

Insurance Implications For The Disasters in Japan

APR 01, 2011 | BY ROBIN COHEN, RANDY PAAR

The global insurance and reinsurance communities are just beginning to grasp the enormity of loss from the March earthquake and tsunami in Japan. For an overview of the potential ramifications, *Claims'* Christina Bramlet spoke with attorneys Robin Cohen and Randy Paar, partners with Kasowitz, Benson, Torres & Friedman's insurance recovery litigation group in New York.

Bramlet: What coverage(s) may be triggered as a result of these events?

Cohen and Paar: Most large commercial policyholders purchase first-party property insurance, which is sometimes referred to as "all risk" insurance. Those policies generally provide insurance under the following grants of coverage:



APR 13/2011. KESENNUMA, Japan - Rescuer workers come to the aid of people who had been trapped at a building in Kesennuma, Miyagi Prefecture, northeastern Japan, on March 12, 2011, a day after a massive earthquake and tsunami struck the area. (Kyodo via AP Images)

- *Property damage coverage:* Insures the value of the policyholder's property.
- *Business interruption (BI) coverage:* For the insured's loss of earnings or revenue resulting from the interruption of the policyholder's business because of loss or damage to the policyholder's property.
- *Contingent business interruption (CBI) coverage:* For loss, including lost earnings or revenue, as a result of damage to the property of third parties such as suppliers and receivers.
- *Civil authority coverage:* For losses arising from an order of a governmental authority that interferes with normal business operations.
Third-party property coverage: For the property of third parties in the care, custody, or control of the policyholder.
- *Ingress and egress coverage:* For the loss caused when access to a business premises or location of the policyholder is blocked for a time.
- *Service interruption coverage:* For losses related to the interruption of electric or other power supplies.
- *Claim preparation coverage:* For the costs associated with compiling and certifying a claim.

All of these coverages may be potentially implicated by the recent catastrophic earthquake and its resultant tsunami, flooding and fires in Japan. However, the most significant grant of insurance coverage for U.S. policyholders and their insurers is CBI. The total amount of loss from these covered perils has been estimated to exceed \$325 billion (estimated by World Bank). Of course, any estimate of loss is entirely speculative, particularly given that losses are still accruing for BI.



▲ Robin Cohen

Bramlet: How does the fact that the events happened in Japan differ from the consequences of a U.S. catastrophe?

Cohen and Paar: Because the property loss occurred in Japan, the insurance market will be impacted less than if the loss had occurred in the U.S. For comparison purposes, the loss from Hurricane Katrina was approximately \$120 billion, 50 percent of which was insured. Assuming the loss from the Japan catastrophe is projected to be \$235 billion, the estimates being circulated by insurance company modelers anticipate the insured loss to be between \$15 and \$35 billion, less than 15 percent of the total loss.

There are two reasons for this. First, the amount of insurance purchased by Japanese policyholders for a given exposure is less than that purchased by policyholders in the U.S. Most of the earthquake loss will be submitted to the Japanese Earthquake Reinsurance Pool, a semi-public entity. Second, residential and personal lines insurance in Japan is generally limited to companies in the Japanese insurance market. Even large Japanese policyholders tend to place most of their insurance with Japanese insurers such as Tokia Marine, Mitsui Sumitomo and Sampo.

Bramlet: What specific types of losses do you expect? What impact (if any) have the disasters had on U.S. businesses?

Cohen and Paar: Although all of the types of coverages listed previously may be implicated in some way by the Japanese events, the most important for U.S. policyholders and their insurers is CBI coverage, which applies when the policyholder suffers an interruption in its business because the property of a third party, such as a supplier or receiver, is damaged or destroyed. Accordingly, an American auto manufacturer may have an interruption in its business and a resulting loss, if it relies on parts manufactured and shipped from Japan. These types of losses stemming from a break in the chain of supply already have caused some U.S. manufacturers to either cut back in production or close plants entirely.



▲ Randy Parr

Bramlet: What type of issues do you anticipate will be raised by the Japanese earthquake claims?

Cohen and Paar: Issues surrounding what caused the loss are likely to dominate claims handling, along with the calculation of the amount of loss. There are a number of relevant perils that arguably caused a loss, including fire, earthquake, flooding, the tsunami, orders of the civilian authorities limiting access, and contamination from nuclear radiation. A property insurance program is generally written on overall limit, but losses caused by certain perils are capped with a much smaller sublimit. There is generally no sublimit on a fire loss. However, earthquake and flooding generally have significant sub limits—for instance, although the insurance program provides \$500 million in insurance, the policy may pay only \$50 million for a loss due to earthquake. Additionally, damage from radiation is generally excluded from any coverage. Therefore, how the policyholder presents its claim, and whether a portion of a loss can be attributed to a covered peril, will make a difference as to which and how many sub limit(s) can be applied.

The cause of the loss also may make a difference in calculating the amount of the deductible. For instance, the deductible for an earthquake claim may be based on a percentage of the value of the property lost or destroyed. In a straight BI claim, where the property of the policyholder was damaged, the value of the policyholder's property will likely be disclosed in the underwriting material, or on a schedule referenced by the policy. In the case of a CBI loss, the property that is damaged belongs to a third party and its value may be difficult to determine.

Finally, the calculation of loss can involve consideration of many aspects of the policyholders business. In the case of a CBI loss where damage to the property of a Japanese third party affects the global supply chain of a U.S. business, there are numerous factors to be considered. It often takes a very sophisticated analysis to determine what portion of the loss is covered and what is not.

Bramlet: Will these claims arising out of the earthquake affect global insurance/reinsurance markets? How so and to what extent?

Cohen and Paar: This has not been a great time for those selling insurance for catastrophe losses. Prior to the Japanese earthquake, there was an earthquake in Christchurch, New Zealand causing an estimated \$20 million in property losses, \$10 million of which may be insured. The last few months also have seen significant losses because of floods in Australia. However, despite the severity of the losses from the Japanese earthquake, a relatively small portion of the losses are insured. Therefore, the impact on the global insurance and reinsurance markets is not likely to be significant. Indeed, after Hurricane Katrina, which resulted in larger insurance payouts than what are expected from the Japanese earthquake, the price of property insurance and the financial strength of insurers and reinsurers was not materially affected.

Bramlet: Could the earthquake potentially change the way insurers approach BI claims or managing risks?

Cohen and Paar: Every time there is a significant loss, insurers modify their approach to underwriting a risk. After Japan, insurers will undoubtedly re-examine their policy language to correct what they believe are unanticipated ambiguities that resulted in coverage. For instance, to prevent the possibility of multiple sublimits, an insurer may define “earthquake” to include the related tsunami. The events in Japan undoubtedly will affect the underwriting and investigation that is done before a policy is sold. At a minimum, insurers are likely to inquire into what operations, or supply chain links the policyholder has to Japan or other companies on the Pacific Rim prone to earthquakes. Perhaps even more important, the events in Japan should alert policyholders to potential risks that they need to manage by moving away from, or finding possible substitutes for, Japanese suppliers.

Featured Video

OptimaWrite-Intake for Insurance Carriers

PROVIDED BY COGNIZANT TECHNOLOGY SOLUTIONS

SHARE THIS VIDEO



Most Recent Videos



The Rising: Part one



Insuring Fine Art: Collectible Comics & Memorabilia



Risks in Focus: Aviation



Insurance protection for sports stadiums: What's at stake?

(http://www.propertycasualty360.com/RealMedia/ads/click_lx.ads/www.pc360.com/claims/catastrophe-restoration/1658910866/Position4/default/empty.gif/2b4a364d7546614e686a414143534562?x)