Superstorm Sandy's Insurance Considerations (Briefly)

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Every single one of the millions of people in the Northeast who experienced Superstorm Sandy has his or her own personal story of that harrowing day and night. Ask them a year from now and their recollection will probably include some comment regarding insurance – good or bad.

One of the most difficult tasks in the insurance business is telling someone their loss is only partially covered, or not covered at all. That is what thousands of business owners may unfortunately hear in the days ahead.

What "flood" coverage does your insurance program provide?

Since many of the areas affected by the flood surges were not usually known and/or prepared for substantial high waters, insurance consideration and due diligence for such an event is now an afterthought. As a consequence, there will be a wide disparity of coverage in place to respond. Most homeowner policies exclude flood coverage. Commercial property policies often provide some form of flood (or water) coverage, but it varies significantly. How the policy defines "flood" or "water" will come into play. Is there a sub-limit for flood and, if so, is it enough? What is the deductible for flood and how is it applied across multiple affected properties?

In addition, some policies will identify separate insurance provisions, terms and conditions or outright exclude coverage for "named storm" events. A "named storm" is just what you think - a storm, atmospheric disturbance or other weather phenomena designated by the US National Weather Service and/or US National Hurricane Center that has a name or number assigned to it. Named storm deductibles are often a percentage of the total insurable values (TIV) at risk (2% or 5% for example). So if the property's TIV is $20 million, you may be financially responsible for the first $1 million based on a 5% deductible. Per the policy language, percentage deductibles are applied differently as well (per property, per building, per coverage unit, etc.). This can greatly increase the out-of pocket expense.

If the damaged asset is in an identified FEMA flood zone, your policy may stipulate coverage is excess of and/or apply a deductible over the maximums limits available under FEMA's National Flood Insurance Program (NFIP). As a side note, the NFIP does not provide coverage for business interruption and/or extra expense.

What other policy provisions might we look to for coverage?

The most obvious other coverage consideration is wind damage. Most homeowners and commercial policies provide coverage for wind resultant damage. However, due to the most current windstorm model (RMS Version11) and the similar path of Hurricane Irene in 2011, some coastal properties may be subject to recently added restrictions and/or deductibles specific to wind (or "windstorm" which complicates things even further).

Commercial policies typically pay for business interruption/extra expense resulting from covered physical damage. Business interruption in basic terms is your loss of revenues as a result of the damage. Extra Expense is the additional costs incurred to keep your business operating (leased generators, temporary security, etc.). Given the broad range, complexity and nuances of the damages resulting directly and indirectly from Sandy, any discussion on business interruption/extra expense easily warrants a separate white paper.

In short, coverage applies during the "period of restoration," which is the time it takes to restore/rebuild the property to the condition prior to loss. Some insurers will offer an additional period post restoration of 90-365 days, which is essential when a business is back up and running, but still suffering from a lack of customers or diminished market share.

Other coverage extensions to consider/ review include:

- Contingent Business Interruption - business interruption due to damage to customers, venders or suppliers' premises
- Civil Authority or Ingress/Egress - business interruption due to inability of employees, customers or suppliers to reach your premises
- Service Interruption or Off Premises Power - business interruption and/or physical damage due to lack of power, water, communication resulting from damage to non-owned utility
- Expediting Expense - cost to expedite shipment of mission critical equipment or supplies
- Professional Fees - costs incurred to quantify/ prove loss (consultants, engineers, forensic accountants)

Will our insurance rates go up next year due to Sandy?

Current estimates of insured loss range from $10 billion to $20 billion with total economic loss at $30 billion to $50 billion. This makes Sandy the 3rd costliest U.S. storm behind 2005's Katrina and 1992's Andrew. As with any catastrophic event, a more accurate account of loss is months if not years away. The early consensus is that while this magnitude of insured loss will most certainly affect insurer's profitability this quarter, there is ample capacity in the marketplace to absorb the loss. In other words, your rates will not increase solely due to the impact of Superstorm Sandy.

We are not as confident on how FEMA's National Flood Insurance Program (NFIP) will respond. Time will tell how many homeowners and businesses actually purchased flood policies from NFIP, but Sandy will no doubt be a significant hit to the program. NFIP's recent 5 year extension back in July included several provisions for rate reform to help mitigate the reported $18 billion deficit.

Where do we go from here?

First and foremost, we need to protect human life at all costs and it appears authorities at every tier clearly support that action. Second, we need to get people back in their homes and businesses back on their feet and this is where insurance can assist. The challenge insurers and insureds will face include logistics of adjusting such widespread damage and assessing how their policies will respond to multi-faceted claims. It will not be easy for anyone.

Lastly, we need to learn from this event, hope there is no recurrence in the near future, but nonetheless be better prepared if there is. From an insurance policy perspective, that means reviewing the coverage considerations above and more. What risk management applications we pursue (on a macro scale) will be a topic of discussion by all levels of government and it is way too early to predict the outcome.

Finally, your broker or agent should be intimately involved through the entire claim process, advocating on your behalf to secure the best result.