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Federal Terrorism Reinsurance in Limbo; Why Businesses Should Care

Unless Congress votes to reinstate it, the federal terrorism reinsurance program will end on December 31. Proponents of extending it say that this backstop is necessary for a healthy insurance market, particularly in major metropolitan areas.

Terrorism risks affect the availability and affordability of many types of insurance that businesses need, including workers' compensation insurance, commercial property insurance and group life insurance. By law, your workers' compensation policy must cover all injuries your employees sustain at work—even if they are caused by terrorism. In addition, lenders require commercial property owners to cover their property for a wide variety of losses, including terrorism, as a condition for obtaining a

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This Just In

Cost-shifting from the health insurance system could cause property-casualty insurance rates to rise, says the Insurance Research Council (IRC). In a recent study, the IRC concluded that medical providers anticipating a loss in income from health insurers will try to shift costs to property-casualty insurers. This will eventually cause property-casualty insurance rates to rise.

The Affordable Care Act (ACA) is putting controls on the reimbursements medical providers receive for treating health insurance patients, particularly Medicare and Medicaid patients. As their incomes drop, this gives them incentive to shift costs to other payers, including property-casualty insurers. This will even-

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mortgage. Without terrorism coverage, commercial lending dries up, and businesses can no longer build and expand.

Before September 11, 2001, most commercial insurance policies included coverage for terrorism-related losses. That changed after the terrorism events of 9/11. Insurers paid out more than $32.5 billion (more than $43 billion in today's dollars) in insured claims for events related to 9/11, making it the second most costly insured event in U.S. history. Insurers paid billions in property claims, along with disability and workers' compensation losses on a scale not seen before in the U.S. commercial insurance market.

After 9/11, property insurers began excluding coverage for terrorism in new and renewing insurance policies, if allowed by state law, or pricing it so high that policyholders opted to go without. (Workers' compensation insurers could not exclude coverage, because state laws require workers' compensation to cover all work-related injuries, illnesses and deaths.) To operate as an effective risk-transfer mechanism, insurers should be able to spread risk of loss over a large number of similar organizations or individuals. To allow proper pricing, these losses must be accidental, quantifiable and fairly predictable; they should not be geographically concentrated or catastrophic. On all these counts, terrorism events fail as "insurable events."

With no terrorism coverage, many businesses (especially those in major metropolitan areas) were unable to get financing for land and improvements, and clamored for a solution. The lack of available coverage prompted Congress to write the Terrorism Risk Insurance Act of 2002 (TRIA).

TRIA, as amended by the Reauthorization Act of 2007, requires property/casualty insurers to offer terrorism coverage to their commercial policyholders. In return, it provides reinsurance to insurers that will kick in once insurers pay $100 million in a year for losses due to a "certified terrorist act" (as determined by the U.S. State Department). In other words, private insurers would pay the first $100 million of terrorism losses, but after that point, the federal government and insurers would share in the cost of paying terrorism-related claims.

In June, Moody's Investor's Service released an analysis saying that failure to reauthorize TRIA could have serious effects on "virtually every property owner or business" in major metropolitan areas that wants or needs terrorism coverage.

The Act has been in jeopardy before—as written, TRIA would have expired at the end of 2005. Congress debated TRIA extensively before enacting the Terrorism Risk Insurance Act of 2005, which extended the law for two more years, and again in 2007. The current law will expire on December 31, 2014 unless reauthorized.

Although some consumer advocates have long called TRIA an unnecessary giveaway to the insurance industry, business groups in general have been in favor of extending it. This time around, some members of Congress are questioning whether TRIA is still necessary. TRIA was written to "allow for a transitional period for private markets to stabilize, resume pricing of [terrorism] insurance, and build capacity to absorb any future losses..." and some argue it has done just that. Counterterrorism efforts have been more successful; insurers are doing a better job of modeling (predicting) terrorism-related risks and losses; and prices and take-up rates (the percentage of insurance buyers offered coverage who actually buy it) have stayed stable over the last few years. However, many insurers have said they will no longer write terrorism coverage if TRIA expires.

Is terrorism coverage a concern for your organization? Please call us for more information on this important topic and how it affects your insurance coverages.

This Just In

tually cause property-casualty insurance rates to rise.

The IRC expects cost-shifting to have a major impact on property/casualty insurance. "The prices that are charged and that are ultimately paid for medical services often are different, sometimes dramatically, across payers. Large health insurers, of which Medicare is the largest, are able to negotiate or impose lower prices or substantial discounts for medical services provided to plan participants. At the other extreme, individual, uninsured purchasers of healthcare services typically pay the highest prices with little or no discounts because of relatively weak bargaining positions. Other payers, including property-casualty insurers, are somewhere in the middle."

How a Business Income Worksheet Helps You Rebuild after Disaster

An estimated 70 percent of companies that undergo a major loss eventually go out of business because they failed to plan for the disaster. Proper planning includes completing a business income/extra expense worksheet. This worksheet can help you get all the funds you're entitled to after a disaster—here's how.

Business property policies usually include business income and extra expense coverage. This valuable coverage reimburses you when a property loss covered by your policy causes you to lose income due to a shutdown or slowdown. In other words, if a fire (an insured loss) gutted your building and you had to close for four months to rebuild, your business income coverage would reimburse you for lost income. The extra expense portion of the coverage will reimburse you for any unusual expenses you incur to get your business up and running again after an insured loss, such as renting space while your building is under repairs.

How Much Coverage?

Businesses typically buy insurance to replace six to 12 months of lost income and extra expenses. Ideally, you will want to buy coverage for the "period of restoration," or time it takes to repair or rebuild the property, or the date you resume business at a new location. While it is possible to overinsure, most businesses underestimate the time and expense they will incur. When calculating lost income, be sure to factor in compensation for your projected growth — not last year's income.

What Is a Worksheet?

Completing a worksheet may seem like a hassle, but it will help you estimate recovery costs and give you a blueprint to follow during the restoration period. It also documents your organization's pre-loss income and expenses when you submit a worksheet as part of your application for coverage. This is important if you want "agreed value" coverage.

To calculate your income, use the formula: net sales minus costs of goods and services. This will give a figure that's accurate to within 3 to 4 percent of the actual claim if a loss should occur. Try not to fill out a generic worksheet, which will have cells that are not relevant to your industry. Your insurer should have worksheets specific to your industry sector available.

After a disaster occurs, the costs of rebuilding and replacing new equipment represent only a part of your costs to restore your business. You might have to incur unusual expenses to speed the restoration and avoid losing business to competitors. This could include the cost of renting temporary premises, expedited shipment of equipment or goods, hiring public relations counsel to do "damage control" and more. You will also have to pay the cost of moving to your temporary premises, advertising the new location, not to mention heating, lighting and insuring the new site. You will likely have to pay employees overtime, incentives and perhaps increased

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transportation costs. Consider all these factors when completing your business income/extra expense worksheet and your recovery plan.

Why Is the Worksheet so Important?

Typically, business income coverage has a coinsurance provision. Like the coinsurance provision in your health policy, it requires you to pay a certain percentage of covered losses out of pocket, which lowers your monthly premium and gives you incentive to control your healthcare costs. Unlike your health policy's coinsurance, the coinsurance provision of the business income policy acts as a penalty for not having enough insurance.

For example, let's say your business has annual net income and operating expenses of $5 million. Fortunately, you have business income coverage, with a coinsurance of 80 percent. Unfortunately, you haven't updated your policy in a few years, and your business has grown. You have only $2.5 million in coverage, where you should have $4 million in coverage (80 percent of $5 million).

If you have a business income claim, your insurer will reduce your claim payment by the amount by which you are uninsured. In this example, that would be $2.5 million/$4 million = .625. Let's say a fire closes your facility for six months and you lose $1.7 million in income. At claim time, then, you'd recover 62.5 percent of the covered loss, or $1.06 million (your $1.7 million loss times .625, less any deductible).

Unfortunately, underinsurance occurs fairly often. You can avoid this problem by making sure your policy has an "agreed value provision," which your agent can add by endorsement. This provision eliminates the coinsurance penalty, so the insurer will use your worksheet as the basis of your claim payment.

After a disaster is the worst time to discover you don't have enough insurance. Business income and extra expense are fairly complex products—if you need assistance in estimating your business income/extra expense needs, please contact us.

Climate Change: A Quick Guide for Risk Managers

Severe weather events are becoming more frequent. As populations shift to more vulnerable coastal regions, their effects become more catastrophic, in terms of lives and property lost.

According to risk management experts, business organizations must update their planning to reflect new risks in four main areas:

1. **Floods, Fires and Hurricanes.** On the most basic level, climate change is redefining the risks that businesses face from floods, fires and hurricanes. Reinsurance company Munich Re estimates weather-related losses in the U.S. have increased nearly fourfold since 1980. Prudent risk managers will take this weather volatility into account when assessing their flood insurance limits and would do well to err on the side of caution.

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Fire risks, especially in the West, are also increasing. Prior to the devastating 2007 fires in Southern California, which caused more than $2 billion of damage, the insurance industry expected a $1 billion fire loss every 10 years. Insurers are revising their expectations and look for fire losses exceeding $1 billion to occur more frequently due to drought and increased construction in forested and remote areas.

In the Atlantic, changing weather patterns could cause more frequent and more violent hurricanes on the East and Gulf Coasts of the U.S.

2 **Coverage Questions.** Climate change can affect numerous insurance lines. Property coverage is obviously at the top of the list, but climate change will also affect crop insurance, health and life insurance, business income coverage, liability insurance and directors and officer's liability (D&O) insurance.

"More insurance companies will have to make payments they never would have predicted because of climate change," says Kevin Haroff, a partner in the Environmental and Climate Change Practice Group at the law firm Sonnenschein, Nath and Rosenthal. His advice: Reassess insurance assumptions. Uncertainty over climate change makes risk more volatile. Are you retaining too much risk?

3 **Legal Liability.** Businesses also face the prospect of increasing legal liability and regulatory changes caused by climate change. Companies whose activities emit greenhouse gases could face lawsuits and huge damages in a rapidly changing legal climate. Additionally, companies may face lawsuits that try to hold them responsible for the permanent loss of ecological assets due to climate change.

Corporate executives who do not recognize the importance of environmental problems and fail to mitigate their company's impact face exposures in their directors' and officers' (D&O) liability and errors and omissions (E&O) coverage. Regulatory changes could also force changes in production methods. Companies must also weigh heavy risks to their reputation and goodwill if they fail to take action to curb emissions and pollution.

4 **Market Changes.** Even companies whose activities are carbon-neutral need to think about the possible effects of climate change. Will hotter, drier, wetter or more volatile weather affect demand for your products? How will it affect supply chains, distribution, and your physical facilities?

Failure to ask these types of questions doesn't just lead to an inability to meet new market conditions. They also expose company officers to lawsuits for failing to adequately plan. Ceres, a nonprofit organization that works with investors, companies and public interest groups to promote sustainable business practices, analyzed 10-k filings for all companies on the S&P 500 between 2009 and 2013, and found, "Most S&P 500 climate disclosures are very brief, provide little discussion of material issues, and do not quantify impacts or risks. Based on this report's 1-100 scoring scale, electric power companies received an average score of 16.7 for the quality of their SEC reporting—by far the highest industry average." (Form 10-K provides a comprehensive overview of a publicly traded company's business and financial condition.)

5 **Societal Changes.** Climate Change Risk Management (CCRM), a scientific consultancy developed at Oxford University, cautions businesses not to overlook other potential effects of climate change. These include political, economic, social and regulatory changes. They caution that in certain regions, particularly in central Asia, southern and northern Africa, the Middle East and parts of South America, conflict could arise over the control of water resources. "Climate change will increase operating costs for businesses, potentially disrupt commercial activity and reduce the economic life of structures. Further, social instability will affect the ways in which companies can trade, affect their net worth, and in many countries will be reflected in inward and outward migration and social unrest."

The insurance industry is trying to cope with the threat of climate change through the development of new policies, including special property policies for "green" buildings and pay-as-you-drive auto insurance.

For more information on these and other changing risks, or for a review of your current insurance program, please contact us.

Special Events Require Special Planning

The National Alliance of Special Event Planners defines a "special event" as an event such as "a wedding, anniversary party, Bar Mitzvah, fair, carnival, exhibition, fundraising dinner or other event of short duration, usually lasting ten days or less." Because they are out of the ordinary and not frequently held, special events fall outside most organization's risk management expertise and require thoughtful planning.

Depending on the type of event, special events can involve any number of hazards: an unfamiliar location with unknown safety risks, crowds, food-borne illness, alcohol and more. Crowds can multiply the potential for injury, illness and property damage claims…and costs to your organization. As Practical Risk Management notes, special events often cater to people's desire for excitement, and crowd behavior can be unpredictable.

Special event insurance can prevent a special event from turning into an especially expensive claim.

When you hold a special event off premises, the venue will usually ask you to provide proof of liability coverage. In addition, it might also require you to add the venue to your policy as an "additional insured." This will extend coverage under your policy to the facility for purposes of your event. In other words, if someone is injured at your event, your policy would cover both your organization and the facility if he or she sued both organizations.

Although your commercial liability policy might provide coverage for a special event, buying separate coverage can ensure your commercial liability policy's limits will be there when you need them for more "routine" claims. Special events liability insurance programs usually limit coverage to activities described for the event "scheduled" (or listed) in the policy's coverage certificate. Although policies are nonstandard, most have the same exclusions as a commercial liability policy. This means that they will not cover your employees, but will cover members of the general public. Special events policies frequently have the additional exclusions of medical payments coverage, fireworks, aircraft, slander (by entertainers), abuse/molestation, sports events and coverage for athletes/sports participants. We can provide more specific information on special events liability insurance tailored to your needs. For information, please call us. ■

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