



Since 1943

**J.B.BODA GROUP**



Special Issue

November 2012

## **PEBBLE AND RIPPLES**

*( Special Issue on HURRICANE SANDY )*

Just to introspect the backdrop before Cyclone Sandy, at the industry's big reinsurance gatherings in Monte Carlo and Baden Baden prior to this cyclone, market forces were anticipating an end to the firmer rates witnessed in the aftermath of major catastrophes in 2011, citing excess capacity and intense competition. Mostly, positive assessment prevailed on basis of low investment returns, dwindling reserve releases and the threat of major cat losses regarding maintenance of rates and causing positive adjustments in underlying rates.

Hurricane Sandy shut down the New York Stock Exchange for two days, putting significant pressure on insurance sector stocks, particularly those of US companies such as AIG, Allstate, Travelers and State Farm, perceived as being specifically exposed to the damage caused by the storm, which swept across one of the most densely populated regions in the US, including the cluster of high value properties in the Metropolitan New York area. In the London market, the shares of Amlin, Hiscox and Catlin, all of which write a significant volume of US property related business, similarly came under pressure, but managed to recover to post either a gain or to limit the deterioration in stock value to a small loss.

Sandy's huge diameter has added to the uncertainty about the storm's expected losses, with damage spread over a broad area. Atleast 24 states were affected by Sandy, which had tropical storm-force winds spanning 1,100 miles – making the largest Atlantic Storm on record in terms of wind span.

Trade disruption as a result of hurricane Sandy has been significant and Business Interruption (BI) remains one of the biggest uncertainties related to the insured loss. As the storm stretched for more than 1,000 miles, the area it affected was extremely large, close to one-third of the US population was affected by the storm, which lasted for a number of days. New York City suffered the largest weather – related power outage and more than 1.5 million people were left without power across the state.





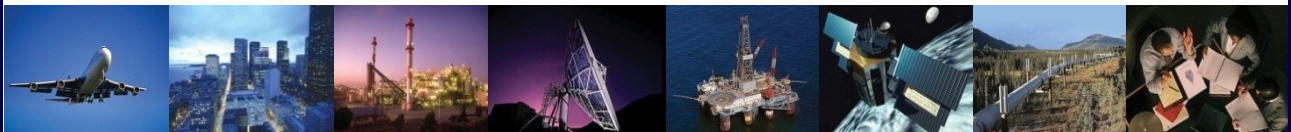
Since 1943

Insured losses from superstorm Sandy could be upto USD 25 billion, making it the second costliest storm on record following hurricane Katrina, according to a release by an estimate catastrophe modeler Risk Management Solutions (RMS). This estimate has come out after other modellers AIR Worldwide and Eqecat issued loss figures for Sandy in projected range of USD 10 billion to USD 20 billion in insured losses. Even with the higher loss figure from RMS, rating agencies expect the sector to be able to handle losses from Sandy. According to Standard & Poor's (S&P), insured losses from the storm would have to top USD 50 billion before the reinsurance sector's capital base would begin to deteriorate materially, which it defined as a 5 % to 10 % erosion after earnings. It is believed that Sandy will be an earnings event for the sector and will have a limited impact on ratings on global reinsurers. However, according to some industry sources, estimates of insured losses from Sandy are not high enough to trigger losses for investors in catastrophe bonds and will have little impact on the pricing or volume of new issuances.

While these forecast potential losses represent staggeringly large numbers, Sandy will barely dent the reinsurance programmes of companies with large market share in the affected region. This view is based on the previous high estimate of USD 25 billion in losses, warning that some bonds could be at risk if actual losses climb higher. Fortunately for investors, the scope and scale of the storm make it unlikely that any bonds will be triggered solely by Sandy, noting 72 % of cat bonds have some exposure to US storms.

With current predictions that Sandy could result in insured losses of upto USD 25 billion, the loss still pales in comparison to the Year of the Cat, which cost reinsurers more than USD 100 billion. It is a major event in the industry's biggest peak zone, however, and has occurred just as renewal deliberations get underway. Nevertheless, with excess reinsurance capacity and a relatively benign catastrophe year so far, it is questionable whether the hurricane will be sufficient to drive rate hardening. But it could be enough to maintain rates and prevent any noticeable deterioration for now.

Sandy has elicited mixed reviews on the direction of reinsurance rates at the 1st January 2013 renewals. Some reinsurance executives are predicting that rates will remain firm for these renewals. The market outlook of business is stable and premium rates will come under pressure for the January renewals with significant capacity in majority of lines of business. Munich Re perceives that the tropical storm occurred at the right time to influence bullish pricing in the upcoming renewals. Cyclone Sandy could lead to further rise in prices in US property business and for non-proportional natural catastrophe covers. Munich Re believes that currently, there is still sufficient capacity available in the reinsurance markets so as to estimate stability in prices, terms and conditions in the forthcoming renewals in most markets. In particular, the low interest rate level will have impact on pricing.





Since 1943

Whilst releasing this Special Issue, the position is that economic losses will be close to USD 50 billion, with insured losses not far behind in the USD 30 billion to USD 50 billion range. Say even with a ballpark loss figure of USD 25 billion, Sandy would be put in the top three costliest hurricanes of all times, behind only Katrina (USD 46.6 billion) and Andrew (USD 22.9 billion) at today's values.

### **Non-damage Business Interruption (NDBI) Insurance Coverage:**

Hurricane Sandy caused the cancellation of almost 20,000 flights in three days, leaving thousands of aircraft sitting unproductively on the tarmac from Florida to Toronto. The lost revenues could hurt airlines already pushed to the limit by overcrowding in the market, price wars and more selective passengers. There is also an insurance gap when it comes to cover for enforced groundings by airport or airspace closures. The problem lies in the fact that standard Business Interruption (BI) policies would usually cover airlines for lost revenues, where there is damage caused by a natural disaster. However, if there has been no damage, as in the case of airport closures, the policies may not be triggered. **Non-damage BI (NDBI) is a relatively new area of insurance, which can protect airlines against events such as Sandy, even when there has been no physical damage to their fleet.**

Under standard BI products, a supplier or airport could file a claim on the Property Policy or BI Policy owing to damages caused by a natural disaster, fire or other circumstances that result in a break of commercial activities and / or the inability to maintain a turnover or income. However, when there is no material damage, but airlines are simply not allowed to take off and land anymore, they are not eligible to file a claim.

The need for a NDBI solution became apparent in 2010 when Iceland's Eyjafjallajokull Volcano created an ash cloud large enough to close down European airports for 16 days. Leasing costs, wages, overheads and parking fees remained outstanding for months after the event. Passengers demanded compensation, hotel accommodation and rebooking. Almost 95,000 flights were cancelled and 10 million passengers were left stranded. The airline industry estimated lost revenues of USD 1.7 billion. In essence, NDBI products would indemnify an airline for any cancelled flights arising from airspace or airport closure caused by non-manmade events. This covers most natural phenomena, such as atmospheric conditions like volcanic ash, seismic activity, earthquakes and meteorological events like floods, storms and snow.





Since 1943

In the case of hurricanes, a combination of flood and wind damage creates a difficult situation for loss assessment. Sandy's record storm surge is likely to be a major loss scenario for commercial policies, as they typically provide cover for wind, surge and flood. Thankfully, wind speeds were not too high and damage to individual buildings should be relatively minor. Claims for BI could add up due to the widespread physical damage losses & power shortages and are difficult to determine. Effectiveness of contingency plans will be essential to mitigate the duration and impact of such interruptions.

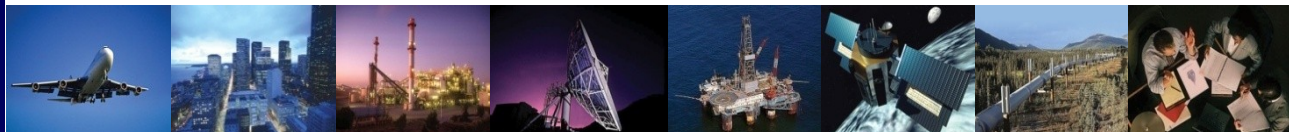
### **Contingent Business Interruption (CBI) Insurance Coverage:**

The superstorm has vividly demonstrated that at times like these, having Business Interruption Insurance is the differentiator between surviving a disaster and not surviving at all. Most commercial property policies availed by businesses come bundled with coverage for Business Interruption. These policies indemnify earnings that were lost directly as a result of a catastrophe such as flooding or wind damage, that is a named peril.

**In this context, another type of Policy known as Contingent Business Interruption (CBI) offers protection for lost revenue that comes as a result of disruptions to a business's suppliers or customers. Generally, it is observed that business tend not to have policies that protect them from disruptions to their supply chains or customers. Other protections available to businesses include coverage for the period of time after a business has reopened after a disaster, but before its revenue returns to normal.**

There are certain limitations to Business Interruption Insurance. Generally, insurers will only provide coverage for the amount of time they believe it should take a business to get back again. If a business uses the time they are closed to do a more extensive remodeling than necessary, their insurers in most cases will only reimburse lost earnings for the time it would have taken to do just repairs that would have allowed the business to reopen. Businesses that lose their books and records in the storm have added problem of proving the income that they lost as a result of business interruption. Thence, claims will have to be assessed by considering hypothetical earning on basis of past results.

It is unfortunate that the developing world continues to cling, to behold and to adopt the pace of nature, whose secret is patience. Developing insurance and reinsurance markets have been indulging in shy pondering and soft pedalling on niche / novel insurances available in developed world such as NDBI and CBI. This indifference is costing these markets dear. There is urgent need to introduce NDBI and CBI in developing countries by drifting away from conventional / traditional "Material Damage Proviso" (MDP) appearing in Business Interruption (BI) Insurance. MDP provides that the Insured is required to maintain an insurance covering the interest in the Property at the premise against damage.





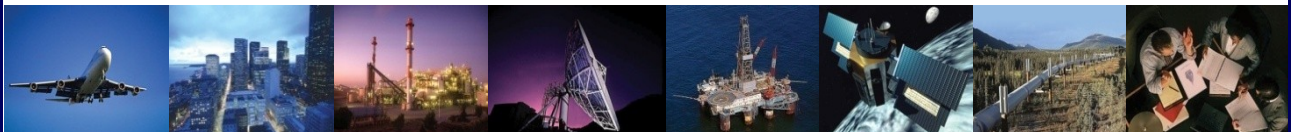
Since 1943

Another requirement is that payment of loss under B I Insurance is subject to payment of, or admission of liability for, the loss under the Property (Material Damage) Insurance. The perils covered under both insurances, therefore, must be the same.

It is high time for change. Change does not happen when circumstances improve. Change happens when we decide to improve our circumstances. Past is experience, present is experiment, future is expectation. Let developing insurance and reinsurance markets utilize experience of developed world in an experiment to achieve the expectation of change for the future.

*It is time for developing insurance and reinsurance markets to grow, to throw the pebble and start the ripples.....*

\*\*\*\*\*





Since 1943

## **J.B.BODA GROUP AT YOUR SERVICE**

**J.B.BODA Group, well-known internationally for its capabilities, well-spread network around the world and personalised services for almost seven decades.**

**24 Offices in India & 5 Offices Overseas in U.K., Singapore, Dubai, Nepal, Kenya.**

### **SERVICES**

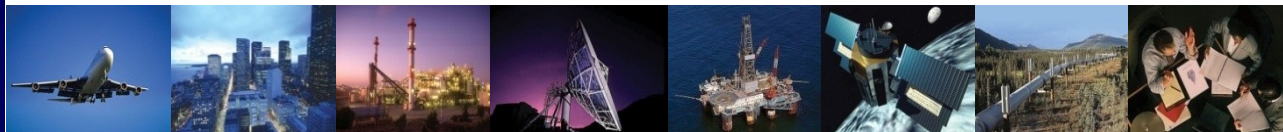
- **Insurance & Risk Management Consultants, Life Valuation,**
- **Life & Employee Benefit Schemes,**
- **Training Academy, Assistance for Actuarial Valuations.**
  
- **Valuation of Land, Building, Plant & Machinery.**
  
- **Protection & Indemnity Insurance Services.**  
**London**  
**Luxembourg**
  
- **Fire, Engineering, Miscellaneous Accident Surveyors & Loss Assessors.**  
**Marine Cargo Surveyors, Loss Assessors, Superintendents.**  
**Container Surveyors, Tank Calibrators, Samplers & Analysts.**
  
- **International Reinsurance Brokers (Non-Life & Life)**
  
- **Direct Insurance Brokers (Non-Life & Life)**

#### **Head Office :**

**Maker Bhavan No. 1., Sir Vithaldas Thackersey Road, Mumbai 400 020 (INDIA)**

**Telephone : + 91 22 6631 4949 / 6631 4917 \* Telefax : + 91 22 22623747 / 22625112**

**E-Mail : [jbbmbi@jbbodamail.com](mailto:jbbmbi@jbbodamail.com) \* Web : <http://www.jbboda.net>**





Since 1943

**Team Co-ordinator : Sanjiv Shanbhag,**  
**Executive Director,**  
**J. B. BODA & Company Pvt. Ltd.,**  
**Mumbai, India.**  
**[sanjiv@jbbodamail.com](mailto:sanjiv@jbbodamail.com)**

**We value feedback at : [median@jbbodamail.com](mailto:median@jbbodamail.com)**

### **DISCLAIMER**

- This document is intended for general information purposes only. We do not accept any responsibility or liability for any errors or omissions therein / therefrom.
- We have not verified the contents of this document and we do not vouch for their authenticity. We hereby disclaim any responsibility or liability in these regards.
- Any statements, facts, figures, opinions, beliefs or views contained in this document do not necessarily reflect our sense, opinion or view and we cannot be held responsible or liable for them.
- Nothing herein contained shall constitute or be deemed to constitute a recommendation or an invitation or a solicitation or a suggestion for any party, person, product or service.
- Reproduction or distribution of this document without our permission is strictly prohibited.
- All disputes subject to Mumbai jurisdiction only.

**Visit us at:**

**[www.jbboda.net](http://www.jbboda.net)**

**(Click on “NEWS” for back Issues of “MEDIAN”)**

