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Is There a Natural Disaster in Your Future?

Agents, Insurers Ought to Prepare Clients for Hurricane Season

By Janet H. Cochrane

Those of us who live in the Northeast were fortunate to escape the ravages of serious weather-related disasters in 2005. From Katrina and Rita to tornadoes and wildfires, many of our fellow citizens weren't as lucky. By all accounts, 2005 was a record-breaker in the sheer number and severity of catastrophes.

However, just because we dodged a bullet last year does not mean we can breathe a sigh of relief. Meteorologists are painting an ominous picture for the upcoming hurricane season which begins on June 1. Predictions call for 17 tropical storms and nine hurricanes, with five being Category Three or higher. And at least some forecasters are sounding the alert that the Northeast is overdue for a major hurricane. That's a fearful prospect for anyone who was around to see the effects of the 1938 hurricane which cut a wide swath from Virginia to Massachusetts, leaving more than 300 dead. In terms of economic damage, if translated to today's dollars, the 1938 hurricane would cost about $17 billion.

Precisely because such storms are a rarity in the Northeast, we may be less prepared than those in the southern states. Those of us in the insurance industry — agents and insurers alike — have a special public trust and responsibility to educate our mutual clients to prepare for potential disasters. Nowhere has that been more evident than in the aftermath of Katrina.

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Advising our clients of ways to protect their families, their assets and their businesses can mitigate catastrophic losses of life and property. It is equally important to develop emergency plans for our own businesses so we can continue to serve our clients in the hour of their need following an emergency. Our value to our customers is weighted most heavily at times when they experience major losses. Finally, because the industry-wide impact of disasters is little understood by most consumers, we would do well to educate our clients in advance about potential swings in pricing and availability.

Understanding the Impact

Disasters can have unanticipated economic effects. For a recent example, our traditional understanding of "replacement cost" has been shaken by the emerging phenomenon of "demand surge." In the aftermath of major hurricanes in Florida and Louisiana, one major insurer reported that actual replacement costs increased by upward of 70% over anticipated replacement costs. Demand surge occurs when building material and labor costs rapidly escalate as demand far outstrips supply. Traditional replacement-cost models assume property damage will be sporadic, contained and spread out over large areas. When blockbuster storms like Katrina wipe out entire towns,

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local supplies of materials and labor become overwhelmed, sending the cost of available supply skyrocketing. With this reality in mind, how should an agent counsel clients on the proper amount of building insurance? With insurers increasingly reluctant to offer guaranteed replacement cost protection, insureds could be in for a rude awakening when their insurance falls far short of paying for damages. Even as much as 150% in replacement cost coverage may be woefully inadequate, especially if insured building limits have lagged behind standard replacement cost. The combined effect of demand surge and under insurance creates compounded coverage inadequacy, which could lead many clients to economic and psychological ruin.

Likewise, dire predictions about potential dangers of the 2006 U.S. hurricane season can cause insurers to limit market access, reflecting concerns about whether there will be sufficient capital and resources to adequately respond to the needs of insureds in the aftermath of such events. The mathematics of rapidly shrinking insurer capital following a series of insurance mega-disasters on the heels of 9/11 could severely impact pricing and availability of insurance products for years to come.

Reinsurers have also been hit hard in recent years, having paid out billions of dollars in claims to insurers. Just as primary insurers, reinsurers are also required to maintain reserves. This is causing a reinsurance "big squeeze." Many reinsurers are now in danger of folding because their reserves have been so depleted by one unforeseen disaster after another in the past two years. Fewer reinsurers would lead to less competition, driving up prices and driving down availability. Reinsurers react to dramatic negative shifts in their claims experiences and reserves by increasing the rates they charge insurers for reinsurance. Just like local banks that raise consumer interest rates when the federal government increases the prime rate, insurers increase consumer premiums when their costs of reinsurance rise and when disaster-related claims begin to deplete reserves beyond comfortable and stable levels.

Insurance pricing and availability are determined by predictability. When predictability is shaken, insurers become threatened and often react by raising prices or ceasing to take risk. We are in a period of significant insurer apprehension because traditional methods of predicting the frequency and severity of loss have been challenged by the unprecedented number of serial mega-storms. Proactive consumer education might help prevent a frenzy of knee-jerk price shopping and loss of clients.

As agents, we need to reassure clients that insurance is merely one of several risk management techniques that can help them cope with the uncertainty and anxieties associated with the furies that nature can inflict.

Forewarned is Forearmed

Insurers and agents can collaborate in promoting their services and strengthening their positions by educating and supporting their clients before any disasters occur. Educated and knowledgeable clients are far more likely to remain loyal when their expectations of loss settlements and insured events are based in fact rather than unqualified personal or public opinion.

For those of us in the agency business, this is a good time to communicate with clients to remind them that the upcoming tropical storm season is upon us, an opportune time to take stock of their natural disaster preparedness. Here are some communication points:

- Offer to fully explain what their current insurance covers, what it does not cover and its limitations. Explain demand surge and how it could limit the coverage available to rebuild their homes and businesses. Do they need flood insurance? Do they need to up the coverage limits of their homes or businesses? Should they add any special riders or new coverage? Have they had any life events that would warrant changing beneficiaries or coverage?

- Provide clients with updated contact information for all insurers so that they would readily know who to contact and how to seek assistance in the event of an emergency, including how to file a claim. Include all policy numbers in the information.

- Encourage clients to make an inventory of personal property, including photos and videos for documentation. This inventory and other vital information, along with medical records, wills, passports and financial documents, should be securely stored in waterproof containers or at off-premises secure locations.

- Recommend that all families and businesses have a disaster plan in place. Prepare an evacuation plan. Arrange where family members or business colleagues would meet if an emergency occurred. Identify a distant communication hub if local communications were disrupted or family members and colleagues become dispersed. Normal phone service, including cell, are often non-existent following a natural disaster. Suggest that they double-check the condition of their primary residence, secondary residence, boats and cars to be certain every precaution to prevent damage has been taken. Check cellars, drains, roofs, windows and doors for damage that might lead to flooding.

- Suggest storing batteries, flashlights, a wireless radio, and a few days supply of fresh water and canned goods.

Practice What You Preach

In any disaster, you and your organization will be just as vulnerable as your clients with one difference: you have a service mandate to your clients, and it's precisely when an emergency occurs that your services would be most required. That's why you should be taking many of the above steps yourself to prevent any business disruption:

- Check the adequacy of your

own coverage.

- Inventory your equipment and supplies.

- Build an emergency plan for an alternate place to work should your premises become unusable.

- Back up records and computer files so you could recreate access to records following a disaster.

- Create an emergency plan for servicing clients.

- Identify key business partners and vendors that could provide support.

- Keep a master list of all clients and key vendors in a safe and redundant facility.

The best antidotes for anxiety and uncertainty are knowledge and preparation. As agents, we need to reassure clients that insurance is merely one of several risk management techniques that can help them cope with the uncertainty and anxieties associated with the furies that nature can inflict. As agents, we are our clients' lifeline to stability in the uncertain world of fortuitous loss. Now is the time for all agents to proactively reach out and reeducate our insureds on the proper way to prepare for what many predict is a rocky road ahead. We owe it to our clients. We owe it to our industry. We owe it to ourselves. ■