

Chile and Japan earthquakes: Business Interruption issues arising

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Overview

- BI quantum issues arising from large scale CAT claims
 - Wide area damage
 - Contingent Business Interruption
 - Japan compared to other recent CATs

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Wide area damage (1)

- Insured may suffer a loss of profits following a catastrophe, even if it sustains no damage, as a result of the following:
 - **Damage to surrounding infrastructure** – e.g. damage to roads, railways, ports, airports
 - **Loss of access** – physical hindrance / denial of access
 - **Loss of attraction** – customers deterred from visiting a particular area
 - **Loss of utilities** – e.g. rolling power blackouts



Wide area damage (2)

- Issue often occurs in CAT losses
- What would have happened 'but for' the damage to the Insured property?
 - Surrounding area will still have been damaged
 - Island theory
- Could increase or reduce a loss at a single insured location



Wide area damage ... common arguments (1)

- Hotel loss in New Orleans – Hurricane Katrina
 - Part of New Orleans was quarantined for a period of time
 - ‘But for’ the damage the hotel would not have been able to trade during the quarantine period, and sales would have been zero
 - This position was adopted by insurers and was upheld by the English courts
 - This situation could reduce a loss



Wide area damage ... common arguments (2)

- Fisheries in Chile
 - Numerous fisheries competing for a finite resource
 - Declining stocks – excess plant capacity
 - Earthquake - 27 February 2010
 - 7 different Fisheries damaged with varying interruption periods
 - If a fishery had not been damaged, it would have received a windfall profit as all its competitors were interrupted
 - Therefore in the ‘but for’ world, the Insured’s sales would have increased
 - This situation could increase a loss



Wide area damage ... practical considerations

- Difficult to eliminate the external factors which would have influenced a business 'but for' the damage to insured property
- There are often two sides to each argument
- Important to adopt a consistent approach to the issue – insurers & reinsurers – Insured's will talk to each other
- In the US, case law suggests that an Insured cannot be penalised or benefit from the wider impact of an event

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Loss of attraction / denial of access - Japan

- Policy extension (generally with a sub limit)
- Generally requires damage (sometimes a non damage sublimit)
- Some examples:
 - Loss of attraction due to damage, or a disinclination to travel due to the nuclear situation?
 - Governments advising against travel – denial of access?
 - Closure of airport – denial of access?

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Contingent business Interruption (CBI)

- Often a policy extension (not part of the 'normal' cover)
- Usually has a sub-limit
- Generally, coverage for losses arising from an insured peril at a third party supplier or customer (subject to the terms & conditions of the Insured's own policy)
- Named suppliers (sometimes)
- Unnamed suppliers often have a further sub-limit



CBI ... possible wordings

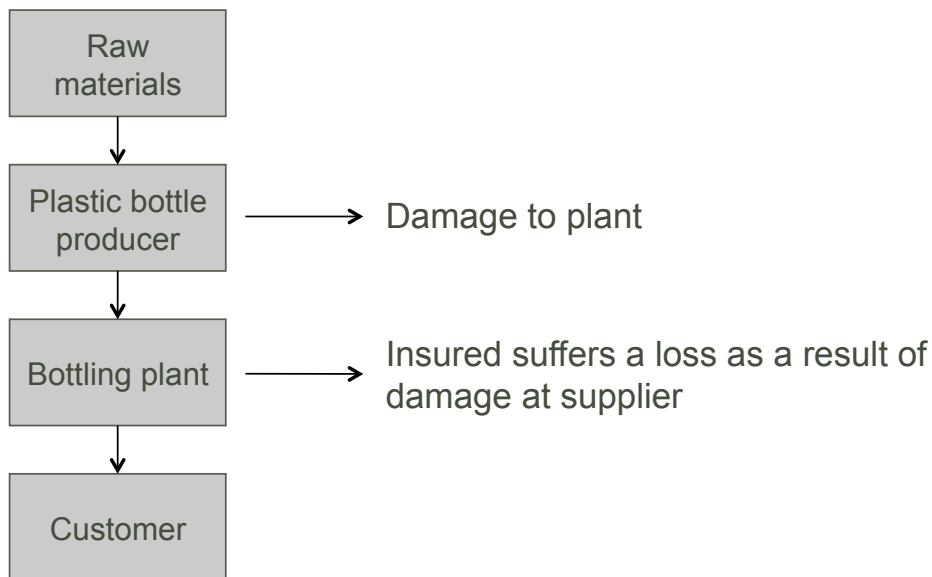
- Coverage as a result of damage to:
 - “Direct suppliers and/or customers”
or
 - “Insured’s suppliers and or their suppliers”
or
 - “1st and 2nd tier suppliers”

Often the above terms are not defined



CBI ... simple enough?

Relatively straightforward if only one supplier is impacted:



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CBI ... complicated by a CAT

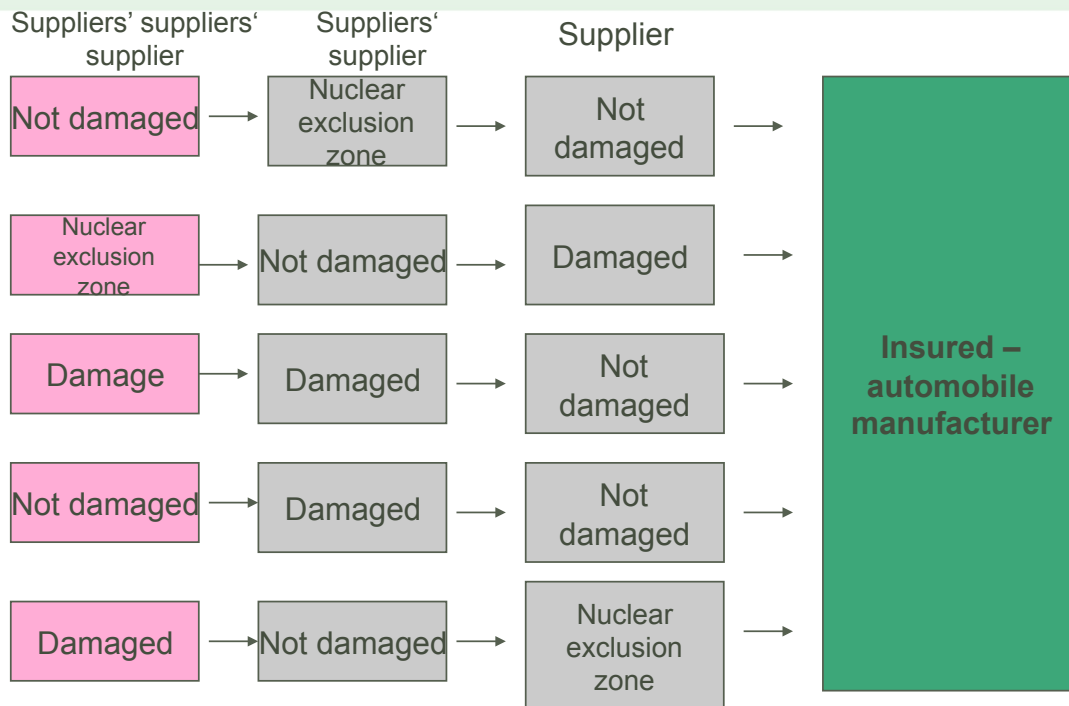
- Multiple suppliers impacted in different ways
 - Damage
- Undamaged, however, their suppliers are not producing
 - Evacuated due to:
 - Fear of a subsequent quake
 - The nuclear exclusion zone
 - Power outages / rolling blackouts
- Establish the “but for” position: no production due to
 - Damage at a supplier
 - Damage at a suppliers’ supplier
 - Nuclear exclusions
 - Power shortages
- Consider policy wording in each situation

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Supplier extension claims - Japan



Easier said than done!

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CBI arising from a CAT: practical considerations

- How much information can you get from third parties?
- A car has c.150,000 to 200,000 parts, however each of these 'parts' have further components
- If one part is missing production may have to cease
- In some cases, many suppliers are 'affected' by the EQ for various reasons - is a detailed review practical?
- Could some 'ground rules' be established once the adjustment team has understood the issues

Japan compared to recent CATs

- EQ / Tsunami
- Interrelated supply chains – widespread use of distributors
- Nuclear issues
- Power outages / rolling black outs / reduced power consumption (15% requested by the government for all consumers of over 500KW)
- Low EQ limits – attempt to ‘stack’ limits – EQ / Flood / CBI
- Local custom – very limited flow of information to reinsurers – cedents only obligated to inform reinsurers at half & full year (usually 31 March year end)

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Conclusions

- CAT claims give rise to numerous complex issues
- Recent Japanese EQ is more complex than most
- Many policy issues
- Legal interpretation required
- Need a competent & experienced team to adjust the loss
 - Adjuster
 - Lawyers
 - Accountants
 - Other experts

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Questions

- Any questions?



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