The Insurance Crisis Grows

Even prior to 9/11, a succession of significant events in 2001 prompted a gradual hardening of terms and conditions of policies in the global property insurance marketplace. Contributing to the crisis was a February earthquake in the Pacific Northwest, the explosion of the Petrobras offshore production platform near Brazil in March and June floods in Texas. In addition, Reliance Insurance Co. stopped writing virtually all new and renewal property and casualty business in June 2000. In May 2001, the company consented to the entry of an Order of Rehabilitation. Then, by October 2001, Reliance was ordered into liquidation.

Lower rates that were available during the soft market of the 1990s began to rise for a number of reasons. These include poor underwriting results from past years, poor investment results during 2000, increased claimant awards, changes in the reinsurance market to higher margin lines of business and a situation in which 70% of reinsurance treaties expired and were up for renewal on January 1, 2002.

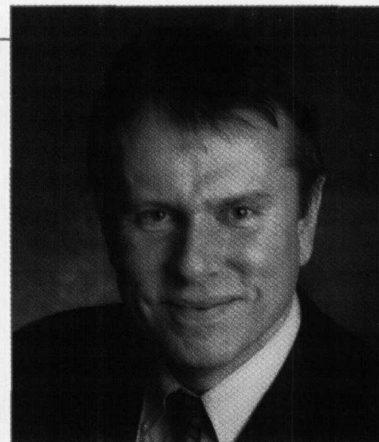
"The coverage available in certain zones, such as Lower Manhattan, is EXPECTED TO BE LIMITED."

The insurance marketplace reacted in different ways following September 11. In general, the lines written were reduced, minimum premium thresholds were increased and liability coverage for soft industries was reduced, especially those industries exposed to severe natural catastrophes.

Many areas of coverage and liability issues have been taken for granted in the past. After 9/11, the industry has limited the coverage terms and conditions in a number of existing areas:

Blanket Limits—The terrorist attacks called into question the philosophy behind total insurable value or maximum foreseeable loss calculations. When calculating premiums, underwriters had previously taken into account that the risk was negligible above a certain level. This methodology has now been met with extreme skepticism, thus driving rates even higher.

Terrorism Insurance—Although New York and California have refused to approve exclusions for terrorism, the market began to exclude or limit this type of coverage shortly after 9/11. North America and the UK have offered stand-alone coverage for sabotage and terrorism. The coverage available in certain zones, such as Lower Manhattan, is expected to be limited. Furthermore, the rates will most likely be exorbitant. Congress recently approved legislation that will cover this type of risk.



John Osborn

Computer Virus Coverage—The market has now begun to see cyber risk as an unquantifiable risk that it is unwilling to cover as part of traditional property coverage. Property underwriters now suggest that this type of coverage should be relegated to a specialized market.

Mold—More underwriters are excluding damage from mold, fungus and mildew. This trend may continue if treaty renewals contain this exclusion. Large claims in California and Texas have heightened awareness of the risks of mold contamination.

The insurance industry can alleviate some of the pain incurred by building owners. First, when the property policy is renewed, it goes without saying that significant additional research and shopping will be necessary.

The solutions to the crisis are logical ones; the insured must increase the amount of the deductible, limit the breadth of coverage when possible, reduce the paid-loss frequency by fighting claims more vigorously and establish a blended-risk program with the insured assuming more of the risk.

The most important tool in establishing a positive differentiation between the insured and the market is an early and comprehensive submission by the insured, in anticipation of renewal. A clear description of the landlord's operations—with demonstrated values, detailed risk control reports and evaluations of natural catastrophes—is essential.

To the extent that investment yields remain poor, the equation is very simple: premium hikes and decreases in paid claims are necessary to meet profit goals. Additional rating downgrades will be imminent if the industry has underestimated the losses suffered as a result of September 11. In turn, this would give larger insurance carriers the ability to charge more money for their creditworthiness. ◆

JOHN E. OSBORN is a partner in the New York City law firm of John E. Osborn PC, which focuses on contract litigation and environmental law. He can be reached at josborn@osbornlaw.com.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.