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Risky Business

Corporate executives trying to avoid a misstep are insuring their assets against a whole new set of catastrophes.

Pity today's corporate risk manager. Never before has protecting a company's assets been so challenging. The rising tide of unfamiliar risks in recent years—some brought on by Mother Nature—has undoubtedly made this tough job even tougher.

Firms with real estate located anywhere on the Gulf of Mexico or along the Eastern seaboard can attest to that. They have reason to fear the new hurricane season, which began June 1. Three of last year's storms ranked among the most destructive in history, accounting for a whopping $65 billion in damages.

Yet today's concerns go well beyond wind and rain. The never-ending possibility of terrorism defies all attempts at forecasting and keeps businesses wondering if attacks, even far away, could force extended shutdowns on the order of those experienced after 9/11. And mounting concerns about database sabotage, which was barely an issue five years ago, led 43% of U.S. executives to say they planned to increase spending on electronic security last year, according to a Deloitte & Touche survey.

These emergent risks are causing substantial changes in the industry. Insurance companies are rolling out property-and-casualty products to meet new needs. Providers also affecting markets by adjusting the amount of insurance available in regions prone to natural disasters. At the same time, Congress is considering major regulatory changes aimed at expanding the range of insurance products available to corporate America.

For risk managers, this shifting landscape means it's critical they find the right navigation tools to obtain the security they need at prices they can afford. Fortunately for them, help is on the way.

Insurers Hunker Down

Last year's devastating hurricane season challenged insurers to demonstrate how well they could deliver in a crisis. Tapping into sufficient cash reserves proved a universal but surmountable challenge. Fourteen startups formed offshore to assume new risk and promptly raised nearly $9 billion in capital, according to the Insurance Information Institute. By Dec. 1, 19 existing firms had also announced their own plans to raise $10 billion of their own to cover what was due to the insured.

XL Insurance, part of the XL Capital group, with headquarters in Bermuda, ranked among those that weathered the storm with flying colors. The XL group focuses on commercial reinsurance lines and raised $3.2 billion in less than a week through the sale of investment products. Those funds helped the company get through a challenging fourth quarter in 2005 and emerge ready to write new risk this year, albeit with a strategy to reduce capacity offered for wind-related damage.

"Clearly, nature can produce problems larger than we thought possible," says Dennis Kane, chief operating officer, Americas. To maintain an A+ rating from the A.M. Best Co., XL Insurance is cutting back its wind-related coverage by as much as 40% this year. The result, Kane says, "should position us well going into the next hurricane season."

While some companies cut back on capacity, at least one is expanding what it has available. Bermuda-based Max Re plans to double the amount of property insurance and reinsurance risk it writes this year, and it will include regions of the United States that are prone to hurricanes, such as the Gulf Coast and Eastern seaboard, according to Angelo Guagliano, president of the firm's insurance division. As he points out, "we focus on tough products."

Max Re can expand in today's property insurance and reinsurance markets, Guagliano says, in part because the company's financial strength was not as adversely affected as those of some long-time insurers, which operated in a market that kept reducing premiums in the late 1990s and early 2000s.

"That's an advantage we have over some other companies that were operating through the soft cycle and may have been writing business at inadequate prices," Guagliano says. "It's an additional issue that they have to deal with."

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helps, he says, because the tax and regulatory environment affords greater flexibility than the United States would.

A Wider Risk Spectrum

Because emergent risks encompass much more than hurricanes, insurers are adjusting their menus for corporate clients in other areas as well.

Companies with substantial assets in regions prone to earthquakes, such as California, Alaska, and even St. Louis, are finding higher insurance costs this year. There's also less of it available. That's because new risk projection models, developed after last year's hurricane season, are revaluing properties in all regions and leading insurers to cut back their exposure, according to Bob Howe, managing director for the property division of Marsh & McClellan, a New York–based insurance consultancy. New models also project higher recovery costs everywhere in the event of a hurricane-induced run on building materials.

In the realm of database security, however, insurers continue to introduce new products and expand available capacity. Firms can now buy policies to cover damages associated with a privacy breach, for instance. Under another type of policy an insurer will pick up the cost of a public relations effort to repair a trust-shaking electronic disaster.

And, in addressing terrorism insurance, options have increased as well. Property-and-casualty insurers are required by law to offer coverage of certain ramifications from a terrorist attack. Buyers of insurance also have a chance to save a little money by declining a line item for terrorism coverage in their policies. That wasn't an option prior to 9/11.

Help From Uncle Sam

Just as Congress shaped the corporate insurance market by requiring insurers to offer terrorism coverage after 9/11, lawmakers are once again surveying the adequacy of today's insurance landscape. Some say it needs streamlined regulation.

Today companies seeking to protect assets face a limited universe of options since they may choose only among products that pass muster with state regulators. But that would change if the proposed National Insurance Act of 2006, now before the U.S. Senate Banking Committee, becomes law.

Under the bill, insurers who must now answer to various state regulatory agencies could instead choose an optional federal charter. That would make them accountable to what would be a new Office of National Insurance.

Consumers, including corporate buyers of insurance, would reap the benefits of a simpler regulatory system, according to former Montana Gov. Marc Racicot, president of the American Insurance Association (AIA).

Mitigating a host of new risks requires managers to be increasingly innovative.

"A market-based approach to insurance regulation—that includes an option for national insurance company charters—will result in a healthier, more efficient, more nimble overall marketplace," Racicot says. "This will benefit all insurance policyholders." He adds that a system free from state-enforced price controls "creates … better prices for policyholders and a more stable risk-management environment."

U.S. Sen. John Sununu (R-New Hampshire), co-sponsor of the proposed legislation, adds that insurance buyers concerned about insufficient competition among providers should welcome the initiative. "Streamlining an overwhelming and tangled web of state rules for financial regulation, licensing, policy forms, rates, and market conduct exams under an optional federal charter system will encourage greater competition," Sununu says.

Corporate buyers of insurance aren't arguing. By and large they accept the rationale that a federal regulatory system could encourage insurers to be more innovative, according to Michael Liebowitz, president of the Risk and Insurance Management Society (RIMS), an association of executives who buy insurance for their companies.

"I don't think it would be bad for RIMS members" if Congress were to adopt national standards, Liebowitz says. "We need to have a consistent approach to licensing regulation of the insurance industry because it varies from state to state."

Short-Term Solutions

As Congress considers the AIA-supported proposal, risk managers must make quick decisions about how to spend precious resources.

As insurers cut back their hurricane risks in order to appease ratings agencies, buyers are facing "a supply-and-demand crisis," according to XL's Kane. The result: "Prices are going to go up," he says. "That's just the nature of things."

Premiums are indeed climbing. Firms in regions prone to hurricanes are watching the cost of insurance from private providers climb anywhere from 15% to 40% over last year's rates, according to the New York–based Insurance Information Institute. Howe says some properties have seen a 100% increase of premiums, even when coverage has gone unchanged.

In commercial property rates, "we've seen the market spike in the last two [to three] months," Howe says. "It's an incredibly challenging time for brokers," who, he says, are tapping all corners of the globe in order to increase the supply of available coverage. Another option: Howe says companies are in some cases pricing catastrophe bonds as an

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When Disaster Strikes

Here is a list of the top ten most costly losses incurred by the world's insurance industry since 1970. Compiled by Swiss Re, the list includes property and business insurance losses only. It excludes life and liabillity losses. That is why the 2004 tsunami that hit Southeast Asia is not on the ranking.

1 Hurricane Katrina
Losses: **$45 billion**
Aug. 24, 2005; U.S., Gulf of Mexico, Bahamas, North Atlantic

2 Hurricane Andrew
Losses: **$22.27 billion**
Aug. 23, 1992; U.S., Bahamas

3 Terrorist Attacks
Losses: **$20.72 billion**
Sep. 11, 2001; U.S.

4 Northridge, Calif. Earthquake
Losses: **$18.45 billion**
Jan. 17, 1994; U.S.

alternative to conventional insurance.

In the realm of database protection, insurers are eager for business, offering coverage in at least eight categories. But a March 2006 Swiss Re survey found that only one in ten U.S. executives uses one insurance as a risk-mitigation strategy.

Apparently firms are tackling problems first with preventive in-house solutions before insuring whatever they cannot defend on their own. Here again, price matters. The high cost of cyber-insurance, which can range from a few thousand dollars to hundreds of thousands, may be discouraging executives from buying it, according to a March 2006 report from the Insurance Information Institute.

Factors Beyond Price

Still, as important as cost considerations are, they aren't the only factor that matters to risk managers. Equally important, perhaps, is contracting with reliable firms that can deliver on claims when necessary, or with those who can effectively help mitigate risky situations. In today's shifting risk environment, some organizations are showcasing the way they stand out in these niches.

Since Hurricane Katrina pummeled Louisiana, Mississippi, and Alabama last year, Zurich North America Commercial has taken pride in its record of paying claims. Customers in the Gulf Coast region filed more than 80,000 claims in the aftermath of Katrina and four other storms in 2005. Zurich has so far successfully resolved more than 90% of them.

According to Zurich North America Commercial CEO Axel P. Lehmann, this track record is partly the result of the Gulf Coast Claims Alternative Dispute Resolution system, which Zurich created specifically to address Katrina's extreme aftermath. Participants engage in a resolution meeting, where all involved parties and attorneys strive to reach agreement within 90 minutes. If all issues aren't settled in that time, customers may go to mediation, followed by binding arbitration. The program administrator is Kenneth Feinberg, who oversaw the government's settlements with individuals who lost family members on 9/11. Thus far, more than 200 Zurich customers have used this ADR program to settle their complex cases.

"It is in our customers' interest, and certainly Zurich's, to resolve disputes in a timely and fair manner and avoid protracted legal disputes," Lehmann says. "To date, all but a few of these complex claims have been successfully adjusted without the need for mediation or binding arbitration."

As always, most companies and insurers prefer to avoid claims altogether by reducing the likelihood

5 Hurricane Ivan
Losses: **$11.68 billion**
Sep. 2, 2004; U.S., Barbados, et al.

6 Hurricane Rita
Losses: **$10 billion**
Sep. 20, 2005; U.S., Gulf of Mexico, Cuba

7 Hurricane Wilma
Losses: **$10 billion**
Oct. 15, 2005; U.S., Mexico, Jamaica, Haiti, et al.

8 Hurricane Charley
Losses: **$8.27 billion**
Aug. 11, 2004; U.S., Cuba, Jamaica, et al.

9 Typhoon Mireille
Losses: **$8.1 billion**
Sep. 27, 1991; Japan

10 Winter Storm Daria
Losses: **$6.86 billion**
Jan. 25, 1990; France, U.K., Belgium, the Netherlands, et al.

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Companies might hire UL to evaluate whether storing certain chemicals side by side poses a threat to a warehouse. Others might work with UL to test building materials under extreme conditions, using UL's turbine, which generates winds of more than 100 miles per hour.

"We can help insurers and building owners evaluate complex risks through detailed analytical testing," says Chris Hasbrook, general manager for UL's Fire and Security business. "From our roots in electrical and fire safety, we have grown to help clients assess many types of risk, including those associated with homeland security and weather."

Insurers eager to understand risks for a particular property can benefit from UL's resources in two ways: 1) commission analytical testing to evaluate complex building systems, or 2) search UL's Website for UL-certified materials and systems. Businesses can similarly use UL's certification information and services in multiple ways—to get the latest on new construction requirements and to gain a better understanding of risk.

Looking Ahead

Looking ahead, companies trying to plan for risk management will need to keep an eye on a few key factors: Mother Nature, market forces and Congress. In the near term the cost of property coverage will hinge largely on what happens during the current hurricane season, Liebowitz says. A relatively calm season with minor damages will suggest the intensity of 2005 was an anomaly, and prices all along the Eastern seaboard would feel less upward pressure. But a season approaching 2005's devastating record is sure to suggest, rightly or wrongly, a pattern of intensifying storms and will portend higher insurance costs for years to come.

Perhaps no factor will determine what's to come in the insurance marketplace as much as decisions made on Capitol Hill. The Terrorism Risk Insurance Act (TRIA), which enables insurers to rely on federal assistance to pay terrorism-related claims, is scheduled to expire at the end of 2007. Insurers insist failure to extend TRIA would render their industry incapacitated, since acts of terrorism are impossible to predict and often cause severe damage when they occur. What's more, AIA argues that today's extremely virulent form of international terrorism looks much like an act of war; therefore Congress must help manage risks and costs associated with national attacks.

Though corporate buyers of insurance often butt heads with providers in negotiations, the two groups stand side by side in insisting that the federal government continue to provide a safety net for terrorism-related damages.

"We all need TRIA," says Liebowitz. "It's not only important to us, it's important to the economy of this country. Imagine if all construction stopped because terrorism coverage went away."

Moving forward, companies can expect that today's emergent risks won't go away anytime soon. But chances are they will be managed—through systems that are still taking shape. ■

Resource Guide

The American Insurance Association (AIA) represents approximately 400 major insurance companies that provide all lines of property-and-casualty insurance and writes more than $120 billion annually in premiums. The association is headquartered in Washington, D.C., and has representatives in every state. All AIA news releases are available at www.aiadc.org.

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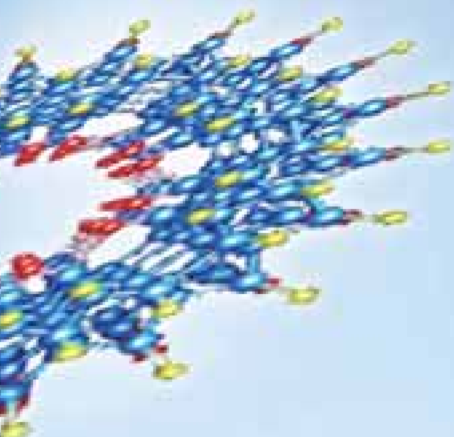

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