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WHITE PAPER

How Contingent Business Interruption Can Ease the Impact of a Natural Disaster

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In recent years,

natural disasters have been growing in intensity and severity, with the United States routinely experiencing losses in the billions of dollars. Whether hurricanes in the Southeast, droughts and wildfires on the Pacific Coast, or flooding and winter storms in the Midwest, businesses across the country now regularly experience extreme weather-related property damage.

Unfortunately, there is no sign that natural disasters will decrease in the future. Many scientists and insurance professionals believe climate change has contributed to the trend of stronger storms and increased droughts, and underwriters are now incorporating climate change into their property and casualty pricing modeling.

Businesses should consider preparing for property damage through an in-depth emergency management plan and a comprehensive business interruption insurance policy protecting against natural disaster-related damages. Risk mitigation planning is especially important for companies that rely heavily on customers or raw goods from disaster-prone areas, such as the Southeast or California. Contingent business interruption may be necessary to avoid losses.

The Role of Climate Change

Climate Change is a Concern for Property & Casualty Insurance

The consensus in the property and casualty insurance sector is that climate change is an existential threat facing humankind, requiring drastic action to curb potentially catastrophic environmental changes.

In 2021, Chubb CEO Evan Greenberg stated that "we are seeing changes globally in the frequency and severity of the perils such as tropical storms, wildfires and floods." He added that the increased precipitation and likelihood of severity of the storms would increase the amount of loss stemming from these events.

AIG's tone concerning climate change has shifted dramatically in the past ten years. After Hurricane Sandy in 2012, the insurance giant published a report addressing the phenomenon while still questioning the scientific consensus that humans cause climate change. In 2022, AIG has now committed to reaching net-zero emissions by 2050 through underwriting and investments portfolios.

"As a global insurer, AIG is in the business of managing complex risk, so we are in a prime position to promote sustainable action," said AIG Chief Sustainability Officer Jennifer Waldner Grant.

Why are Insurance Companies Now Taking an Interest in Climate Change?

Natural disasters are growing more intense, costing businesses and insurance companies more money than ever. With these changes, organizations across the country must prepare for the possibility of severe property damage and higher insurance costs. Simply put, insurance companies understand the growing financial threat climate change poses and are positioning their pricing to offset potential losses.

Preparing for Natural Disasters

40% of businesses permanently close after a disaster*

Disaster takes on many forms, including droughts, tornadoes, floods, earthquakes, fires, active shooter incidents and cyberattacks, and all can cause business interruption, high claims and months of uncertainty. Fortunately, a mix of planning and new technology can help ease the pain of disasters, natural or otherwise.

**According to FEMA*

The Time to Strategize Is Now

Mother Nature is unforgiving and can often defy logic. Hurricanes divert at the last minute, hailstorms and tornadoes appear swiftly and earthquakes give no warning. Even wildfires can change course and destroy homes initially thought to be safe.

The only way to help manage the chaos of natural disasters is to craft an emergency strategy before they hit. Consider organizing a group of employees from each business division and verify that they understand what to do when a disaster strikes. This group will be jointly responsible for executing actionable items and communicating subsequent information to the rest of your staff.

The U.S. Government's disaster planning website, ready.gov, is an excellent place to start, and it includes toolkits that help organizations identify risks, develop plans and take action when natural hazards strike. Simple checklists and planning tools are also available.

Use Technology as Your Guide

Once your plan is in place, open communication across the business will help you weather the proverbial storm, mitigate risk and possibly save the lives of your employees.

Mobile disaster planning technology allows organizations to save critical documents, planning preparations and phone numbers on a network of external servers unlikely to go down during a natural disaster. So even if your business loses power, your phone will remain connected and help guide you through the immediate aftermath. In the example of "In Case of Crisis," the secure app houses pre-planned, step-by-step workflows needed to mitigate the effects of a disaster, with defined, role-based views that allow for individualized tasks.

Technology also enables quick messaging and picture and video storage, so risk managers in an unaffected office can quickly coordinate with those in the middle of an emergency. This documentation also can jump-start the claims process faster, quickly capturing disaster response expenses and related support.

Most Importantly, Stay Safe

Natural disasters kill hundreds of Americans each year. All businesses should prepare for crisis, prioritizing the safety of their employees. Disaster planning should involve carefully thought out evacuation strategies and periodically scheduled drills to certify that employees know exactly where to be in case of a tornado, fire or earthquake. Exit signs should always be well marked.

When it comes to disasters, preparation and practice make perfect. Develop your emergency strategy, clearly communicate the responsibilities of all internal employees and share plans with your insurance broker.

Contingent Business Interruption

2021 marked the third most active and most expensive hurricane season in history. In 2018, the entirety of the hurricane season totaled $50+ billion in damages, while Hurricane Ida alone caused $60 billion in damages. Ida made U.S. landfall in Louisiana, causing wind damage, flooding and severe thunderstorms as it traveled up the eastern half of the country. In addition, flash floods and tornadoes hit states as far north as Pennsylvania and New York. This region had never experienced the issuance of a tornado emergency, let alone faced such consequences from a tropical cyclone.

While the sites of these storms felt the devastation and destruction most acutely, the impact reverberated across the U.S. One essential component of planning is incorporating contingent business insurance (CBI). CBI helps protect a policyholder from income losses that results from damage to a property not owned by the policyholder.

When looking specifically at Hurricane Katrina's national economic impact, damage done to suppliers and wholesalers in Louisiana shut down businesses across the country because of supply, delivery and supply-chain logistics.

As storms and hurricanes continue to grow stronger, the oil and gas industry may be forced to adapt its on-shore and offshore infrastructures. For example, Hurricane Katrina destroyed many oil hubs, some of which are still unable to operate. Hurricane Ida further damaged refineries and halted operations for major oil companies, highlighting the need for change to help avoid continued interruptions.

CBI is Not Traditional Business Interruption Insurance

Business interruption can cover organizations that temporarily close or lose revenue following a catastrophic event if a property loss directly affects the insured's property. On the other hand, CBI covers only property damage inflicted on a third-party organization vital to the insured's revenue. It is important to note that CBI is not an umbrella policy, meaning specific kinds of damage must be explicitly outlined for coverage to go into effect.

For example, if a storm affects a manufacturer in North Carolina whose product directly impacts an organization in Wisconsin, CBI would be necessary for the Midwestern company to recover any losses. Meanwhile, the North Carolina business would pursue its first-party losses under traditional business interruption insurance.

Polar Vortex and Resin Shortages

A key instance demonstrating the importance of CBI was the dramatic impact of the 2021 polar vortex in Texas, adding another layer of economic disruption to the COVID-19 pandemic. Texas shutting down most of their petrochemical plants during the winter storm caused a drop in the most integral polymers to make plastics, including PVC, polypropylene and polyethylene. Additionally, the decreased resin supply caused a paint shortage that lasted months into 2021.

It took weeks for the plants in Louisiana and Texas to reopen, and production still did not meet the demand. As a result, according to AlixPartners, 60% of producers still face resin shortages, which could continue through the next three years.

CBI Claims Coverage Trigger

Like traditional business interruption insurance, a CBI claim generally must result from a cause of loss that is insured under the organization's policy, but occurs at the supplier or customer's premises. In an incident such as a hurricane, claims become complicated, with wind and flood playing a significant role, as insurers and claims advocates investigate what caused the property damage.

The scope of coverage can vary for hurricanes, wind and floods. Insurance carriers will frequently request support or evidence of damage to supplier and customer facilities, which is easier said than done when the property is located hundreds or even thousands of miles away.

Insurers frequently ask for extensive documentation to support CBI claims. The insured must prove that they have lost revenues due to the property damage of a vendor, customer or manufacturer. Organizations must also provide evidence that the loss cannot be recuperated through another means, such as a comparably priced raw materials manufacturer.

Limitations

Some policies may only extend coverage for your tier 1 suppliers or may require you to name your suppliers in the policy and only provide a relatively small sublimit for unnamed suppliers.

This can limit your coverage since CBI will only trigger if your suppliers are directly impacted.

For example, if a natural disaster wipes out a cotton farm, it can no longer supply cotton to the fabric mill. A t-shirt manufacturing company with a CBI policy buys materials from this fabric mill. However, the t-shirt manufacturing company may not be able to file a claim because the disruption happened with a tier 2 supplier (the cotton farm) and not a tier 1 supplier (the fabric mill).

A careful review of your policy can outline any coverage limitations.

The Lessons of **Hurricane Katrina**

When Hurricane Katrina hit the city of New Orleans in late August 2005, it shut down one of the busiest ports in the United States, ravaged an entire state and caused approximately $125 billion in direct damage. Of that damage, insurance only covered $41 billion. Oil production was reduced to a third in the weeks following the storm, and U.S. economic growth dropped a full percent in Q4 2005. Businesses across the country were impacted by Katrina and left many without sufficient insurance coverage to recuperate quickly from one of the most devastating hurricanes.

Since then, storms have only grown stronger and more unpredictable, as Hurricane Ida proved last year. Commerce has become more interconnected, leaving more companies vulnerable to business loss or interruption in disaster areas.

While CBI coverage is not exclusive to hurricanes, these natural disasters tend to create severe destruction, the repercussions of which can reverberate around the country. Chances are, your organization relies on businesses in disaster zones and may suffer should disaster unexpectedly strike.

Next Steps

CBI is a distinct coverage from traditional business interruption insurance. Your broker can help determine and find coverage for your organization.

Natural disasters are inescapable and unpredictable. Even hurricanes that often move at a snail's pace can change direction at the last minute and destroy cities thought to be safe the previous day. For that reason, an organization should prepare well in advance of potential catastrophes. Businesses in the Southeast should use the first of the year to shore up their hurricane preparations, while Midwestern and Northeastern organizations should use the relatively quiet summertime to ensure that their emergency plans are in order.

Talk to your insurance broker about how property coverage, business interruption and contingent business interruption can help your organization quickly get back on its feet after a natural disaster.

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