Policyholder Insurance Webinar Series: Covering Hurricane Loss for Commercial Insureds

October 19, 2017

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Topics Covered Today

- Commercial Property Insurance
    - Standard Commercial Property Policies
    - Establishing a Covered Cause of Loss
    - Commercial Wind & Windstorm Deductible
    - Business Interruption & Contingent Business Interruption Coverage
- Excess & Surplus Lines Insurance
- National Flood Insurance Program
- Managing an Insurance Claim
- Questions

Risk from Natural Disasters

- U.S. regularly experiences disasters involving substantial loss to real and personal property
- Ten costliest catastrophes in U.S. by insured loss (in millions):*

Date	Peril	Dollars when occurred
Aug. 2005	Hurricane Katrina	$ 41,100
Sep. 2001	Fire, Explosion: World Trade Center, Pentagon terrorist attacks	18,779
Aug. 1992	Hurricane Andrew	15,500
Oct. 2012	Hurricane Sandy	18,750
Jan. 1994	Northridge, CA earthquake	12,500
Sep. 2008	Hurricane Ike	12,500
Oct. 2005	Hurricane Wilma	10,300
Aug. 2004	Hurricane Charley	7,475
Sep. 2004	Hurricane Ivan	7,110
Apr. 2011	Flooding, hail and wind including the tornadoes that struck Tuscaloosa and other locations	7,300

*Source – Insurance Information Institute

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Harvey and Irma Projected Economic Loss

- **Harvey –$70 Billion to $90 Billion**
- **Irma – $60 Billion to $95 Billion**

- Less than half of these losses are expected to be covered by insurance

Most Losses from Natural Disasters are Uninsured or Underinsured

"Insurance coverage for losses resulting from natural disasters is typically less than 20 percent of the total loss, because of limited participation in voluntary insurance coverage"

- U.S. Geological Survey

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Commercial Property Insurance

Commercial Property Insurance (CPI)

- Provides coverage for loss or damage to policyholder's real and personal property
- Can be limited to a single facility or extend to all of insured's facilities
- Policy may provide blanket coverage limit on multiple insured properties or single property limits
- Policy will specify types of property covered and covered perils

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Covered Perils

- "Named Perils" or "All Risk"?
- ISO "Named Perils" forms:
  - **Basic form (CP 10 10) ("named perils")** – covers common perils like fires and storms
  - **Broad form (CP 10 20)** – covers common perils, as well as water damage, structural collapse, sprinkler leakage, and damage caused by ice, sleet, or weight of snow
- ISO "All Risks" form:
  - **Special form (CP 10 30) ("all risks")** – covers all types of perils except those specifically excluded. Typical exclusions include loss from flood, earth movement, war, terrorism, nuclear disaster, wear and tear, insects, and vermin

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Special Form Policy Recommended

- More coverage if specific perils excluded rather than limiting coverage to only named perils
- Impossible to pinpoint all loss scenarios that would not be covered under basic or broad form
- Easier to identify insurance gaps and obtain supplemental coverage, if necessary
- Shifts burden to insurer to prove that a cause of loss falls within exclusion
- Premiums typically priced similar to premiums for basic or broad forms

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Valuation of Loss

- Replacement cost or actual cash value ("ACV")
- Replacement cost coverage pays to rebuild or repair property based on current construction costs
- Must rebuild to receive replacement cost
- ACV covers only the depreciated value of your property
- ACV may not allow your organization to fully rebuild or repair in the event of a loss

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Valuation of Loss (cont'd)

- Coinsurance penalty

Example from CP 00 10 04 02:

Example No. 1 (Underinsurance):

When:	The value of the property is	$	250,000
	The Coinsurance percentage for it is		80%
	The Limit of Insurance for it is	$	100,000
	The Deductible is	$	250
	The amount of loss is	$	40,000

Step **(1)**: $250,000 x 80% = $200,000 (the minimum amount of insurance to meet your Coinsurance requirements)

Step **(2)**: $100,000 ÷ $200,000 = .50

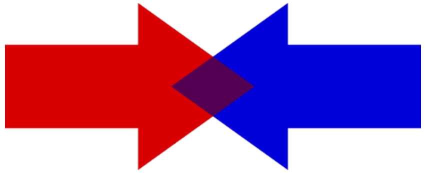
Step **(3)**: $40,000 x .50 = $20,000

Step **(4)**: $20,000 – $250 = $19,750

We will pay no more than $19,750. The remaining $20,250 is not covered.

Establishing a Covered Cause of Loss

Concurrent Cause



- Issue arises when a loss arises from multiple causes, but only one is covered under the policy
- Example: wind/rain and flooding have combined to destroy property
- Minority of states apply concurrent causation rule
  - A loss caused by multiple perils is recoverable if at least one cause is covered under policy

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Efficient Proximate Cause

- Under majority approach, covered peril must be the “efficient proximate cause” of the loss
- Efficient proximate cause is one that sets other causes in motion and, in an unbroken sequence, produces the loss

Anti-Concurrent Causation Clauses

- No coverage for losses caused by excluded risk, even if caused in part by a covered risk

"We will not pay for loss or damage caused directly or indirectly by any of the following [excluded causes]. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss."

CP 10 30 04 02

Special Form Policy Exclusions – Group 1

- Group 1 Exclusions – Anti-concurrent causation clause applies:
  - Ordinance or Law
  - Earth Movement
  - Governmental Action
  - Nuclear Hazard
  - Utility Services
  - War and military action
  - Water (including flood)
  - Fungus, wet rot, dry rot, and bacteria

Special Form Policy Exclusions: Group 2

- Group 2 – No anti-concurrent causation clause

- Artificially generated electrical, magnetic, or electromagnetic energy
- Delay, loss of use, or loss of market
- Smoke from industrial or agricultural smudging operations
- Wear and tear, etc.
- Boiler explosion
- Continuous leakage, humidity, or moisture
- Discharge caused by freezing
- Dishonesty
- Voluntary parting/trickery
- Precipitation damage to personal property outdoors
- Collapse (except as provided under the collapse additional coverage)
- Release of pollutants
- Neglect to preserve property from further damage

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Special Form Policy Exclusions: Group 3

- Group 3 Exclusions do not exclude "ensuing losses" if excluded cause results in otherwise-covered loss
  - Weather conditions
  - Acts or decisions of a person, group, organization, or government body
  - Faulty, inadequate, or defective:
    - Planning, zoning, development, surveying, siting;
    - Design, specifications, workmanship, repair, construction, renovation, remodeling, grading, compaction
    - Materials used in repair, construction, renovation or remodeling; or
    - Maintenance

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Madelaine Chocolate Novelties, Inc. v. Great Northern Insurance Company

- Chocolate manufacturer sought coverage for $49.5 million in property damage and $13.5 million in business income loss after facility inundated with sea water during Hurricane Sandy and forced to close through 2012 holiday season
- Manufacturer sought coverage under wind endorsement
- Policy excluded loss caused by flood, regardless of any other contributing cause
- Court ruled that policy unambiguously excluded damage from storm surge

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Commercial Wind & Windstorm Deductible

Windstorm Deductible

- Wind typically a covered peril under property policy
- To limit losses, insurers insert special endorsements for policies sold in hurricane-prone areas that increase deductibles for hurricanes, “named” storms, and other high wind events
- Endorsements used in 19 states on Atlantic seaboard and the District of Columbia

Windstorm Deductible (cont'd)

- A "Hurricane" endorsement applies a percentage deductible only to declared hurricanes
- "Named Storm" endorsement applies to storms that have been named by the National Weather service, i.e., tropical storms and hurricanes
- A "Windstorm" deductible is the most broad and, depending on jurisdiction, may apply to most weather events characterized by high wind
- Since storms are fluid, the timing of upgrading and downgrading of storms may be critical to determining which deductible applies

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Windstorm Deductible (Cont'd)

- Windstorm endorsement typically imposes a percentage deductible, such as 1, 2, or 5 percent
- May be percentage of policy limits or percentage of value of damaged property
- Example:
  - Insured suffers $35K in wind damage to $500K facility due to hurricane
  - Windstorm endorsement specifies a deductible equal to 5% of the value of damaged property
  - $25K deductible (5% of $500k)
  - Insurer pays $10K for wind damage

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Wind Only & Excess Wind Coverage

- Wind-only policy necessary if policy excludes windstorm
- May be available from state-run insurance association
- Coverage limits may be less than property value, requiring purchase of excess wind coverage from surplus lines market
- Wind buy-back insurance – allows policyholders to buy down wind deductible and reduce from percentage of property value to a fixed amount

State Residual Insurance Associations and Insurers of Last Resort

Alabama Insurance Underwriting Association

http://www.alabamabeachpool.org/

Mississippi Windstorm Underwriting Association

http://www.msplans.com/MWUA

North Carolina Insurance Underwriting Association

http://www.ncjua-nciua.org/

South Carolina Wind & Hail Underwriting Association

http://www.scwind.com/

Texas Windstorm Insurance Association

http://www.twia.org

Citizens Property Insurance Corporation (Fla.)

http://www.citizensfla.com/

Lousiana Citizens Property Insurance Corporation

http://www.lacitizens.com/

Surplus Lines Coverage

- Surplus lines market provides custom coverage for which standard insurance is unavailable or does not meet the insured's coverage requirement
- More freedom to set rates and prepare specialized forms allows surplus lines insurers to adapt to market conditions and meet unique needs of consumers

Business Interruption and Contingent Business Interruption Coverage

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What is Business Interruption (BI)?

- First-party insurance for loss of "business income," "extra expense," or both when damage to "premises" by a "covered cause of loss" causes a slowdown or suspension of operations

- Also called: "Business Income Coverage" or "Time Element Coverage"
- Not included in Building and Personal Property Coverage (ISO Form CP 00 10)

What is Contingent Business Interruption (CBI)?

- First-party insurance for loss of income or increase in expense resulting from a covered cause of loss to the premises of another organization on which the insured depends (usually a key supplier or customer)
- Suppliers and customers can be specifically named or defined by class (Tier 1, Tier 2, etc.)
- Also called “Dependent Properties Time Element Coverage” or “Contingent Time Element Coverage”

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Why BI and CBI Coverage

- Losses not limited to property damage
- BI coverage reduces exposure to unforeseen loss
  - Covers lost profits and extra expenses (if purchase)
  - Interdependency coverage
  - Most organizations underestimate the additional costs associated with a loss; extra expense covers some of those losses

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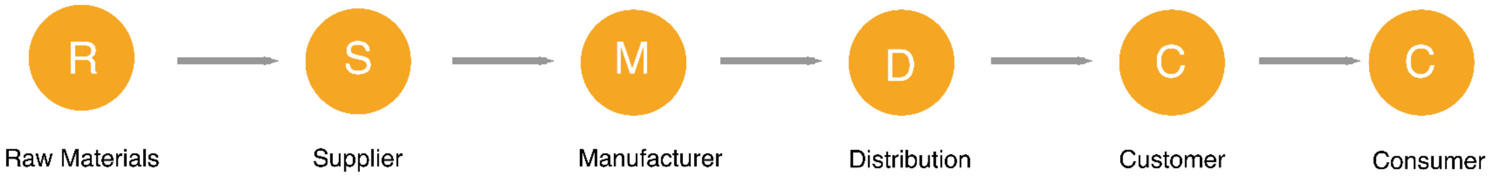
CBI Supply Chain Coverage

- Definition of “supplier” or “customer” critical
- Standard forms specifically name suppliers and customers
- Manuscript forms may identify classes of customers or suppliers
- Some insurers may provide a blanket limit for all suppliers in form, with endorsements only for specific supplier coverage



CBI Coverage for Offsite Power Interruption

- Utility Service Interruption Coverage
  - Coverage for loss due to lack of incoming electricity caused by damage from a covered cause to property away from the insured's premises—usually the utility generating station
  - Also referred to as "off-premises power coverage”
  - Available by endorsement because utility services are not usually considered “suppliers”
  - Utility service interruption coverage endorsements vary widely as to scope of included utility services

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For Both BI and CBI: Did a Covered Cause of Loss Cause "Direct Physical Loss or Damage"?

- What is a covered cause of loss in your policy?
- Causation?

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“Direct Physical Loss or Damage” Requirement

- BI/CBI Coverage requires “direct physical loss or damage”
- Courts have generally held that BI/CBI Loss requires either “direct physical loss” or “direct physical damage”
- Courts have rejected arguments that economic damages without direct physical loss are covered
  - Courts have held that CBI loss arising out a supplier’s loss of power does not trigger coverage without a covered cause of loss at a dependent property

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Difference in Location of Direct Physical Loss or Damage in BI and CBI

- BI: Direct physical loss of or damage to insured's own property
- CBI: Direct physical loss of or damage to another organization's property away from the insured's premises
  - Within the supply chain
  - Suppliers
  - Customers
- CBI coverage is determined by covered causes of loss under *your policy*, not your supplier or customer's policy

For Both BI and CBI: Does an Exclusion Bar Coverage?

- Exclusions can bar recovery for BI or CBI loss
- Common exclusions:
  - Earth Movement (earthquake, landslide, mine subsidence, earth sinking)
  - Water (flood, mudslide, sewer back-up or overflow, surface water)
- Can argue that the excluded cause of loss was not the efficient proximate cause, but outcome depends on jurisdiction

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Obtaining BI/CBI Coverage for Flood

- Standard commercial property insurance market may offer BI/CBI coverage, but typically exclude flood
- National Flood Insurance Program policies do not included BI/CBI coverage
- Supplemental coverage may be available on the surplus lines insurance market
  - Obtain a separate BI/CBI policy that does not exclude flood coverage; or
  - Purchase excess flood policy that offers BI/CBI coverage

Excess & Surplus Lines Insurance

Insurance Offered by Excess & Surplus Lines Insurers

- Insure risks declined by admitted insurers
  - Including wind and flood
- Insures property damage
- Insures business interruption
- Provide high-capacity coverage

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National Flood Insurance Program

Importance of Flood Insurance
Billions in Losses

- Between 1980 and 2016, the United States sustained more than $280 billion in flood losses
- Losses resulted in significant flood insurance payouts
  - Hurricane Katrina: $16.3 billion
  - Superstorm Sandy: $8.6 billion
  - Harvey: $16 billion (projected)
  - Irma: $12 billion (projected)

National Flood Insurance Act of 1968 (NFIA)

- Federal response to increased flood damage, costs of disaster relief, and lack of flood insurance
- Makes federally-subsidized flood insurance available in special flood hazard areas (SFHA) in participating communities
- Administered by Federal Insurance and Mitigation Administration (FIMA) (a department of FEMA)
- Insurance available through
  - Direct Program agents
  - Write Your Own Program (WYO) from private insurers
  - Private insurers using their own paper

NFIP Commercial Flood Policy

- Coverage for up to $500K for a building, and up to $500K for personal property
- Single peril policy – only covers damage caused by flood
- Pays for direct physical damage to property up to the cash value

NFIP Flood Policy – Cont’d

- Building coverage – includes insurance for structural elements of building, HVAC, other fixtures
- Personal Property coverage – includes insurance for furniture, machinery, equipment, and other personal property used in business
- NFIP policies do not insure most automobiles and property outside of a building
- Do not insure for business interruption

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NFIP Flood Policy – Increased Cost of Compliance (ICC) Coverage

- ICC Coverage applies to property found to be “substantially damaged” or a “repetitive loss structure” by a flood
- May require owner to bring structure up to current floodplain management standards
- Provides up to $30K to elevate, demolish, relocate, or floodproof insured structures

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Future of the NFIP

NATIONAL FLOOD INSURANCE PROGRAM

- Program's authorization previously due to expire on September 30, 2017
- On September 8, 2017, President Trump signed legislation to extend NFIP for three months to December 8, 2017
- Legislative efforts to reauthorize NFIP
  - HR 3285 – Sustainable, Affordable, Fair & Efficient NFIP Reauthorization Act
  - S.1571 – NFIP Reauthorization Act

Surplus Lines Coverage to Supplement NFIP Flood Insurance

- Excess flood insurance may be available on surplus lines market
- Insured may need surplus lines coverage for flood if:
  - Need higher limits than $500,000 for commercial property
  - Need enhanced coverage such as replacement cost rather than cash value of property
  - Need additional coverage such as business interruption

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Managing an Insurance Claim

Notifying Your Insurer of a Loss

- Notify all potentially responsive insurers as soon as possible
- Coverage may depend on timely notification
- Comply with specific notice terms
- Insurers can contest coverage based on purported defects in notice

Proof of Loss

- Insured’s sworn statement regarding the loss
- Significant losses require forensic accountant and legal counsel to prepare proof of loss

Proof of Loss: BI & CBI Coverage

Most Recent 12 Month Period Ending: (mm/dd/yyyy)		Income and Expenses	Estimated 12 Month Policy Period Beginning: (mm/dd/yyyy)
0/0/2000			0/0/2000
$ -	A.	**Gross Sales**	$ -
[illegible]	B.	**Less:** Finished Stock Inventory (at selling price) at beginning of 12 month period	-
$ -	C.	[illegible] of 12 month period	$ -
$ -	D.	**Equals:** Gross Sales Value of Production	$ -
[illegible]	E.	[illegible] **Less:** Discounts, Returns & Allowances	[illegible]
$ -		**Less:** Bad Debts & Collection Expenses	$ -
[illegible]	F.	[illegible]	[illegible]
		Add: Other Earnings from your business operations (not royalties or investment income):	
$ -	G.	*Commissions or Rents*	$ -
$ -		*Cash Discounts Received*	$ -
$ -		*Other*	$ -
$ -	H.	**EQUALS: TOTAL REVENUES**	$ -
		Click button to Go to Cost of Goods Sold worksheet to calculate	
$ -	I.	**Less:** Total Cost of Goods Sold	$ -
$ -	J.	**Less:** Cost of services you purchase from outsiders to separately resell that DO NOT continue under contract. Costs that continue are NOT deducted.	$ -
$ -	K.	**Less:** Power, heat and refrigeration expenses that do not continue under contract. Expenses that continue are NOT deducted.	$ -
$ -	L.	**Less:** All "Ordinary Payroll" Expenses if they are to be excluded or limited. Payroll Limitation worksheet item PL5 Click to go to Payroll Limitation worksheet	$ -
$ -	M.	**Business Income Exposure for 12 Mos. (H-I-J-K-L)**	$ -

- Detailed showing to establish lost income
- Business income worksheet completed at time of application for policy provides basis for calculating loss

Takeaways

- Commercial property insurance and NFIP often insufficient to cover risk from disasters
- Assess your organization's risks and procure matching coverage where available
- BI/CBI coverage for flood, wind, and other perils may be critical to bring your organization through a disaster
- Surplus lines market provides excess capacity and coverage where standard insurance unavailable
- Notice of loss must be timely and comply with policy provisions

Questions?

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For Updates on Flood Insurance

www.itpaystobecovered.com