

USING CAPTIVES FOR TERRORISM SOLUTIONS

IN 2007, the U.S. Congress passed the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) to serve as an extension of the government insurance backstop TRIA. Consequently, companies with terrorism risks are turning to **Willis SECURENET** to develop and create optimal alternative risk financing options. One increasingly popular and cost effective option is a captive insurance company.

Captives provide a form of self insurance, which can offer companies a more cost effective way of funding their terrorism exposures. A captive can retain the premium and pay its parent dividends, net of reinsurance, if there are no losses during the policy period. Other immediate benefits of a captive can include:

- Significant cost reduction in stand alone terrorism insurance coverage.
- Access to increased insurance capacity for risks that would otherwise be difficult to place.
- Accumulation of investment income rather than annually transferring premium to insurance markets.
- Tailored, expanded coverage which can include protection against the consequences of Nuclear, Biological and Chemical and Radiological terrorism.
- Pricing stability in a volatile marketplace.
- Direct access to reinsurance.

Companies that have been penalized by exorbitant rates for terrorism insurance and that have found commercial capacity to be insufficient to meet their needs are frequently finding the creation of a captive insurance vehicle as a simple cost-effective route to securing adequate insurance.

Captives domiciled in the U.S. writing Property and Casualty coverage on a direct basis, are obligated to offer terrorism coverage and comply with the act's reporting provisions, and in return are eligible for support under TRIPRA.

WHO SHOULD CONSIDER FORMING A CAPTIVE?

- Companies constrained in their ability to buy sufficient or cost appropriate terrorism coverage in their territory of operation or due to their risk profile.
- Companies which consistently pay more premium to third-party insurers than they receive in claims.
- Recognize the potential for an otherwise uninsured loss as a result of a nuclear, biological, chemical or radiological terrorism attack.
- Companies for which terrorism premiums are tied to unrelated natural catastrophe rating models.

“ CAPTIVES DOMICILED IN THE U.S. WRITING PROPERTY AND CASUALTY COVERAGE ON A DIRECT BASIS, ARE OBLIGATED TO OFFER TERRORISM COVERAGE AND COMPLY WITH THE ACT'S REPORTING PROVISIONS, AND IN RETURN ARE ELIGIBLE FOR SUPPORT UNDER TRIPRA.”

HOW TERRORISM COVERAGE WORKS IN CAPTIVES

Captives domiciled in the U.S. providing Property and Casualty coverage on a direct basis, are eligible for support under the provisions of TRIPRA. They are obligated to offer terrorism coverage and comply with the act's reporting provisions. Currently, domestic captives are direct writing certified terrorism coverage most commonly for Property exposures, however, TRIPRA support is available for losses resulting from any terrorism event that complies with the definition under the Act and when certified by the Secretary of Treasury.

For certified acts of terrorism, insurers providing TRIPRA coverage would be subject to a deductible equivalent to a percentage of their annual direct earned premiums (20%) and would subsequently be eligible for an 85% quota share reinsurance reimbursement from the federal government for certified terrorism losses in excess of the deductible. Utilizing a captive to provide terrorism coverage under TRIA offers several advantages over a commercial insurance carrier, in addition to the typical advantages of a captive program.

For example, coverage can be extended to cover:

- Certified losses resulting from nuclear, biological, chemical and radiological perils—typically excluded in most commercial terrorism policies.
- Unlimited contingent time element coverage.
- Losses as a result of cyber terrorism.
- Confiscation, denial of access, or public order to demolish a building after an act of terrorism.
- Time element coverage as a result of a port or airport closure.

Additionally, captives are not required to pay funds to their policyholders in advance of receiving reimbursement from the federal government, alleviating cash flow issues.

STRUCTURING THE CAPTIVE

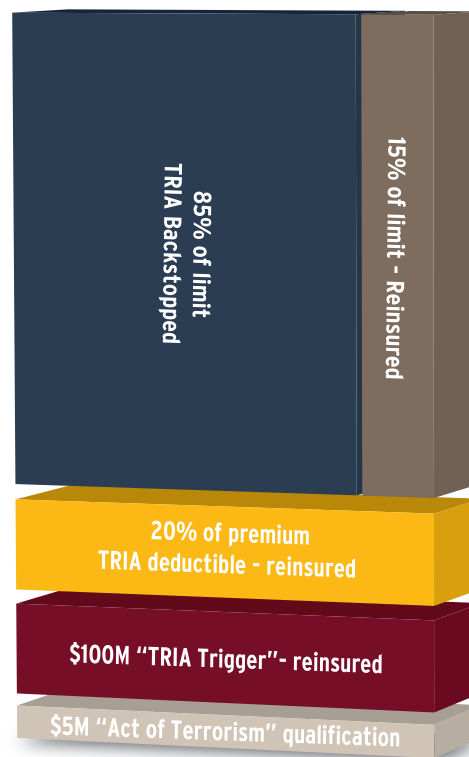
For TRIPRA to operate there has to be losses to a certain level which are deemed to be due to a Certified Act of Terrorism

Losses must be in excess of a \$5M threshold and then all certified insured losses in a year must exceed an “across industry” national aggregate of \$100M.

“ CAPTIVES DOMICILED IN THE U.S. PROVIDING PROPERTY AND CASUALTY COVERAGE ON A DIRECT BASIS, ARE ELIGIBLE FOR SUPPORT UNDER THE PROVISIONS OF TRIPRA.”

TRIPRA cover details are:

- First dollar cover in excess of deductible of 20% of premium.
- 85% of program limit.
- Premium: 133% recovery assessment.
- Total coverage limit: \$100 BN.
- Follows form – coverage and limits.



Reinsurance for those risk exposures not backstopped by TRIPRA is normally available; including the 15% retained quota share, the 20% of premium TRIPRA deductible and the \$100M “TRIPRA trigger”. Coverage can also extend to provide for a delay in the certification and/or payment process which extends more than 180 days. The Willis SECURENET Team is a leader in structuring seamless and highly competitive reinsurance programs which protect the captive’s balance sheet.

On the whole, entities accessing TRIPRA directly through their captive subsidiaries have broader coverage, and in the event of no loss may recoup premiums. TRIPRA coverage does however have its limitations:

- In the event of losses being paid by TRIPRA, TRIPRA will assess all insurers (regardless of whether or not they made a claim) covering Terrorism insurance, an assessment which recoups 133% of TRIPRA's loss aggregate payout.
- There is a \$100 Billion coverage cap to TRIPRA in any one annual year.

The Department of the Treasury has cautioned that captives must be adequately capitalized, charge a market based premium and should not be constructed in such a way as to be deemed as "gaming" the program. Statutory capitalization requirements and start up costs vary by domicile and lines of coverage written.

WHY EMPLOY A CAPTIVE OVER A COMMERCIAL INSURANCE CARRIER?

In addition to the typical advantages of a captive program, employing a captive to provide terrorism coverage under TRIPRA offers several advantages over a commercial insurance carrier.

For example, coverage can be extended to:

- Properties perceived as high risk or in highly aggregated zones.
- Certified losses resulting from nuclear, biological, chemical and radiological perils that are typically excluded in most commercial terrorism policies.
- Unlimited contingent time element coverage.
- Losses as a result of cyber terrorism.
- Confiscation, denial of access, or public order to demolish a building after an act.
- Time element coverage as a result of a port or airport closure.

Additionally, captives are not required to pay funds to their policyholders in advance of receiving reimbursement from the federal government, alleviating cash flow issues.

Working as one team, Willis SECURENET and the Willis Captive Practice are market leaders in the development of captives to fully utilize the benefits available under TRIPRA.

As necessary, we will assist at every stage of captive formation and management, which includes but is not limited to:

- Feasibility analysis.
- Domicile selection.
- Determination of estimated start-up costs and operating expenses.
- Exploration of marketplace options for reinsurance.
- Development of underwriting parameters and policy issuance.
- Maintaining communications with state insurance departments for regulatory and filing matters.
- Preparation of stewardship and broker research reports.
- Claims administration and reporting.

" ON THE WHOLE, ENTITIES ACCESSING TRIPRA DIRECTLY THROUGH THEIR CAPTIVE SUBSIDIARIES HAVE BROADER COVERAGE, AND IN THE EVENT OF NO LOSS MAY RECOUP PREMIUMS."



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