipr_topics/topic_tria.htm

Using a captive to insure an organization against acts of terrorism can be a viable, cost-efficient alternative or adjunct to a traditional insurance program. There are many considerations that organizations should take into account when determining whether to use their captive to provide or supplement their terrorism insurance.

POTENTIAL ADVANTAGES OF ACCESSING TRIA THROUGH A CAPTIVE

- **Profit:** If there are no losses, the actual expense of the terrorism insurance program to the consolidated group is limited to the cost to operate the captive, which is generally only a fraction of the premium paid.
- **Relative ease:** It is relatively easy to add terrorism coverage to an existing captive. Doing so typically requires demonstrating a business need and sound plan of operation to the captive insurance regulator, which will often promptly approve the addition or expansion of a terrorism insurance program.
- **Enhanced coverage:** Generally, captives are willing and able to provide terrorism insurance coverage using a customized policy form, which may result in coverage that is better aligned to needs, including covering perils generally excluded or limited by traditional insurers. An example of this is captive insurers providing coverage for nuclear, biological, chemical, and radiological (NBCR) perils. Although TRIA guidance states that the Act provides reinsurance protection to insurers when they offer NBCR (and a loss occurs), TRIA does not require insurers to offer the coverage. Given the lack of a TRIA mandate, combined with the perceived risk, NBCR is not widely available in the traditional insurance marketplace. Captive insurers are able to offer this coverage and gain access to reinsurance afforded through TRIA. It is also possible to cover other perils in a similar fashion, as is occurring in some cases based on the unique needs and coverage limitations experienced by those seeking a viable risk transfer alternative.

TERRORISM INSURANCE MARKET

Terrorism insurance take-up rates generally have remained steady over the past few years. Most companies that purchased terrorism insurance in the past still do so as insurers continue to underwrite the risk, with the support of the TRIA backstop. The reauthorization of TRIA through 2014 has afforded needed capacity in the market for terrorism insurance.

Property insurers are able to include terrorism insurance in their risk portfolios at typically nominal rates to insureds. Clearly, the demand for terrorism risk insurance remains and the existence of TRIA plays a major part in the availability and affordability of the coverage.

TERRORISM INSURANCE TAKE-UP RATES BY YEAR

The percentage of companies buying property terrorism insurance — the terrorism insurance take-up rate — has remained fairly constant since 2005. In 2003, the first full year TRIA was in effect, the take-up rate was 27% but has since increased steadily, remaining in the low 60% range since 2009 (see Figure 2).

TAKE-UP RATES BY COMPANY SIZE

Looking at take-up rates by company size (see Figure 3), it is useful to consider four categories of total insured value (TIV):

- Companies with TIV in excess of \$1 billion typically work with several insurers and likely pay large premiums. Of those companies that use their existing captives or establish new ones to provide TRIA, the majority are in this TIV group.
- Companies with TIV between \$500 million and \$1 billion are large organizations that also typically work with multiple insurers and have layered programs.
- Companies with TIV between \$100 million and \$500 million tend to have no more than three insurers involved in their insurance programs.
- Companies with TIV less than \$100 million generally entail a smaller spread of risk, have lower overall premiums, and often work with a single insurer.

Changes in take-up rates by company size were marginal from 2010 to 2012. Companies with TIV less than \$100 million had the lowest take-up rates among those analyzed, with 59% purchasing property terrorism insurance in 2012.

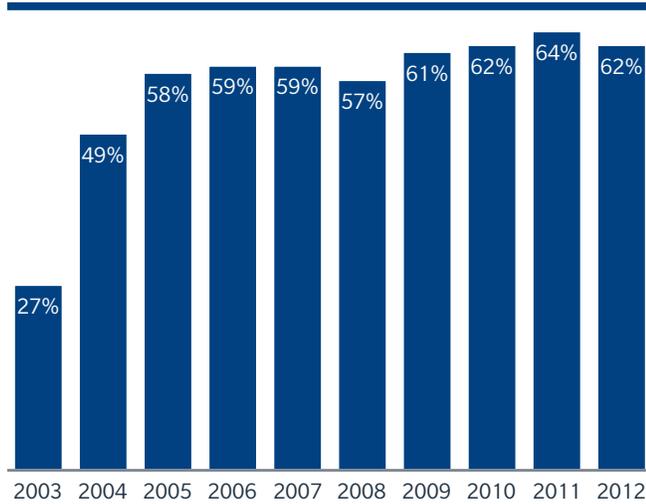
Conversely, the take-up rate for companies with TIV higher than \$100 million was nearly 66% in 2012. This may be due to a perception that larger companies are more susceptible to an attack or because smaller companies typically have lower insurance budgets with which to purchase insurance.

TAKE-UP RATES BY INDUSTRY

Media clients purchased property terrorism insurance at a higher rate — 81% — than did those in any other industry segment in 2012.

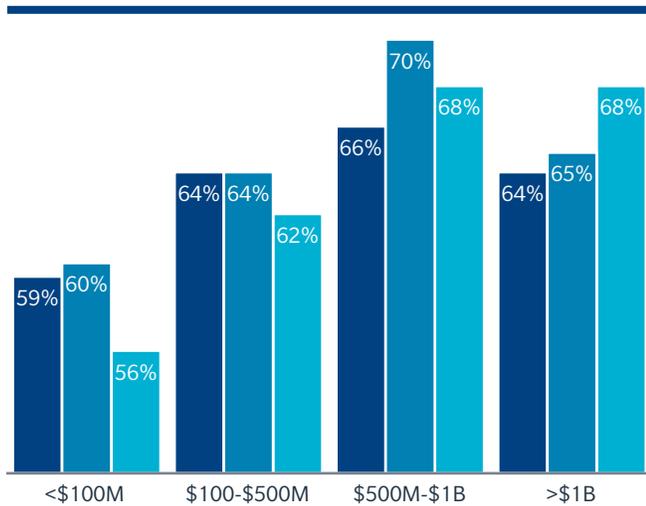
Companies in the health care, financial institutions, education, and public entity sectors had the next highest take-up rates among the 17 industry segments surveyed, all above 70%. This may be due in part to concentrations in those sectors of organizations in central business districts and in major metropolitan areas, which are likely perceived as being at a higher risk for terrorism. The manufacturing, energy, and chemicals sectors were the only three in which take-up rates did not exceed 50% in 2012 (see Figure 4).

FIGURE 2: TERRORISM INSURANCE TAKE-UP RATES BY YEAR



Source: Marsh Global Analytics

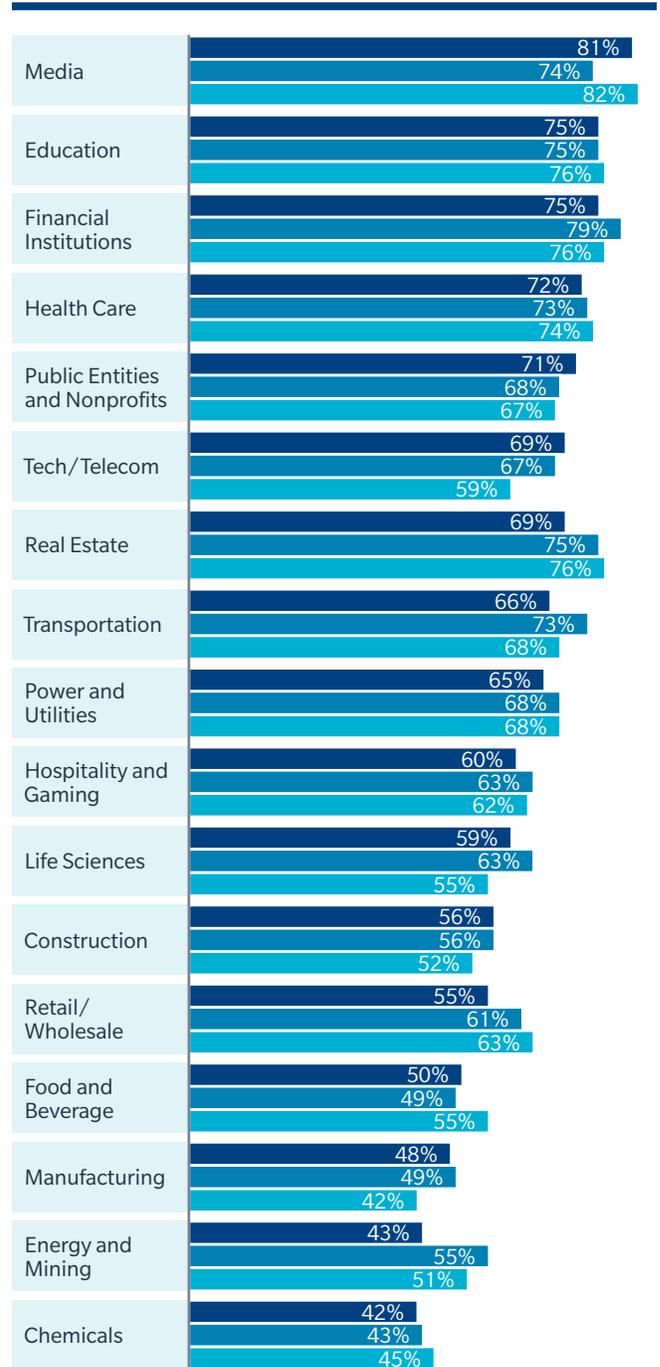
FIGURE 3: TERRORISM INSURANCE TAKE-UP RATES BY TIV



Source: Marsh Global Analytics

● 2012 ● 2011 ● 2010

FIGURE 4: TERRORISM INSURANCE TAKE-UP RATES BY INDUSTRY



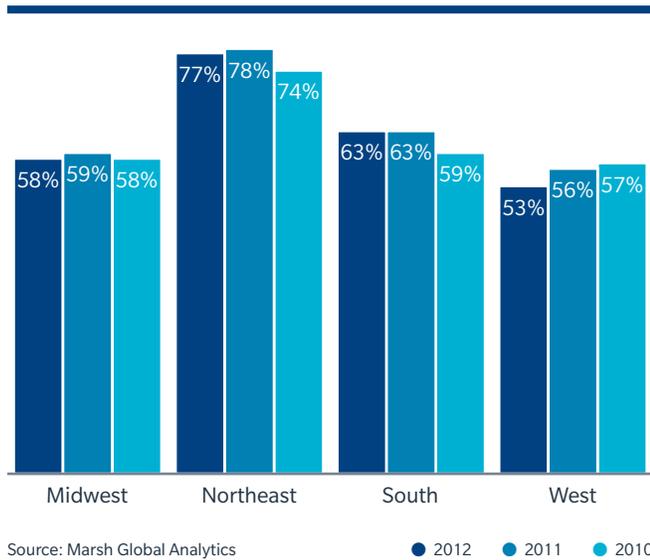
Source: Marsh Global Analytics

● 2012 ● 2011 ● 2010

TAKE-UP RATES BY REGION

A higher percentage of companies in the Northeast — 77% — purchased property terrorism insurance than in any other region. This is likely attributed to the Northeast’s concentration of large metro areas, including Washington, D.C., and New York City; the perception that major cities may be at a higher risk of a terrorist attack; population density; and the fact that the 2001 attacks targeted sites in the region. The West saw the lowest take-up rate, at 53% in 2012 (see Figure 5).

FIGURE 5: TERRORISM INSURANCE TAKE-UP RATES BY REGION



TYPES OF TERRORISM COVERAGE PURCHASED

Approximately 95% of clients that purchased terrorism insurance did so as part of their property policies rather than as standalone placements. However, standalone policies are an important alternative and/or supplement to TRIA coverage for some companies. The primary industry segments purchasing standalone policies have been hospitality, large real estate firms, and financial institutions. Lesser but still significant amounts were purchased in the retail, media, transportation, public entity, and utilities segments.

Before the 2007 extension, companies that purchased terrorism coverage as part of their property policies generally purchased both TRIA coverage and noncertified acts coverage. However, because TRIPRA expanded the definition of covered acts to include domestic terrorist events, many companies since have elected not to purchase noncertified terrorism insurance in addition to purchasing TRIA coverage as part of their property policies. Nevertheless, certain events may still be considered noncertified, although to a more limited extent than before TRIPRA, which removed the foreign terrorism requirement to trigger certification.

More companies now are securing terrorism insurance through their captives and are purchasing reinsurance to cover their retention or liability under TRIA. Typically, those captives that do purchase reinsurance often buy coverage for noncertified terrorism exposures in addition to TRIA coverage.

THE COST OF TERRORISM INSURANCE

It is useful to measure the cost of terrorism insurance both as a premium rate — premium divided by TIV — and as a percentage of a company’s overall property premium. Analyzing costs by premium rate allows companies to track what they paid in absolute terms; evaluating the cost as a percentage of their total premium shows how terrorism coverage affected their overall property insurance budget.

COST BY COMPANY SIZE

Property terrorism insurance rates typically decrease as the size of the company increases (see Figure 6). Since 2010, companies with TIV less than \$100 million experienced moderate median rate decreases, from \$54 per million in 2010 to \$49 per million in 2012; however, their terrorism premium rates remained significantly higher than those of larger companies. Median rates for the largest companies stood at \$19 per million in 2012. This generally is in keeping with overall insurance pricing patterns: Larger companies typically purchase more insurance, which leads to lower rates compared to rates for smaller companies.

FIGURE 6: TERRORISM INSURANCE PRICING – MEDIAN RATES BY TIV (RATES PER \$MILLION)



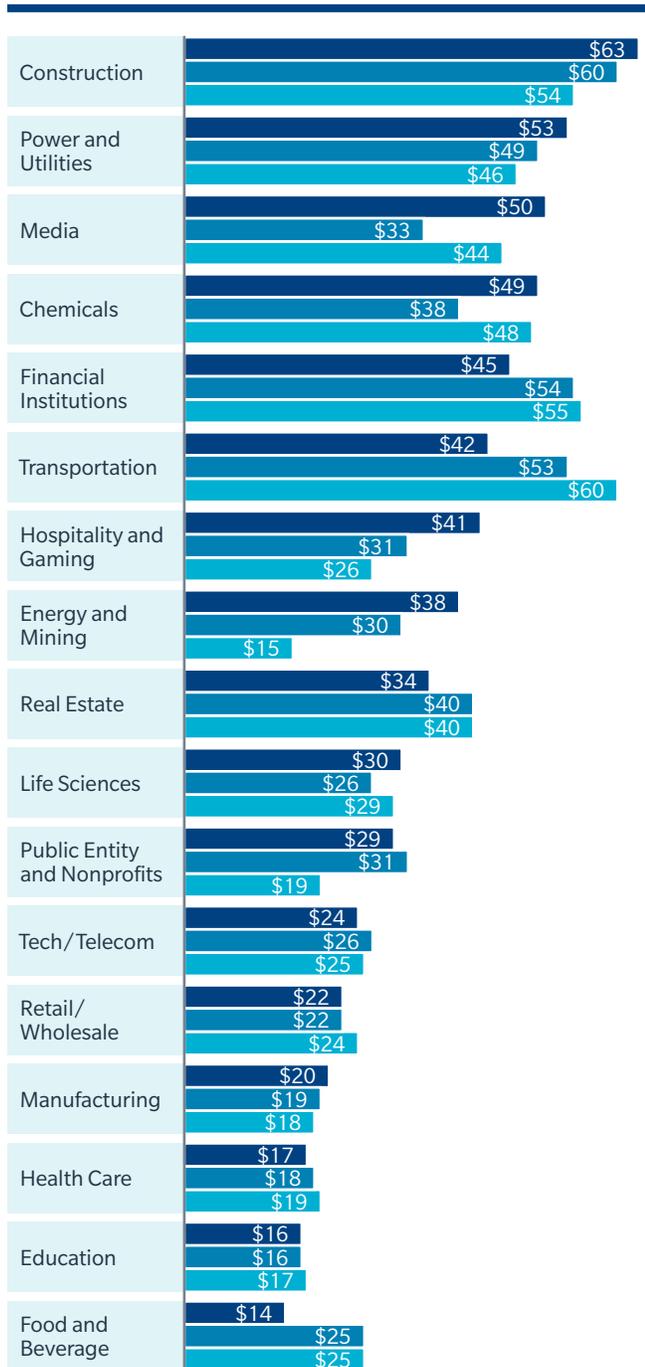
The cost as a percentage of overall property premiums (see Figure 7) was similar for all companies, regardless of TIV. Modest changes — no more than one percentage point per year — were seen across the board, although companies with TIV between \$100 million and \$500 million remained flat at 4% over the past three years. Only companies with TIV less than \$100 million experienced an increase from 2011 to 2012, and only companies with a TIV range between \$500 million and \$1 billion saw a decrease.

Although this suggests that the cost of terrorism coverage generally remained the same in the various size classes, individual businesses may have experienced significant swings based on their property insurance program’s performance. For example, organizations with significant catastrophe (CAT) losses may have faced large increases in their overall property insurance program, but little change in their terrorism insurance pricing, resulting in a smaller percentage of their overall premium being attributed to terrorism coverage. Conversely, companies that had favorable loss histories in recent years may have experienced rate decreases in their overall programs while their terrorism insurance pricing remained constant or decreased, which may show in the analysis as an increase in terrorism pricing as a percentage, despite no overall increase in total costs.

FIGURE 7: TERRORISM INSURANCE PRICING AS PERCENTAGE OF PROPERTY PREMIUM BY TIV



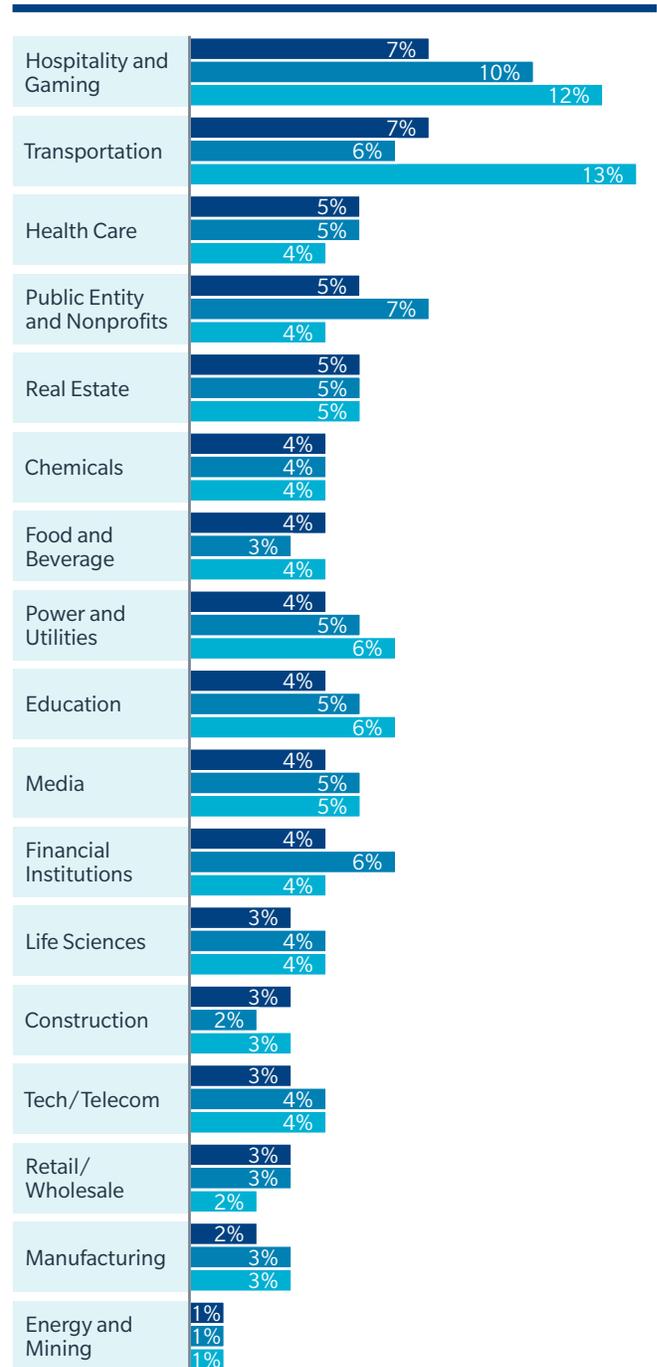
FIGURE 8: TERRORISM PRICING – MEDIAN RATES BY INDUSTRY (RATE PER MILLION)



Source: Marsh Global Analytics

● 2012 ● 2011 ● 2010

FIGURE 9: TERRORISM INSURANCE PRICING AS A PERCENTAGE OF PROPERTY PREMIUM BY INDUSTRY



Source: Marsh Global Analytics

● 2012 ● 2011 ● 2010

COST BY INDUSTRY

Compared to rates in 2011, median property terrorism insurance premium rates decreased in 2012 for seven of 17 industry categories: financial institutions, transportation, real estate, public entity and nonprofit, technology/telecom, health care, and food and beverage. Organizations in the financial institutions, food and beverage, and transportation sectors experienced the most significant decreases.

Rates increased most significantly for media companies, while construction, power and utilities, chemicals, hospitality, energy, life sciences, and manufacturing companies also experienced increases in their median rates (see Figure 8). Although each company's policy is priced based on its unique exposures, it is possible that a combination of prior CAT losses and location — namely businesses located in a central business district — may have contributed to any increases.

Overall, construction companies paid the most for their terrorism insurance, at a median rate of \$63 per million, up from \$54 per million in 2010. Companies in the food and beverage, health care, and education sectors paid the least for coverage, with median rates less than \$20 per million. Food and beverage firms experienced the most significant reductions in median rates over the past three years.

When analyzing terrorism insurance pricing as a percentage of overall property premiums, hospitality and transportation companies paid the largest share, allocating 7% of their total property programs, which also represents the largest increase as a percentage of total property insurance cost among all industry groups (see Figure 9). No other industry sector paid more than 5% of its total property premium for terrorism coverage. Energy companies continued to pay the lowest, allocating only 1% of total property premiums to terrorism insurance over the last three years.

COST BY REGION

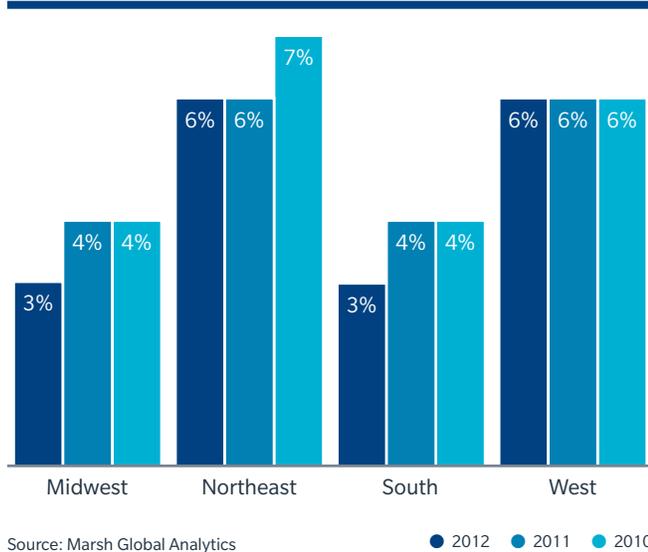
Companies in the Midwest paid the lowest rates for property terrorism insurance in 2012, followed closely by companies in the West (see Figure 10). Based on median premium rates, terrorism insurance was the most expensive in the South and in the Northeast, although the regional variation has narrowed. Companies in the Northeast experienced the highest median rates per million.

FIGURE 10: TERRORISM INSURANCE PRICING – MEDIAN RATES BY REGION (RATES PER MILLION)



Terrorism insurance pricing as a percentage of property premium varies slightly in the four US regions analyzed (see Figure 11), accounting for an average of 3% of total property premiums for companies in the Midwest and South, and 6% in the West and Northeast. Much of this difference can be explained by regional differences in terrorism exposure. Companies in major metropolitan areas — for example, New York, Washington, D.C., and Boston — are likely to pay a higher premium for their terrorism coverage, which results in a larger percentage of their overall property insurance costs being dedicated to terrorism coverage.

FIGURE 11: TERRORISM INSURANCE PRICING AS PERCENTAGE OF PROPERTY PREMIUM BY REGION



US property terrorism insurance rates generally have decreased or remained flat over the past three years. However, the overall property insurance marketplace was affected in 2011 and 2012 by a number of significant CAT events in the US and globally, contributing to slight increases in property and terrorism insurance rates. Additionally, the release of updated CAT models from modeling firms AIR Worldwide and RMS contributed to a general push by insurers to increase rates or to slow or cease rate decreases. Companies without significant CAT exposures or with favorable loss histories were less likely to experience rate increases.

CONSIDERATIONS IN USING CAPTIVES FOR TERRORISM COVERAGE

Among US captive insurers managed by Marsh, 25% underwrite at least one TRIA-specific (standalone) program. Additionally, hundreds of owners use their captives to provide some element of terrorism coverage, thereby participating in TRIA. Captive insurers' participation stems both from TRIA's make-available provision and from the standalone programs they underwrite. It is common for the policyholder to accept the captive's offer of terrorism insurance when the captive is also providing property or casualty insurance.

In more complex scenarios, captives provide standalone terrorism programs, often as a supplement to a traditional insurance placement. These arrangements most commonly involve providing insurance for property losses resulting from terrorism, not standalone liability placements. In some cases, the captive is asked to provide limits in excess of what is available in the commercial market and/or to provide additional breadth of coverage.

An example of a more complex structure is a captive providing \$500 million in excess of \$500 million of conventional terrorism insurance purchased from commercial insurers, \$1 billion of NBCR coverage, and wraparound protection for the commercial insurance program. The wraparound element provides for payment of losses by the captive insurer if the commercial insurance program does not result in the expected coverage after a loss.

CAREFUL EVALUATION REQUIRED

Although implementing a terrorism insurance program within an existing captive (or forming a new captive to implement a terrorism insurance program) is relatively straightforward, it is important to thoughtfully evaluate the feasibility and appropriateness of doing so prior to implementation and again during subsequent renewals. Several key considerations follow.

- Captives are included in the definition of insurers under TRIA according to Department of Treasury guidance; however, captive owners have been specifically cautioned against "gaming" the program.

These cautions are in recognition of the inherent conflict of interest and unusual level of control a policyholder (typically the captive's parent and other affiliated companies) has over an insurer in a captive insurance transaction. The cautions emphasize that captive owners should not take actions that would improperly reduce an organization's overall share of a loss — for example, captive insurers should not deliberately price the premium low in order to reduce the captive's TRIA deductible.

- Capitalization must be determined and provided. Two major factors are considered when determining capitalization. The primary consideration is that capitalization must be sufficient to satisfy the responsible domicile's insurance regulator. Captive insurance company regulators apply different standards, but are primarily concerned with statutory minimums and ensuring that the captive insurer has the capacity to meet its reasonably foreseeable obligations to policyholders. Regulators also consider such traditional factors as reinsurance protection in this analysis, as well as nontraditional "assets" such as letters of credit posted with the regulator. Second, capitalization should be evaluated based on appropriateness considering the overall business plan and objectives of the captive.
- Premiums charged by the captive should be based on current market prices. If premiums are not thoughtfully derived and supported, financial penalties, including not recovering in the event of a loss, may apply.
- Captives, like all subject insurers, may be required to submit information on terrorism premium rates for review by NAIC and the Secretary of the Treasury. Should actual aggregate insured losses exceed \$100 billion — the amount at which the federal government's annual liability is capped — it could result in a policyholder receiving less than the stated policy limits.
- TRIA permits insurers to obtain reinsurance coverage for all or any portion of any loss not covered by the Act. No payments will be made for acts of terrorism resulting in aggregate insured losses of less than \$100 million. The effect of the trigger is to introduce uncertainty in the event of smaller losses. A worst-case scenario could see an insurer exposed to up to 100% of a loss of up to \$99,999,999.
- Timing must be considered when creating a captive or amending its purpose to write new lines of coverage in order to avail itself of coverage provided by TRIA. It typically takes between 30 and 60 days to establish a new captive. With an existing captive, the timeframe will depend on its current scope and desired amendments, but it is likely to take at least seven days to secure the required approvals and incept the coverage.
- The startup and ongoing administrative costs of a US-domiciled captive should be considered and can vary depending on several factors, such as scope and fees for management, audits, legal advice, and actuarial work required.
- Under TRIA, insurers — including captives — are required to process claims in accordance with customary business practices. Other procedures may also be prescribed by the Secretary of the Treasury.
- If a captive insurer is affiliated with other organizations that qualify as insurers under TRIA, the direct earned premiums of the affiliated insurers will be considered along with the captive's when determining insurer deductibles.

STANDALONE PROPERTY TERRORISM INSURANCE MARKET

**FIGURE 12: TERRORISM INSURANCE MARKET
CAPACITY (IN \$ MILLIONS)**

INSURER/REINSURER	CAPACITY
Chartis	\$1,500
Berkshire Hathaway	\$1,000
Lloyd's	\$900
Lancashire Insurance Group	\$200
AXIS Specialty	\$150
Hiscox USA	\$100
Validus	\$100
Western Re	\$85
ACE Global Markets	\$50
Montpelier Re	\$50
Transatlantic Re	\$50
Beazley US	\$50
Torus	\$40
IRI/Westport	\$40
Aspen Re	\$30
Inter Hannover	\$25

Note: The theoretical marketwide capacity would be difficult to acquire at a reasonable cost for any individual client, and few clients seek coverage above \$1.5 billion. For a client with significant exposures in central business districts of Tier 1 cities or those with exposure schedules with properties perceived as targets for terrorism attacks or where there have been instances of foiled plots, the available capacity is lower. Insurer capacity (and pricing) is also affected by accumulation of aggregates within ZIP codes including Tier 1 cities such as New York, Chicago, Washington, D.C., and San Francisco.

Source: Marsh's Property Specialized Risk Group. Data as of April 23, 2013.

Terrorism and political violence events remain a threat worldwide. Demand for terrorism and political violence insurance coverage has grown in the Middle East, Asia, and North Africa following the so-called Arab Spring of 2010.

Standalone capacity can vary considerably, primarily due to:

- **Location of risk:** The demand for coverage in major metropolitan areas has a substantial affect on the available capacity.
- **Insurer's accumulation of exposure:** Most insurers place aggregate limits on the risks they will take, which can limit capacity in certain locations.
- **Concentration of exposure:** Terrorists attack targets of opportunity. Although it is certainly possible that an attack could occur in a rural area, a remote town, or a small city, demand for coverage will likely be higher in major metropolitan areas due to the concentration of exposures and higher perception of risk.

MARKET CAPACITY

- Standalone capacity has increased significantly for exposures outside central business districts.
- Approximately \$750 million to \$2 billion per risk in standalone capacity is available to companies that do not have sizeable exposures in locations where standalone insurers have reached or are approaching aggregation limits. Capacity in excess of \$2 billion is available but is more expensive.
- For locations where standalone insurers have aggregation issues, the estimated market capacity is approximately \$850 million or lower in some cases. Additional capacity can be accessed, but typically at significantly higher rates.
- Monitoring of aggregates is a priority for insurers, with capacity in top-tier cities being priced accordingly.

TERRORISM REINSURANCE MARKET

Global unrest has begun to affect the terror reinsurance market, not only with regard to supply and demand but in terms of how risks and coverages are defined. Although there is an abundance of capacity in the market due to the absence of a major recent terrorism insured loss (resulting in a stable to softening treaty terrorism market), civil unrest and/or riot coverages in some international terrorism programs are impacting several carriers. Indeed, the dramatic increase in global unrest has caused an increased frequency of localized or territory-specific losses in the facultative reinsurance market. As noted earlier, the Boston Marathon bombing's impact on the insurance markets is still to be determined as of this writing.

On a per-risk basis, there is an estimated \$2.5 billion of capacity, approximately, for terrorism and sabotage coverage available in the facultative reinsurance market at the time of this writing. Capacity for the broader political violence coverage varies depending on world events and losses within specific territories. As loss activity increases and pricing subsequently rises, capacity is attracted to the territory. Nevertheless, the recent increase in loss frequency in the facultative market has not yet affected the general market and a general market hardening is not presently anticipated. Instead, there have been changes to capacity and pricing at the local level.

GLOBAL UNREST

The scale and damage caused by the recent global unrest has prompted a number of insureds in several countries and regions to broaden the coverage they purchase in an effort to mitigate any potential gaps. Coverage trends, however, vary by country and region. Rather than take a one-size-fits-all approach, reinsurers are increasingly evaluating coverage needs on a per-territory or per-region basis.

The unrest occurring in the Middle East and North Africa has led to a change in coverage purchasing behavior. As the nature of events in the region continues to change, a number of reinsurers are reassessing their overall protection. While strikes, riots, and civil commotions are typically included in an "all risk"

policy, larger scale political upheavals — including events categorized as insurrection, civil strife, rebellion, revolution coup d'état, mutiny, and war — are covered only by the specialist political violence market.

The volatility in the region has therefore led to increased demand for political violence coverage, as carriers are looking for comprehensive reinsurance coverage to ensure that claims will be dealt with effectively and swiftly. Recent events in countries such as Tunisia and Egypt have illustrated how situations can rapidly escalate from those categorized by reinsurers as strikes, riots, and civil commotion to full political violence events. By purchasing full political violence coverage, reinsurers and insurers have a broad spectrum of insurance, meaning protection is provided regardless of how the event is defined. As a result, the market has become more restrictive in some Middle Eastern and North African countries.

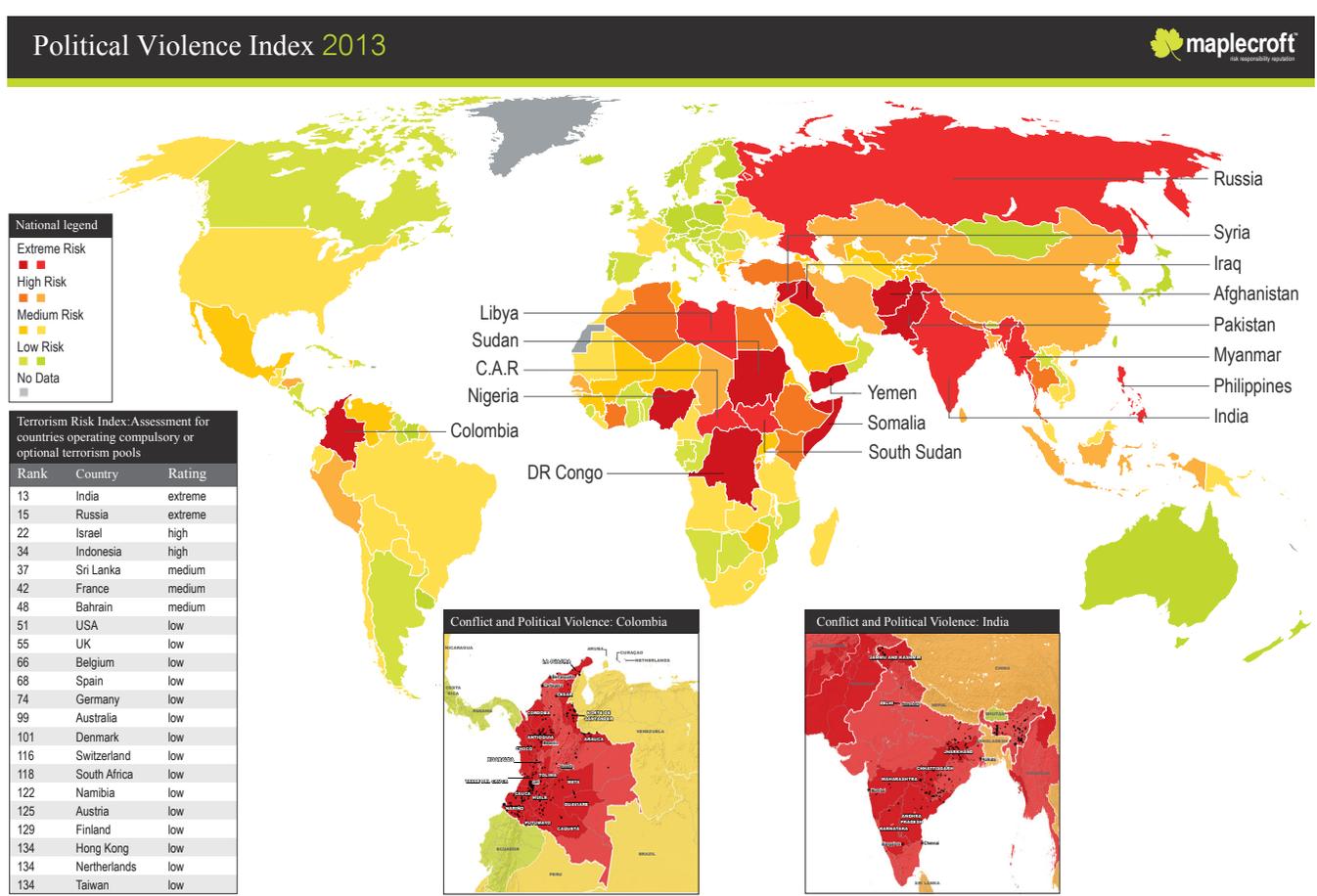
Loss history and incorrect interpretations of terrorism coverage in the past have also emphasized the importance of understanding the subtle differences in coverage. In Israel, for example, attacks by Hezbollah were classed as war losses by the government rather than as terrorism losses.

INTERNATIONAL SCHEMES — GOVERNMENT POOLS AND TRIA

To help insureds manage the global terrorist threat (see Figure 13), terrorism reinsurance pools have been created in a number of countries. The pools were established in reaction to the specific threats faced within each country, and each pool generally requires a declaration by the national government that a terrorist event has occurred to trigger coverage. In the countries

where compulsory or optional terrorism reinsurance pools exist, property insurance policies can be extended to include terrorism coverage in accordance with the local pool. In such situations, the application of the standalone terrorism, sabotage, and/or political violence policy should be either difference in conditions (DIC), difference in conditions and limits (DIC/DIL), or primary of the locally issued property policy pool coverage depending on the pool being accessed.

FIGURE 13: GLOBAL POLITICAL VIOLENCE RATINGS



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Maplecroft's *Political Violence Index 2013* illustrates global political violence and terrorism risks. The accompanying table summarizes the compulsory and optional terrorism pools that operate around the globe. Note: The table includes Northern Ireland in the rating of the United Kingdom; however, Northern Ireland maintains its own terrorism pool, "Criminal Damage Compensation Scheme Northern Ireland."

Source: Maplecroft

FUTURE OF TRIA/TERRORISM INSURANCE IN THE UNITED STATES

Since TRIA's enactment in 2002, terrorism insurance has been widely available for property and other qualifying lines of insurance. Insurers are mandated to offer TRIA as part of their original quote, and the coverage must substantially follow the terms and conditions of the policy to which the TRIA cover attaches.

POTENTIAL RAMIFICATIONS IF TRIA EXPIRES OR IS MATERIALLY CHANGED

If TRIA is allowed to expire or is substantially changed and the mandatory make-available provision is removed, insurers would not be obliged to offer terrorism coverage. The pricing that insurers charge for TRIA is effectively subsidized, in part because the federal backstop does not charge insurers for the protection it offers. Therefore, the TRIA premium charged by insurers without TRIA in place is likely to be considerably higher.

Potentially, property reinsurance capacity and competition could positively influence the supply of terrorism capacity; however, available coverage and limits would not be as readily available. In particular, this may impact companies that have substantial property exposures in central business districts and where reinsurance capacity would be diminished and insufficient to meet insurers' demands.

Additionally, some industries are susceptible to certain insurance requirements, such as mortgage lender requirements with real estate companies. Within TRIA's current structure, the limits available for terrorism insurance are typically sufficient for real estate companies to meet their risk transfer and lender requirement needs. A change in the Act's structure could potentially cause a gap in demand and availability. This susceptibility is not limited to "central business districts" or major cities.

STANDALONE MARKET

The main alternative for a property terrorism risk transfer mechanism if TRIA is not reauthorized would be the standalone terrorism insurance market. As standalone capacity is finite, the cost of this capacity likely would be considerably higher in areas or cities where demand is high, such as major metropolitan areas, central business districts, iconic buildings, ports/airports, and even "soft targets" such as shopping malls. This market dynamic varies considerably by location. In certain high-risk cities — such as New York or Washington, D.C. — the cost of standalone terrorism insurance capacity can be five to 10 times higher than the current pricing for TRIA embedded as part of property programs. However, standalone capacity in certain ZIP codes is so limited that approximately 10% of the current embedded TRIA limit may be currently available in the standalone property terrorism market; should TRIA no longer be in effect, capacity will be affected. In areas perceived to be lower risk, the costs and capacity can be similar between the standalone property terrorism market and TRIA embedded as part of an "all risk" property program.

STATE REGULATIONS

It is important to note that state insurance regulations in 14 of 29 states where standard fire policies (SFP) are mandated do not permit property terrorism exclusions or sublimits for fire caused by a terrorism event. In the absence of substantial market reinsurance capacity to offer insurers an alternative reinsurance mechanism to TRIA, this would likely impact the level of fire or "all risk" property capacity these insurers could offer in areas or cities where they are concerned about the aggregation of terrorism risk. For companies with locations in those areas or cities, this will result in less available fire/"all risk" property insurance, as well as terrorism coverage if TRIA is materially changed or not reauthorized.

In the absence of TRIA, companies with single-carrier property insurance programs and large limits (\$100 million or more) in high-risk areas or those in states that have "fire following/no terrorism exclusion permitted" may require insurance programs to be shared and layered in order to achieve desired limits. This will increase the number of insurers needed to provide the same level of insurance and likely will increase the total cost to insureds.

PROPERTY PROGRAMS

Without a reauthorization of TRIA, shared and layered property insurance programs likely will be subject to substantial differences by layers of insurance on the extent and terms of terrorism coverage. The main implications of such potential differences are using higher-cost standalone terrorism capacity to fill gaps in insurance programs, increased risk if self-insuring gaps, and non-concurrent coverage in the event of a loss.

WORKERS' COMPENSATION

In addition to property insurance, other coverage lines likely will be impacted if TRIA expires or is significantly changed, particularly workers' compensation insurance, as workers' compensation insurers are not permitted to exclude terrorism from their policies. Insurers are concerned about potential aggregation of risk, which may impact the availability of workers' compensation insurance should TRIA materially change or expire. Where these insurers are also offering other lines of insurance, such as property, the combined aggregate exposure likely will further limit their ability or willingness to offer substantial property limits.

The workers' compensation market has been affected by the risk of a terrorist attack, even with the reinsurance backing TRIA provides. Because TRIPRA scaled down the protections afforded by the original 2002 Act (via mechanisms such as increased retentions), it forced insurers to be more vigilant in enforcing concentration guidelines. For example, some carriers have not renewed marquee financial services accounts because of the concentration risk in cities perceived to be terror targets.

If TRIA is either modified significantly or not renewed in 2014, the expectation is that employers will continue to have sufficient insurers from which to purchase workers' compensation coverage in order to comply with state laws. Since such coverage is statutory and cannot be limited, the terms of workers' compensation coverage will not be impacted by the absence of TRIA. An exception to this is the market for excess coverage for self-insured employers. Immediately after the September 11, 2001, attacks, some excess insurers responded by capping their liability at levels less than full statutory coverage. However, in the past, other insurers responded by writing statutory coverage above the limits of the underlying carriers; competition for workers' compensation business continues to exist in the market in 2013, albeit at higher prices.

Two likely impacts that the absence of or a serious modification of TRIA could have on the workers' compensation market are in the areas of pricing and capacity. It is expected that the reinsurance market would likely increase pricing because of the increased potential exposure. This would, in turn, have a trickle-down effect on the primary workers' compensation marketplace. Further, the ability of insurers to use reinsurance capacity to manage their maximum tolerable losses could prove more difficult, especially for the terrorism perils of NBCR events. This could significantly alter carriers' risk appetites and their willingness to offer coverage to employers with large employee accumulations.

In addition, insurers have had more than 10 years to collect premium and build surplus for the potential exposure to terrorist acts. Because of this, there arguably is capacity in the workers' compensation industry to respond to a terrorist event should one occur. One question that arises: Is that accumulated capacity adequate in the event TRIA is allowed to sunset?

While not frequently mentioned, the employers' liability component to the workers' compensation policy may also be a factor. When barred by workers' compensation's exclusive remedy from suing the employer, claimants will frequently sue others — for example, fire suppression system installers or security guards — in an effort to find a deep pocket. The employer is then brought in via third-party practice, and the employers' liability policy would have to respond. To a lesser extent, serious injuries and allegations of wanton conduct by the employer tend to produce attempts to surmount the workers' compensation bar in search of higher tort damages. For example, there could be allegations that cost-cutting measures resulted in a reduction of the number of security guards, despite an awareness of a serious threat.

GENERAL LIABILITY

Unlike property insurance, the general liability (GL) insurance market does not have robust standalone terrorism capacity. While it is possible to model the potential of loss with a single building of "\$X" value, insurers typically find it difficult to become comfortable with GL risks, because the frequency, severity, and instrumentality of loss or number of victims cannot be predicted. Additionally, in the absence of TRIA, although there is no terrorism exclusion in a typical GL policy,

other exclusions and conditions could be brought to bear by an insurer seeking to avoid exposure to large terror losses. For example, depending upon the circumstances, one might see the following types of defenses: late notice, pollution exclusion, professional liability, or war.

CAPTIVES

Organizations that employ captives also are likely to be affected in the event TRIA is allowed to expire or is significantly changed. Captives are widely used to supplement what is available in the commercial market, and, in some cases captive insurers are the only available option for certain layers and/or perils. This is most common in areas of higher perceived risk such as for property or employee-related coverages in major cities. Generally speaking, since captives are best suited to primary operating layers, or as a mechanism for accessing risk transfer solutions, it is very likely that, absent TRIA, captive utilization for terrorism coverage would change significantly. Without TRIA, captives will likely revert to their traditional role of providing commercial reinsurance access to the captive sponsor (where such reinsurance exists) or simply as a mechanism for funding lower-level retentions more consistent with the net retentions that are in effect under TRIA.

CYBER RISK

Although there has been no precedent where TRIA has been applied in response to a cyber attack, a cyber-terrorist attack arguably could trigger coverage under TRIA so long as the Treasury Secretary certified the attack as an “act of terrorism” and all other statutory requirements were met. Thus, TRIA could be instrumental in providing stability in the event of a “cyber Pearl Harbor,” in which catastrophic damages resulted. Notably, as the severity and frequency of cyber attacks have grown more prominent, several proposals have been made to clarify that TRIA could apply as reinsurance in the event of a massive cyber attack. Were that clarification realized, TRIA could spur additional capacity in the cyber market.

IMPLICATIONS FOR THE REINSURANCE MARKET

If TRIA is not extended or is substantially modified, the impact on embedded terrorism insurance coverage, standalone terrorism pricing/demand for capacity, and TRIPRA captive placements are likely to impact the reinsurance marketplace as well. Although the standalone terrorism market continues to remain an alternative to TRIA coverage offered as part of property “all risk” policies, there is not sufficient capacity for regions with the highest demand for insurance to meet the needs of all policyholders. Coupled with limited availability of standalone reinsurance capacity and continued perceived limitations on the reliability of terrorism risk models, the insurance markets are not well positioned to be a viable alternative replacement to TRIA or other government-mandated and -supported terrorism risk transfer mechanisms in the United States.

Terrorism catastrophe exposure continues to be of particular interest to property and workers’ compensation insurers and to rating agencies for several reasons. First, unlike property insurers, in most cases workers’ compensation carriers are obligated to cover terrorism for every risk in their portfolios. Second, unlike for natural perils, A.M. Best requires a carrier to model the severity of its highest potential attack scenarios as well as a percentage of policyholders’ surplus. This could result in some notably high results with the potential of being stress tested, and, in select cases, could impact an insurer’s rating.

MERITS OF REINSURANCE PROTECTION

Although the need for TRIA is clear, reinsurance protection can help companies withstand the nonrenewal or alteration of the program. Indeed, even though the federal backstop currently is in place, many insurers seek to ensure additional protection via reinsurance. These standalone reinsurance protections typically exclude losses resulting from NBCR instruments, but would protect all losses from the property, casualty, and workers’ compensation policies they underwrite. Standalone reinsurance pricing continues to vary depending on the geographical location of the risk(s) and proximity of the risk to a perceived target of terrorism.

Carriers that are perceived to benefit from lower TRIA deductibles (based on direct earned premiums) likely will see a greater impact and may need to reduce their aggregate exposure to terrorism on the front end (reduce writings) or buy more reinsurance protection. While there currently appears to be ample capacity for insurers that buy standalone terrorism reinsurance, increased demand would likely result in constrained capacity and higher prices. The potential scenario that an insurer suffers a loss less than the current \$100 million (and potentially higher future) industry trigger — without any reimbursement from TRIA — is gaining heightened attention by carriers and the rating agencies.

Higher reinsurance limits and costs could make it less affordable for smaller companies to buy sufficient coverage. Any dramatic change in TRIA potentially could lead to contraction in the marketplace in both insurance and reinsurance. In a recent briefing, A.M. Best indicated that material changes in TRIA would raise rating concerns especially in cases where:

- Net exposure to terrorism (excluding the benefits of TRIA) exceeded 20% of capital and surplus.
- Aggregate exposures of risks in certain geographic areas are notably high.
- The locations of exposures within these areas potentially impact capitalization.

In its discussions with insurers, A.M. Best is questioning potential plans to track exposure, underwrite aggregates more conservatively, not renew specific risks, and/or increase/change reinsurance purchases should their net TRIPRA retention notably increase. Overreliance on the federal backstop is not considered to be a good substitute for sound risk management.

All rating agencies require cedents to model their largest US terrorism exposures and measure their frequency and severity against their policyholder surplus. Those carriers that have notable backstop TRIA protection as a percentage of their policyholder surplus may benefit from having proactive rating agency discussions while improving the accuracy of their exposure data and modeling output. They may also benefit from proactively pursuing exposure identification, exposure mitigation through portfolio management, and exploring various reinsurance solutions.

IMPLICATIONS FOR MEETING LENDER REQUIREMENTS

Terrorism insurance for real estate companies and construction firms is often required as part of their mortgage agreements; TRIA has offered those companies a mechanism for meeting lender requirements. The impact of not meeting the mortgage requirements varies from client to client and can include minimum premium spends, which are considered punitive. It has been speculated that the absence of TRIA could impact real estate investment and construction/development activity because of the challenge with meeting lender requirements.

Terrorism coverage may still be offered by certain property carriers if TRIA is not extended. However, it is very unlikely this would be at the levels that US businesses, specifically real estate and construction companies — two industries especially susceptible to meeting lender requirements — would need to meet their and their lenders' risk transfer needs. Additionally, there likely would be certain areas where market-wide capacity would be limited. Terrorism capacity/coverage would be at higher cost than businesses are currently paying.

POTENTIAL APPROACHES TO TERRORISM PROGRAMS

For insureds that currently rely substantially on TRIA for terrorism coverage, the current period of uncertainty is problematic. During 2013 and 2014 — or until a decision is made about TRIA's future — a number of approaches can be considered by insureds.

Following are some examples of potential approaches. It is important to note that any program structure needs to be implemented based on an insured's specific needs. Also, in most cases for the buyers of TRIA coverage in areas with the highest demand for terrorism coverage, these approaches are unlikely to completely replace the current level of coverage and limits provided under TRIA as part of property or captive programs.

- Insureds with TRIA 100% embedded as part of “all risk” property programs should work in coordination with property brokers and insurers to determine which property insurers are likely to continue to offer terrorism coverage as part of property programs,

regardless of TRIA's extension. If potential gaps in property insurer capacity are identified should TRIA be substantially changed or not extended, insureds likely will have options to consider. For example, they may want to consider placing standalone capacity to fill gaps in capacity. Other alternatives include standalone capacity commitment contracts or excess standalone contracts with the option to drop down and fill gaps in capacity where property carriers cannot continue offering terrorism coverage in TRIA's absence. These approaches are likely to add to the total overall terrorism insurance cost; and in cases where insureds have exposure in major cities or areas where standalone terrorism carriers offer limited capacity, they are likely to result in reduced overall limits and coverage for terrorism.

- Insureds that currently access property TRIA coverage, either as part of a captive property program or as a standalone captive TRIA policy, should consider securing standalone terrorism reinsurance for the captive's liabilities as defined by the Act. This standalone capacity can then be accessed on a direct basis in the event TRIA is not extended.
- Captives providing property TRIA coverage that already purchase standalone terrorism reinsurance, can consider identifying options with standalone terrorism insurers to increase their capacity to cover potential changes in TRIA — such as an increase in the level of reinsurance required. If TRIA is not extended, they can consider converting the standalone terrorism reinsurance limits to primary coverage and seek additional limits in the standalone terrorism insurance market.
- Insureds that currently access standalone terrorism insurance markets for either US noncertified or international terrorism coverage should engage standalone terrorism carriers to discuss various options and terms for converting capacity to cover full terrorism risk in the US, including any foreign or domestic acts that would have been covered under TRIA.

Since both insurers and reinsurers focus on catastrophe models to help determine their underwriting strategies — including whether to offer coverage, the amount of capacity offered, and pricing — it is critical that insureds provide the highest quality of data possible for both property and employee accumulation, as this will help to ensure they receive the most accurate terms, conditions,

and pricing based on their actual exposures. There is a direct correlation between high-quality data and the credibility of modeled catastrophic losses and ability to quantify an employer's hazard profile.

Some examples of high-quality data elements that can affect a carrier's view of terrorism loss potential for a particular insured and that can help minimize the impact that default assumptions have on expected modeled losses include:

- Accurate 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 at each location at any one time.
- Single location or multiple building campus setting.

From a workers' compensation coverage perspective, providing employees by building location in a campus setting will help to mitigate one pitfall of the catastrophic models that defaults to assuming that all employees are in a single building versus being spread across the buildings where they actually work. Identifying the actual buildings where employees work in a campus setting should, when done according to best practices, reduce the loss potential to most types of catastrophic workers' compensation events (for example, terrorism, industrial accident, and natural disasters).

Two other data elements that can make a difference in quantifying an employer's actual hazard profile are construction type and the floor where employees are located. Some building types are less prone to immediate collapse, which gives employees more time to evacuate in catastrophic loss scenarios.

In terms of an insured's property coverage, the more complete the data, the more accurate and comprehensive the CAT models will be. This lack of volatility and uncertainty allows property insurers to more accurately price coverage and insureds to better understand their exposures. As a result, the insured can be better positioned to purchase adequate coverage limits with appropriate terms and conditions.

STEPS FOR CAPTIVES CONSIDERING ACCESSING TRIA

Captive owners and non-captive owners alike should consider initiating or expanding relationships with traditional insurers in order to be in a stronger position to request expanded coverage should it be desired. Captive owners should also ensure the policies their captives write contain appropriate provisions to enable cancellation or modification of terrorism coverage in the event of a material change in or expiration of TRIA.

Until the Act's scheduled expiration on December 31, 2014, using a captive to access TRIA can be a viable option for some companies. Organizations considering using their captives to access TRIA should consider the following recommendations:

- Determine the captive exposure by calculating the 20% horizontal deductible, and the vertical 15% quota-share based on the policy limit.
- Determine the premium to charge for terrorism coverage. US Treasury guidelines state the premiums must not be discriminatory, excessive, or inadequate. If they are found to be so, this could jeopardize the captive's ability to collect in the event of a loss.
- Be aware of, and factor in, the terrorism risks that are not covered by the Act (such as losses occurring outside of the United States).
- Consider purchasing reinsurance for the horizontal deductible, vertical 15% quota-share, and \$100 million net trigger liability.
- Consider purchasing coverage for a deliberation or delay in the TRIA certification and/or payment process lasting greater than 180 days.
- Keep in mind that the captive, like all insurers, will be responsible for assessing, collecting, and distributing the post-loss surcharge that will be assessed against all policyholders in the event a loss occurs.

- Compare the findings against commercial insurance options.
- If the decision is made to use a captive, secure the approval of the responsible domicile insurance regulator and implement the program.

POLITICAL ENVIRONMENT

Federal lawmakers will likely address TRIA, which is set to expire on December 31, 2014, during the 113th Congress. Members will have to decide whether to reauthorize the Act as is, amend and modify key provisions, or allow the program to expire. Two key factors will influence the debate:

- First, the two congressional committees with jurisdiction over the program — the Senate Banking Committee (SBC) and House Financial Services Committee (HFSC) — have new leaders and members with divergent perspectives on TRIA and its future.
- Second, the composition of Congress has changed considerably since the 2007 reauthorization.

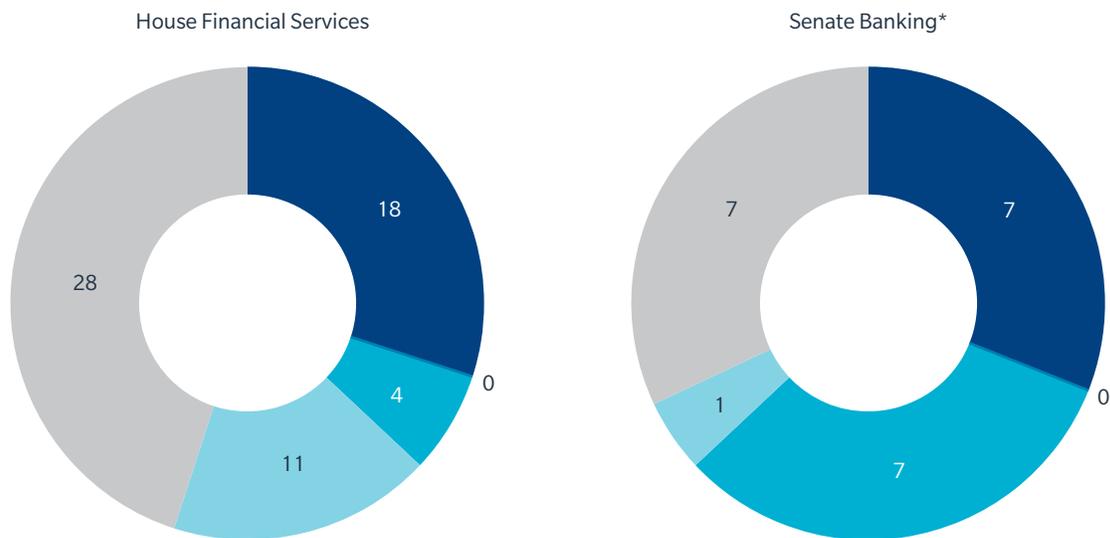
The process will begin in the HFSC, where Republican Jeb Hensarling of Texas, in his new role as chairman, will set the agenda. Of importance to the debate, he and 11 current senior Republican members of the HFSC opposed passage of the 2007 TRIA extension both in the committee and when the entire US House of Representatives voted on the bill in September 2007 (see Figure 14). The voices of the chairman and these 11 senior members will likely carry great weight. New members of the panel will look to their leadership for guidance during the debate. Across the Capitol, Senator Tim Johnson, Democratic chairman of the SBC, likely will preside over a less controversial process. During the 2007 TRIA extension, the bill passed easily in both the committee and in the full Senate.

Both committees have staked out differing views concerning their intent to examine and debate the program. Whereas the SBC's business agenda for the next two years includes language to enact long-term reauthorization of TRIA "with appropriate

improvements, as necessary,” the HFSC’s two-year oversight plan called for expanded deliberation. Indeed, as the oversight plan explicitly points out, the “Committee will examine the private sector’s capacity to assess and price for terrorism risk and consider whether to reauthorize TRIA as well as proposals that would reduce the potential federal exposure and participation in the TRIA.” This language suggests a straight extension without meaningful reforms may be unlikely. The number of congressional members who were not in office for the 2007 debate complicates matters: 46% of the current HFSC members are new since 2007, as are one-third of the members of the SBC.

On September 11, 2012, the HFSC held a subcommittee hearing in which panel witnesses were in near-unanimous agreement in support of the program and a long-term reauthorization. On February 5, 2013, Representative Michael Grimm (R-NY), a member of the Financial Services Committee, introduced a straight extension of TRIPRA. And President Obama’s FY 2014 budget projects net TRIA spending of \$443 million over the 2014 – 2018 period and \$526 million over the 2014 – 2023 period.

FIGURE 14: CURRENT COMMITTEE MEMBERS AND THE 2007 TRIA REAUTHORIZATION VOTE



* Senator Heller voted against reauthorization while a member of the House

Source: Marsh & McLennan Companies Government Affairs

● DEMOCRAT YES ● DEMOCRAT NO ● REPUBLICAN YES ● REPUBLICAN NO ● NOT IN CONGRESS

CONCLUSION

For more than 10 years, US-based insureds have benefited from access to terrorism insurance as a result of TRIA. Insureds and insurers alike must prepare for the possibility the Act will be materially changed or allowed to expire on December 31, 2014. Data clearly show a demand for — and a perceived need of — this coverage across many insurance lines, notably property, casualty, and workers' compensation.

Although there is private market capacity for terrorism insurance, it may not be enough to meet the demand in the marketplace should TRIA not be reauthorized. In that case, despite an ongoing exposure to terrorism events, insureds may be unable to secure adequate capacity to insure their risks, or may be unable to do so at commercially viable prices. It is likely that many would be left to self-insure at least some portion of their terrorism risk.

From the standpoint of global business competition, it should be noted that there are a number of countries that offer government supported terrorism risk transfer solutions that are likely to remain available. For these and other reasons, representatives from real estate, finance, energy, construction, insurance, professional sports leagues, and elsewhere have supported TRIA and are making the case for its reauthorization.

APPENDIX

INDUSTRY CATEGORIES

This report examined property terrorism insurance purchasing patterns for 17 industry sectors, selected based on such criteria as sample population size, perceived exposures, take-up rates, and premium rates. Other industry groups were part of the overall analysis but not reported on individually. The industry groupings included, but were not limited to, the following lines of business:

- **Chemicals:** specialty chemicals, agrochemicals, distributors, industrial gases, and personal care and household companies.
- **Construction:** contractors, homebuilders, and general contractors.
- **Education:** universities and school districts.
- **Energy:** oil, gas, and pipelines.
- **Financial institutions:** banks, insurers, and securities firms.
- **Food and beverage:** manufacturers and distributors.
- **Hospitality:** hotels, casinos, sporting arenas, performing arts centers, and restaurants.
- **Health care:** hospitals and managed-care facilities.
- **Life sciences:** research, manufacturers, biotechnology, and pharmaceuticals.
- **Manufacturing:** all manufacturers, excluding aviation.
- **Media:** print and electronic media.
- **Public entity and nonprofit:** city, county, and state entities and nonprofit organizations.
- **Real estate:** real estate and property management companies.
- **Retail and wholesale:** retail entities of all kinds.
- **Technology/telecom:** hardware and software manufacturers and distributors, telephone companies, and internet service providers.
- **Transportation:** trucking and bus companies.
- **Power and utility:** public and private gas, electric, and water utilities.

METHODOLOGY

The report analyses relied on data from Marsh clients that purchased property terrorism insurance across the United States. Purchasing patterns were examined in the aggregate and were also based on client characteristics such as size, industry, and region.

The 2012 data came from property insurance placements incepting during calendar year 2012. The study population does not include placements in the United States for foreign-based multinationals or for small-firm placements made through package policies.

The 2012 study was based on a sample of 2,558 firms with the following characteristics:

	1ST QUARTILE	MEDIAN	3RD QUARTILE
TIV	\$36 million	\$165 million	\$675 million
Property Premium	\$51,411	\$171,277	\$555,495
Terrorism Premium	\$1,000	\$4,915	\$16,409

It is important to note:

- The sample size for the energy industry sector was relatively small and therefore may not be statistically significant. There may be a larger margin of error in the data analyzed, which may result in property terrorism take-up rates and pricing for energy companies varying more widely than the data indicates.
- For some companies, insurers quoted only a nominal terrorism premium of \$1. These \$1 premiums were omitted from the calculations of the median terrorism premium rates.
- Companies were assigned to regions based on the locations of the Marsh offices that served them. Generally, this was the Marsh office most closely located to a company's headquarters. Many clients have multiple facilities across the US and the world, meaning the potential risk for a terrorist attack may not be fully represented by where a company is headquartered. That said, the decision as to whether to purchase terrorism insurance is typically made at headquarters.

ABOUT MARSH

Marsh is a global leader in insurance broking and risk management. We help clients succeed by defining, designing, and delivering innovative industry-specific solutions that help them effectively manage risk. We have approximately 26,000 colleagues working together to serve clients in more than 100 countries. Marsh is a wholly owned subsidiary of Marsh & McLennan Companies, whose market-leading professional services companies offer clients advice and solutions in the areas of risk, strategy, and human capital.



This report is a coordinated effort among Marsh's Property Practice, Marsh's Casualty Practice, Marsh Captive Solutions, Marsh Global Analytics, Guy Carpenter, and Marsh & McLennan Companies Government Affairs.

For more information, please reach out to your Marsh or Guy Carpenter or other Marsh and McLennan Companies representative, send an email to questions@marsh.com, or visit marsh.com and guycarp.com.

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