MARSH

Marketwatch: Terrorism Insurance 2005
Focus: Financial Institutions

Financial institutions have more experience with—and more exposure to—terrorism risks than does any other industry in the United States.

Now is a critical time regarding the management of terrorism risk as Congress debates the future of the Terrorism Risk Insurance Act (TRIA), a law that has helped keep the economy on track following the terrorist attacks of September 11, 2001.

Financial institutions have a dual terrorism exposure—their own properties and their real-estate loan portfolios. If terrorists strike again in the United States, it is likely the targets will include assets in major cities, potentially inflicting serious losses on financial institutions' real-estate holdings, operations, and other assets.

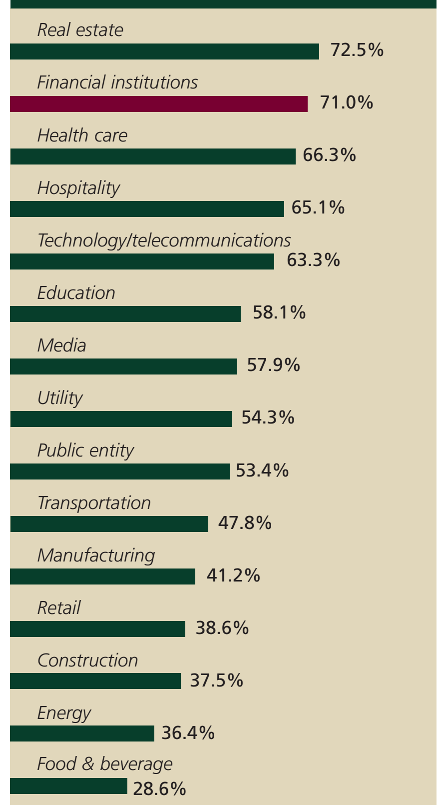
Most financial institutions have recognized the value of terrorism insurance in protecting their financial and physical assets.

- A Mortgage Bankers Association survey revealed that 94 percent of commercial loan administrators required property owners to buy terrorism insurance.

- Financial institutions have the second highest take-up rate for property terrorism insurance, according to Marsh data (see chart).

Uncertainty about TRIA's future has led to an increased interest in standalone terrorism insurance among financial institutions, including in standalone capacity commitment products. Capacity in certain metropolitan areas is becoming more limited, and prices are rising. Companies are being encouraged to start their renewal processes early; new buyers of terrorism insurance should seek coverage as soon as possible.

Terrorism Take-up Rates by Industry—as of August 2005



Source: Marsh's Property Practice

MMC Vice Chairman Testifies on TRIA

"Commercial insureds need terrorism coverage not just for peace of mind, but for their businesses," Jack Sinnott, vice chairman, office of the CEO of Marsh's parent, MMC, said in July 2005 testimony to Congress.

"In some cases, companies may choose to purchase terrorism insurance (or not) based on their particular risk profiles. In many cases, however, purchase of terrorism coverage is not optional—it is required by state laws and regulations, contracts, loans, and mortgages."

Sinnott said that private insurance markets should be able to create a viable means of financing terrorism risk, perhaps through a pooling arrangement. But while a new mechanism is developed, he said, the federal government will still have a vital role to play.

Implications of TRIA Trigger-Level Changes

One of the major changes to TRIA suggested by the Treasury Department and others is to raise the trigger level—the aggregate amount of losses an act of terror must cause for the Act to kick in—from $5 million to $500 million. Insurers would, thus, be assuming more of the risk of terrorism without access to the government reinsurance provided by TRIA.

If the trigger is indeed raised as above:

- terrorism coverage in the first $500 million will become more limited, especially in metropolitan areas;
- the demand for reinsurance in this layer will exceed supply;
- supply will decrease; and
- insureds will face a terrorism capacity squeeze and increased prices.

Marsh has been advising clients with critical terrorism insurance needs to maximize their terrorism capacity from the property insurance markets and then to access the standalone terrorism market on an as-needed basis for excess or gap capacity, either on an annual basis or with a standalone capacity commitment.

This point is critical, as the standalone terrorism market does not have sufficient capacity available to respond to the likely level of demand for terrorism capacity in the event that TRIA is not extended or is extended with major changes.

Property TRIA Coverage Purchasing by Financial Institutions

Region	TRIA take-up rate	TRIA price as percent of property premium
Northeast	81%	9.3%
Midwest	75%	3.2%
South	50%	2.9%
West	45%	4.6%
All	65%	6.1%

Source: Marsh's Property Practice (2004 data)

TRIA, Captives, and Capacity Commitments

Many financial institutions have established terrorism coverage inside of captive insurers to access TRIA's benefits. However, TRIA's expiration—or its extension with changes—could diminish or eliminate many benefits of using a captive to cover terrorism exposures.

If, for example, the trigger level is raised to $500 million (see sidebar), captives providing coverage will not have any federal reinsurance should an event's losses stay below $500 million. As a result, several institutions have given more consideration to purchasing standalone terrorism capacity commitment contracts.

These commitments allow organizations to remove terrorism risk from their captives on January 1, 2006, if TRIA is not extended or undergoes certain major changes. The future commitment of standalone terrorism capacity is subject to a fee, which often can be credited up to 100 percent against future risk-transfer premiums for the standalone terrorism coverage.

In the event that TRIA is not extended, financial institutions with captives can continue to use captives for terrorism risk transfer through the fronting of reinsurance capacity. In the event that limits required for terrorism insurance are substantial—generally greater than $400 million to $500 million for high-risk accounts—the use of a captive to access global reinsurance capacity may be the only means of attaining substantial limits excess of this point.

Marsh is committed to working with financial institutions to obtain optimal terrorism coverage for them.

The information contained in this document provides only a general overview of subjects covered, is not intended to be taken as advice regarding any individual situation, and should not be relied upon as such. Insureds should consult their insurance and legal advisors regarding specific coverage issues.

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