



**SALVAGING AFTER SANDY:** Water from the storm surge caused by Hurricane Sandy filled the many art galleries in the Chelsea district of Manhattan, causing much damage. Inland marine insurers ended up paying in excess of \$200 million for fine arts losses resulting from the storm.

# The New Normal

Once considered rare, catastrophe losses are now a fact of life for inland marine insurers.

by Joseph S. Harrington

**W**ho ever heard of a fine arts catastrophe?

Improbable as it seems, that's exactly what some inland marine insurers experienced after Hurricane Sandy, which hit the northeastern United States in October 2012.

*Contributor Joseph S. Harrington, CPCU, is director of corporate communications for the American Association of Insurance Services. He can be reached at joeh@aasonline.com*



Within the wide area of Sandy's wrath was a concentration of art galleries in the Chelsea district of Manhattan, which was flooded by storm surge. Museums, art dealers, storage locations and their insurers were hardly unfamiliar with catastrophe planning, but the scope and scale of Sandy overwhelmed conventional risk management and loss control.

As the storm approached, it was often impossible to find someone available to move insured valuables. As Sandy hit, it was often impossible to find higher ground to move them to. As Sandy passed, insureds and insurers faced unprecedented

## Key Points

- ▶ **The Story:** Hurricane Sandy caused more than \$200 million in insured fine arts losses to inland marine writers.
- ▶ **The Background:** Construction projects, equipment dealers and warehouses also claimed heavy losses.
- ▶ **The Next Time:** With cat events increasing, inland marine writers are turning to new tools to identify risks by location and mobility.

“demand surge” for art appraisers and restorers.

Inland marine insurers ended up paying in excess of \$200 million for fine arts losses resulting from

Sandy—an unprecedented sum for a class that typically experienced only targeted, if severe, losses.

Fine arts insurers weren't alone among inland marine carriers in the wake of Sandy.

Insurers of contractors' equipment were stunned to learn that they suffered total losses to insured equipment in secured lots well inland when the equipment was struck by salt water overspray that ruined electrical components.

The wide reach of the storm affected an unusually large number of builders' risk job sites and warehouse operations.

"Sandy resulted in heavy losses for many inland marine insurers," said Kevin O'Brien, president of the Inland Marine Underwriters Association. "Particularly hard hit were those with heavy concentrations of fine art and warehouse exposures in the tri-state coastal areas [of Connecticut, New York and New Jersey]."

"The storm demonstrated that you cannot initiate your loss control plan after the fact or during an event," said Sophia Phillips, senior vice president of inland marine for Endurance.

"During Sandy, there were gallery owners who could not get to their locations to move property. There were equipment owners who could not arrange repair and cleaning as the streets were blocked, and there were other insureds whose power was out after other storm-related damage."

### **New Focus on the Line**

Management of catastrophe losses traditionally has not been a principal concern of inland marine insurers. That's because, in the major classes, inland marine risks tend to be at exposed locations only temporarily (in the case of builders' risk) or transiently (in the case of cargo and mobile equipment). Because inland marine risks did not seem to be at high risks for location hazards, it has been common to provide coverage for flood and earthquake.

"Catastrophe management has

largely eluded the inland marine market," according to Anne Marie Elder, senior vice president and chief underwriting officer of inland marine for XL Insurance. "Part of it is the result of sheer luck. Part of it comes from a belief that inland marine is involved in insuring mobile exposures that are not prone to catastrophes. Unfortunately, the industry learned the hard way that managing cat losses is very much germane to the writing of inland marine insurance."

Added Robert Opitz, vice president and worldwide inland marine manager for the Chubb Group: "The concentration of urban and suburban development makes catastrophes a concern for many of the inland marine classes. Catastrophes can and do affect construction projects, equipment dealers, fine art storage and exhibitions, warehouses and everything in between."

### **Recent catastrophe losses could drive some carriers to shift from providing blanket coverage to writing scheduled location coverage, with geographic underwriting tools playing a role in establishing limits for each location.**

Starting with Hurricane Andrew in 1992, but accelerating with the unusually frequent catastrophes of the past decade, inland marine insurers have learned that conducting business as usual will lead to huge losses on an increasingly regular basis.

Figures from A.M. Best's annual reports on operating results tell the story. Over the decade of the 2000s, A.M. Best reports the inland marine industry loss ratio exceeded 50% in only three years: 2001 (65.5%); 2005 (68.5%); and 2008 (51.3%). (Ratios were reported on a direct premium basis.) Coincidentally, these were the years for the occurrences of the

Sept. 11th attacks, Hurricane Katrina and Hurricane Ike, respectively.

Those loss ratios might still look attractive in comparison to other lines, but inland marine departments now operate under high expectations for profitability at a time of increased competition.

Having seen attractive loss ratios and decreasing expense ratios in the line, several new players entered the inland marine market in the 2000s. Inland marine policies that were once viewed as minor components of commercial packages are increasingly expected to be self-standing sources of profit.

### **Analyzing Exposure**

In the face of these demands, inland marine insurers are exploring how they can use the refined catastrophe modeling and geocoding applications developed for gauging location exposure to flood, earthquake, windstorm, wildfire and other catastrophic perils.

Once innovative, these tools are now essential components of commercial property underwriting. They are certainly valuable to inland marine insurers that write location-specific risks, particularly in the Difference in Conditions class.

DIC policies are commonly used to add flood and earthquake coverage to commercial property packages, and refined information on flood and seismic risks is critical to pricing those policies precisely and competitively.

It's a challenge, however, to adapt those applications for risks that are not tied to locations. "Modeling and predictive analytics certainly have limitations for many inland marine exposures," the IMUA's O'Brien said.

"The current data models are not designed to handle the gradual build-up of values in the case of builders' risk," noted Chubb's Opitz. "Nor are they well-suited for the short term and transient nature of the risks associated with many floater policies, such as fine arts."

Thomas Jeffery, senior principal scientist with CoreLogic, a leading provider of geographic hazard information, summed up the problem: “Property that is mobile or only temporarily at various locations poses a difficult challenge for identifying risk from various hazards.” Citing the specific case of cargo, he said, “It would be nearly impossible to determine how long a vehicle would be exposed to territorial hazards, or to seasonal variations of those hazards.”

### Location Intelligence

Even with those limitations, inland marine professionals find value in granular “location intelligence.”

The XL Group’s Elder said location-specific data analytics are “quite helpful, imperative actually” in underwriting inland marine risks. “Leveraging these tools for risks at static locations is a must-have. Insurers can use them to assist in addressing mobile exposures as well.”

Phillips at Endurance agreed. “It is important for inland marine underwriters to use modeling tools to recognize the potential impact of catastrophes and make sure they are accounting for the exposures in their book management and pricing,” she said. “You can use the tools if you think outside the fixed-location box and develop ways to spread the risk in a fashion that relates to the insured’s operations.”

One way to think outside the box is to adapt the use of geographic data developed for controlling losses in other industries and lines of insurance.

For example, Mark Groenheide, director of marine for Acadia Insurance Co. in Westbrook, Maine, suggested at an industry meeting that contractors’ equipment insurers may promote the deployment of telematics sensors in mobile equipment. With such monitoring, carriers will be able to identify aggregations of insured property before a storm strikes and provide monetary assistance to get equipment moved out of harm’s way, Groenheide said.

CoreLogic’s Jeffery said police and fire departments already deploy advanced use of vehicle and traffic monitors to route emergency responders during disasters. “In the case of cargo transport,” he said, “knowing which areas are most affected by a hazard would allow an insurer to assess its risks more effectively.”

### Mitigation Techniques

Adapting applications developed for other purposes to inland marine underwriting will be a costly, time-consuming proposition for operations that generate a small fraction of premium volume of other commercial lines.

Given that, their principal tools for managing catastrophe exposures will be what they have been all along: policy provisions and schedules which can restrict the amount of exposure, if used regularly and systematically.

Recent catastrophe losses could drive some carriers to shift from providing blanket coverage to writing scheduled location coverage, with geographic underwriting tools playing a role in establishing limits for each location.

Insureds under inland marine policies can also expect demands for stricter adherence to reporting requirements for insured property, to ensure that sufficient premium is collected and loss control imposed as insured values grow.

“There is an increased push to utilize terms and conditions on a policy level,” Elder said, “and to institute the right underwriting and catastrophe management controls on a portfolio level basis. All this entails deductibles, sublimits, exclusions [and] limitations for building in certain areas to reporting requirements. It also extends to field underwriting authority and caps on allowable insurance-to-value or average annual losses.” **BR**

**BUILDING A BARRIER:** Sandbags protect businesses from flooding caused by Hurricane Sandy in Lower Manhattan. The inland marine industry experienced a fine arts catastrophe due to the concentration of art galleries in this area.

