

Risk Factor

Volume 1, Issue 3

Your Guide to Risk and Exposure

An Uncertain Horizon

The Terrorism Risk Insurance Act faces the uncertainty of a renewal to 2007. While experts agree that its demise is iffy at best, companies should still plan for the worst.

In This Issue

Special: TRIA Issue

- Preparing for Post-TRIA
- Underwriting Changes
- Homeland Security Spending

Plus:

- News Briefs
- Moves & Notes

Quick quote:

“We’re sitting here saying that’s the worst-case scenario, but if we were having this conversation on September 10, 2001, the idea that someone would plow planes into buildings was beyond comprehension.” Joe Paduda

December 31, 2005 is closer than you think, especially if you’re relying on terrorism coverage through the government’s federal backstop. The Terrorism Risk Insurance Act (TRIA) is due to breathe its last at the tail-end of 2005, though some argue that TRIA’s demise is not a sure thing. The move that pumped immediate, much needed capacity into a terrorized 2001 economy was designed to shore up the industry until other solutions were put into place.

Yet nearly four years later, little has been put into place. Modeling has occurred, but experts wonder if even the most meticulous of modeling could ever take into account unimaginable catastrophic events. And what is happening could have been predicted; insurers are making moves at the state level now to try to remove the responsibility from their shoulders. The Insurance Services Office, Inc. (ISO) filed endorsements with regulators in every state seeking approval for coverage limitations if the backstop ends. The endorsements also included limits in case Congress decided to modify TRIA and increase insurers’ responsibility for losses associated with terrorism.

Should the average risk manager care about terrorism? Only if he/she values a solid, decently priced workers’ compensation plan. That’s right—workers’ compensation policies, not property & casualty policies, stand to be affected most by TRIA’s possible demise.

Workers’ comp insurers are unable to separate terrorism cover in their policies, making the

News Briefs—October 12, 2004

The Survey Says: A study by the Columbia University Graduate school of Business found that a two-year extension of TRIA would enhance the U.S. economic performance near term, and would strengthen the economy overall.

Thwarting Food Threats: The USDA has released voluntary security guidelines for the food haulers industry. Some of the suggested measures include training for spotting suspicious behavior, hijack prevention, and checklists that can help to prevent terrorist incidents.

Mighty Tough Winds: Swiss Re is expecting its losses from Hurricane Jeanne to be approximately \$150 million. Bermuda’s PXRE Group Ltd. estimates its net losses from all four recent hurricanes to fall between \$80 million and \$105 million. Alabama’s Vesta Insurance Group announced that its gross loss before reinsurance from Hurricane Ivan will range from \$7 million to \$12 million. Bermuda-based Platinum Underwriters Holdings estimates a total tax negative impact from all four hurricanes to reach \$130 million.

imminent demise of TRIA everyone's problem.

Unfounded Fears?

While the possibility of a TRIA sunset exists, all the experts we talked with agree that the likelihood of that happening is a long shot. "There are bills pending in the House and Senate to extend TRIA," says Joe Paduda, independent consultant with Health Strategy Associates in Madison, Conn. "My sense is that something will happen on the federal side. It is likely that an extension will occur, and it is likely it will occur before the end of this year."

"There's not much that can be done in the industry to address capacity." — Samir Shah

And while the halls of the Capitol have been silent on this issue since mid summer, many expect that TRIA issues and discussions will re-

surface post-election. A little too late for some, says Bruce Zaccanti, partner with Ernst & Young's insurance and actuarial advisory services in Chicago. "The election's in November, but we have renewals in October, November and December that may include endorsements that say if TRIA is not renewed, the insurer has the option of not offering terrorism coverage at that time." That means that some companies will be faced with either an absence in coverage, or perhaps even exceedingly high premiums to cover the risk, midway through their policy cycle.

Some believe that the government will see the value in TRIA, and will renew until 2007. "The government has requested a study on the effectiveness of TRIA," says Samir Shah, terrorism, risk and insurance expert with Tillinghast TowersPerrin. "What I'm hoping that study will contemplate is what would happen if TRIA wasn't there. If they see that they passed TRIA and now there's a terrorism market, in that sense it (TRIA) was successful. But they shouldn't conclude that if TRIA goes away, the market will still be there."

Without TRIA, What Then?

Many experts agree—without TRIA's renewal, things are going to regress. The workers' comp exposure could look a lot like that of post 9/11, pre-TRIA days. "I think it will go back to where it was prior to TRIA," says Mel Bangs, vice president of risk services for McQueary Henry Bowles Troy in Dallas. "There were a limited number of markets. Most of the bigger carriers had a terrorism product, but it was very expensive." Yet Bangs holds out some hope that underwriters have a better handle on the risks. "They've learned to underwrite it better over the last three years. The same carriers will be players, but they're much better at underwriting it and quantifying what the exposure is, and they know where they don't want to write it."

Pooling funds aren't going to work, either; not according to a Tillinghast TowersPerrin study that examined the possibility of workers' comp insurers putting together a funding pool for the terrorism risk. Paduda says, "The study showed that there is not enough capital in the system today, and there will likely not be enough capital in the system in the near, medium and long term to be able to fund the worst-case terrorism claim. The risk modeling done in the industry suggests that worst case is a \$90-billion workers' comp exposure from a catastrophic terrorism event. The capital in the industry today is \$30 billion. That's just workers' comp."

And there's the rub. "The problem is capacity," says Shah. "There's not much that can be done in the industry to address capacity." Though some have tried. Shah points to attempts to create terrorism pools for workers' compensation. But the Tillinghast TowersPerrin study, he says, showed that pooling the insurers did nothing solve the issue of limited capacity.

Yet all experts we spoke with cautioned that expecting TRIA's demise is putting the cart before the horse. One bill currently in the works, House Bill 4634 that seeks to extend the applicability of TRIA until 2007, is meeting with favorable response. The bill was passed by the House Financial Services Committee on September 29.

Planning for the Possibility

Even with a slim chance of the government not renewing TRIA, smart is the company that has a contingency plan. TRIA's unsettled status is already having a significant impact on the market. Renewals that extend beyond TRIA's 2005 sunset are seeing the uncertainty built into their policies. It's a situation that could prove quite costly for the company caught unprepared.

Two coverage areas that have the most exposure are P&C and workers' comp. "Property is somewhat less of an issue because it's a relatively short-tail line," says Paduda. "Claims usually are resolved within some reasonable time period. With workers' comp, that's obviously not the situation at all." What makes matters worse is that workers' comp coverage requires terrorism insurance. "Anyone who writes a workers' comp policy or is self-insured is on the hook for any illness or injury that arises during the course of employment," adds Paduda. "There are no exceptions."

TRIA (cont.)

With capacity limits being the largest, and most ominous, obstacle to getting coverage, companies should start early to prepare for renewal. Paduda suggest shopping early. "Even if you're six months away from renewal, the sooner you get your information in, the sooner you will reserve a slot in the insurers' risk profile." the sooner you will reserve a slot in the insurers' risk profile."

Paduda suggests a depany's accumulation things underwriters above the obvious. maximum limit of ex- ple are in that build- your probable limit of ager needs to under- are in the building at

your population profile is in a particular area. It tells the insurance companies that your company has thought this through. Also, provide information on what you've done from a safety and loss-prevention perspective."

"Anyone who writes a workers' comp policy or is self-insured is on the hook for any illness or injury that arises during the course of employment. "There are no exceptions."

—Joe Paduda

tailed audit of the com- exposure. "There are two are going to look for First is: What is your posture? How many peo- ing at one time? What is exposure? The risk man- stand how many people one time. Know what

The Sun Also Rises

The goal of the risk manager should be to show the underwriters a more complete, detailed view of the company's overall terrorism risk from both a property and a workers' comp perspective, say the experts.

Paduda says it's like two men running from a bear. "Two guys are running next to each other. One stops takes off his shoes, and puts on his sneakers. His friend says, 'You're never going to outrun the bear.' The guy replied, 'I only have to outrun you.' What you should be doing is outrunning the next risk. When the broker gets two submissions in and yours has a nice binder and a video tape and training documentation, while the other submission is a bunch of papers in a manila envelope, guess who's getting the coverage?"

Moves & Notes

New Policy: FM Global's Affiliated FM commercial property insurer has added a new all-risk policy to its line of products written to meet the property coverage needs of manufacturers. The policy includes a combined business interruption/extra expense form and customized extensions of coverage.

Seminole's Choice: The Hartford Financial Services Group has been chosen by the Seminole County Regional Chamber of Commerce for its annual listing of local companies that have made a significant capital investment in Seminole County and brought new jobs to the area.

Life Sciences Policy: The Chubb Group of Insurance Companies has launched a portfolio of policies to help protect life sciences companies from property and casualty exposures faced by this industry. Chubb's *Customarq for Life Sciences* portfolio offers life sciences customers property, general liability, products liability, human clinical trials and errors and omissions insurance.

Top of the Towers: At What Price?

While it may take nearly 15 years for the World Trade Center site to be rebuilt, no one has been able to answer the ultimate question: Who's going to move back there? Mel Bangs, VP of risk services at McQueary Henry Bowles Troy in Dallas, sees issues for companies who choose the high-profile site. "I think the tenants in that building will have a very tough time with every line of coverage."



In fact, experts predict a sliding-scale premium and coverage shortages in any tall structure that replaces the World Trade Center. As one expert put it, "the higher up you are in the building, the more you're going to pay and the less capacity and coverage you're going to find."

Thanks to accumulated risk modeling, companies may think twice about where they locate and certainly about the number of employees in any particular building, according to Bangs. Bruce Zaccanti of Ernst & Young's insurance and actuarial services practice says that geological and geographical dispersion is now the new modeling tool for property and workers' comp risk. "Insurance rates are based on the probability of risk. There is no predictability on terrorism."

Terrorism Spending: Homeland Security Report Card

In the same Census Bureau report that announced a 320 billion-dollar budget in 2003 comes the news that the state of Washington is among the top 10 states that the Department of Homeland Security chose to spend its money. Ranking eighth behind states such as California, Virginia, Texas and Florida, Washington was where the agency spent over \$267 million. That amounts to nearly \$44 spent per Washington resident.

And not everyone is happy about it. Florida's U.S. Senator Bill Nelson has gone on record to say that it was a "crying shame" that Florida ranked 25th in per capita spending. The Department of Homeland Security is reported to have spent \$458 million in Florida during 2003. The total includes \$330 million in federal salaries, just over \$62 million in grants and \$65 million in contracts.

Nelson is quoted in an Associated Press article, Nelson said that an additional \$300 to \$400 million in funding would increase what he implied is lax security in the state's ports. "It is an undisputed fact that we are only examining five percent of the cargo containers coming into this country."

In the same AP article, Dave Halstead of the state's Homeland Security office said that conditions in Florida have improved dramatically in the past three years. "We are 100-percent better after 9/11 and we are going to continue to improve."

The nationwide expenditures for the agency were \$16.96 billion in its first year of existence. That figure represents nearly 12 percent of federal domestic spending for 2003, according to the Census Bureau.



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Meeting News

October 18, 2004: Network and Cyber Liability Exposures for Financial Institutions Seminar. 8 a.m. to 10:30 a.m. The seminar will address electronic risks including identity theft, online banking fraud, phishing and risks from outsourcing of data management to unrelated companies. Downtown Conference Center, Pace University, 157 William Street, New York.

October 24-27, 2004: The IASA Southwest Regional Conference will be held in Monterey, CA. For more information please contact Ron Lang at ron_lang@wgusa.com.

November 17-19, 2004: National Workers' Compensation and Disability Conference & Expo. Five program tracks, including claims management, cost reduction, integrated disability management and more. Keynote addresses on topics such as insurance technology and workers' comp cost drivers. LRP Conferences, Workers' Compensation and Disability Conference® and Expo, P.O. Box 24668, West Palm Beach, FL 33416-4668, or fax 561-622-2423. Or register online at <http://www.wconference.com/wcdis/register.html>

December 7-9, 2004: 2004 Cayman Captive Forum. Topics to include: forming and utilizing a captive for a health system; captive tax planning; owner's and group captives. Conference to be held at Westin Casuarina Resort & Spa, Seven Mile Beach. Register online at <http://www.caymancaptive.ky>

Lighter Side of Risk

How many economists does it take to screw in a light bulb?

None. If the light bulb really needed changing, market forces would have already caused it to happen.

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