Managing Catastrophe Exposures: Risk of a Big Event Getting Bigger

Climate and catastrophe risk experts are bracing for a wave of extreme weather events in the coming months and years as the current El Niño system strengthens to unprecedented levels and the potential for stronger seismic events in the United States increase.

El Niño, which causes flooding, drought, wildfires, and winter storms, to name a few, is showing no sign of cooling after causing $12.6 billion in natural catastrophe losses during the first half of 2015. On Nov 8, 2015, the El Niño index, a measure of Pacific Ocean temperatures, set a record of 2.8, the warmest in recorded history, according to the National Oceanic and Atmospheric Administration.

Meanwhile, catastrophe risks experts are also concerned about recent scientific studies evidencing an elevated risk of seismic activity in the United States. According to new research, the New Madrid fault line, which has been more active in recent years, has a greater range of potential earthquake magnitude than previously imagined. The New Madrid Seismic Zone extends through parts of Missouri, Arkansas, Tennessee, Mississippi, Kentucky, Indiana and Illinois.

Another study produced by NASA’s Jet Propulsion Laboratory is also disconcerting. It predicts a high probability of a significant earthquake striking the greater Los Angeles area within the next three years.

Given the increased concerns about catastrophe risks, USI’s middle market clients are stepping up their catastrophe risk management programs going into the New Year. In the construction sector, for example, USI has been working with contractors and owners of varying sizes to quantify and plan for not only a Black Swan event, but also for more frequent and costly catastrophic events.

Following are four catastrophe risk management solutions many construction clients are implementing with the support of the USI ONE Advantage®, a unique approach to managing clients’ risks:

Providing Proper Limits for Delay-in-Opening/Soft Costs

In the event of an earthquake, clients can be subject to significant Builder’s Risk exposures associated with soft costs and delays in completion.

Take, for instance, a recent case of a general contractor client that was obligated to provide Builder’s Risk coverage with full earthquake limits as a condition to work on a large project. The client engaged USI to review the contract requirements and its Master Builder’s Risk policy. As part of the process, USI also evaluated the delay-in-opening exposures due to a catastrophic earthquake.

The GC’s program provided an earthquake limit of $1 million and a 30-day Delay-in-Opening provision. However, USI’s earthquake modeling

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identified that the earthquake exposure was $6.3 million, and also showed a delay-in-opening exposure of 90 days at $50,000 per day. Based on the findings USI structured the policy with $6.3 million in earthquake limits and a Delay-in-Opening limit of $4.5 million. These changes protected the GC from a potential $8.3 million uncovered claim.

Wrap-Up Coverage Based on Feasibility Analysis

Extraordinary events such as earthquakes or flooding can significantly delay construction projects. However, oftentimes, insurance coverage for such delays is not anticipated or provided by off-the-shelf policies, leaving clients exposed to unexpected and in many cases, devastating financial loss.

To mitigate such unexpected costs, USI employs a process to determine the appropriate coverage terms based on contractual and actual project exposures including the potential for delay in completing a project due to extreme weather events.

One such case involved a USI client who was obligated by contract to complete a $110 million chemical plant in 36 months. Upon closer evaluation of the project’s timeline, USI determined that the company was exposed to major delays due to higher-than-expected rainfall. USI used its modeling capabilities and structured the wrap-up program to provide an additional 6-months of coverage without an increase in premium. Soon after excavation was completed, an unusually large amount of rain associated with an El Nino event halted construction for 4.5-months. Since the uncompleted construction values totaled $78 million, the wrap-up program’s automatic 6-month coverage extension – negotiated by USI – allowed the client to avoid a $780,000 program extension premium penalty.

Set Proper Limits Based on Catastrophe Modeling

Catastrophe modeling simulates a natural disaster event using a client’s location and building information to measure potential loss. USI relies on this modeling approach in its pre-underwriting process to establish appropriate limits for the client based on actual risks. In addition, the company’s risk specialists, supported by data from USI’s proprietary OMNI engine, negotiate with carriers to place the structured coverage into the market.

Quantification of Risk through Modeling for Catastrophe Exposures

Proper risk quantification and limit adjustment for assets exposed to a flood event or earthquake are a critical aspect of catastrophe risk management.

At USI, risk consultants specialize in performing actuarial analysis, using the AIR Worldwide modeling platform to provide an estimate of the potential cost of damage from flood or earthquakes. The process allows for a better understanding of the coverage and pricing needed.

For example, utilizing its CAT modeling process USI determined that a general contractor client’s upcoming projects had significant values located in a flood zone.

The general contractor’s Master Builder’s Risk policy coverage included $5 million of flood coverage. USI modeled the flood risk and determined that the actual flood exposures were $7.5 million.

As a result, USI restructured the Builder’s Risk Program with a $7.5 million flood limit to address the potential $2.5 million coverage gap.

To learn more about the solutions discussed here and the USI ONE Advantage contact a USI consultant.