



Proceedings of the National Roundtable on Insurance and Corporate Preparedness

October 19, 2006

DISCUSSION DRAFT

I. Executive Summary

This document presents a summary of the proceedings of the National Roundtable on Insurance and Corporate Preparedness organized by the International Center for Enterprise Preparedness (InterCEP) at New York University. Representatives of a variety of insurance industry stakeholder perspectives participated in a discussion that focused on the following key themes:

- All-hazards preparedness can substantially minimize economic losses to businesses after unplanned events. This mitigation results in lower financial costs to both the corporation and its insurance company.
- Preparedness programs are vital to business continuity and successful recovery since insurance coverage generally only addresses a small fraction of the total economic impact of a crisis (e.g., impacts on future sales, customer retention, reputation, etc.)
- Major insurance companies consider business preparedness in their underwriting processes in determining if they will offer insurance and if so then also in determining policy terms including premium pricing and deductible levels.
- There is initial preliminary support among leading insurance companies and key associations to endorse a general public announcement asserting the vital importance of corporate preparedness and that it is considered in determining whether or not to insure a firm as well as in setting premium price and policy terms such as deductible levels. Appropriate wording and other factors remain to be determined.
- There is also initial preliminary support among leading insurance companies and industry associations to investigate the consideration of a generic self-assessment of corporate preparedness which could be completed by companies and provided to insurance carriers to facilitate consideration of a company's preparedness efforts. Such a self-assessment could be based on the consensus-based preparedness standard NFPA 1600 and other guidance.
- Industry-leading large firms use risk-based capital formulas to guide investment in preparedness strategies that include but go beyond insurance.
- Industry observations are that small- to medium-sized enterprises (SME's) continue generally to lag behind large firms in their preparedness efforts.

- There is a significant need for wider awareness among all businesses (especially SME's) about the value of preparedness for business continuity and recovery as well as potential benefits in insurance.

II. Context

The Organization & Related Activity: InterCEP

The U.S. Department of Homeland Security provided the foundational funding for establishment of the International Center for Enterprise Preparedness (InterCEP) at New York University (NYU). InterCEP is the world's first research and educational center dedicated to private sector preparedness.

This initiative to further advance insurance incentives for corporate preparedness has been funded by the Alfred P. Sloan Foundation. It is founded upon earlier work conducted by InterCEP in collaboration with senior representatives from a diversity of insurance firms, corporations which purchase insurance, key associations, government at all levels and other stakeholders.

InterCEP welcomes readers of this document to provide comments as well as to submit relevant and important reference materials related to this topic. Furthermore, we welcome suggestions of any additional stakeholders that should be included in this discussion as it evolves in the future.

The Topic: Insurance and Corporate Preparedness

In the wake of recent natural and man-made disasters, many businesses are increasingly concerned about operational risks associated with extreme events of all kinds. In this context, growing attention is being focused on the extent to which preparedness activities can mitigate the losses associated with extreme events. These losses are shared by both businesses and their insurers. Many insurance companies are placing increased emphasis on preparedness in the underwriting process. In addition, recent constraints in the availability of insurance have resulted in an increase in insurance costs and have caused many businesses to limit their insurance coverage. With less insurance coverage, these businesses must accept increased exposure to loss. This has served as an additional rationale for businesses to explore preparedness strategies.

Nonetheless, many businesses (especially small and medium sized enterprises) remain poorly prepared for emergencies. While not the largest economic factor, making a clearer connection between corporate preparedness and potential benefits in insurance could motivate greater preparedness efforts on the part of businesses.

Given its ongoing contact and communication with business policyholders, the insurance industry could play a most effective role in both identifying and communicating the value of preparedness for the general business community, especially for firms with significant property/casualty, business interruption and D&O risk exposures.

Optimally, communication of the value or the "why" of preparedness would be coupled with some direction as to "what" to do to prepare an organization. The consensus-based Preparedness Standard (NFPA 1600) provides a high level set of criteria for business preparedness programs and is scalable to any size business. It has been endorsed by the U.S. Department of Homeland Security, the 9-11 Commission and the American National Standards Institute. The standard could serve as a common reference guideline in insurance communications.

While it is generally accepted that businesses practicing all-hazards preparedness in conformance with industry standards such as the Preparedness Standard (NFPA 1600) can mitigate post-catastrophe losses, there is still a need for data to correlate specific preparedness strategies and activities to specific loss reduction outcomes.

The insurance industry is potentially positioned to identify this data in view of its records on the history of losses associated with all kinds of disasters. Such data could then potentially be used to clarify the value of specific preparedness strategies and activities for loss mitigation.

The Roundtable Format & Participants

InterCEP organized and facilitated the National Roundtable on Insurance and Corporate Preparedness as an off-the-record, not-for attribution dialogue without formal presentations in which participants were encouraged to speak openly and candidly about their insights. InterCEP provided all participants with a white paper (“Insurance Incentives for Corporate Preparedness”, Bill Raisch & Matt Statler, available at <http://www.nyu.edu/intercep>). The Center solicited participant comments and feedback in advance of the roundtable event in order to develop a discussion agenda that reflected the issues they considered most relevant. The participants were deliberately selected by InterCEP to represent a variety of insurance industry stakeholder perspectives, including: underwriters, brokers, state insurance commissioners, industry associations, academic researchers, corporate risk managers, and the US Department of Homeland Security.

III. Roundtable Proceedings

At the roundtable event, InterCEP prompted participants to respond to the following general questions:

- 1) To what extent do specific preparedness activities mitigate losses due to extreme events?
- 2) How do specific preparedness activities factor into the underwriting process?
- 3) How could the insurance industry promote preparedness to mitigate loss due to extreme events?

The discussion that took place in response to these questions can be summarized thematically as follows:

- **Insurance industry stakeholders concur that corporate preparedness efforts significantly minimize business losses after emergencies.** There is a considerable amount of evidence indicating that businesses with robust, all-hazards emergency preparedness and business continuity programs tend to fare better during and after extreme events than business lacking such programs. Roundtable participants cited specific examples of firms dealing with extreme events ranging from the terrorist attacks on 9/11 to the blackout in the northeastern US in 2003 to Hurricane Katrina. In all cases, preparedness activities such as those outlined in the National Preparedness Standard (NFPA 1600) had a material and financial impact on business success.
- **Leading insurance companies currently consider preparedness in the decision to offer insurance and in setting premium pricing, deductible levels and other policy terms.** Major insurance companies are already acknowledging business preparedness in their underwriting processes. In certain high risk situations, a preparedness program is a prerequisite to receiving any insurance at all. Where

there is information and evidence of preparedness efforts, underwriters take this into account.

- **However, this consideration of preparedness does not necessarily have a high profile in the underwriting process as it is one of a diversity of factors considered, especially for small and medium sized enterprises.** Preparedness status is one of a wide variety of factors considered in determining policy terms including such other issues as industry, nature of operation being insured, location, etc. Consequently, there are no standardized discounts in recognition of specific preparedness strategies. In addition, according to roundtable participants, the economic realities of policy size allow for more time to be spent on larger policy exposures than on smaller policy exposures. Insurance underwriters typically engage in annual, in-depth conversations with their larger client's corporate risk managers. These conversations may include a comprehensive review of corporation's risk assessments and mitigation strategies for business continuity and emergency preparedness. In most instances where a larger firm has made major improvements to its risk profile, underwriters adjust the policy terms to reflect the lower cost of risk. However, the smaller premium / smaller exposure policies, while substantial in total number, can not economically support the same level of individual attention. Yet, roundtable participants agreed that all else being equal insurance companies are more willing to provide insurance and favorable policy terms to firms that can demonstrate increased levels of preparedness for extreme events. Some proactive insurers have attempted to address this issue by providing self-assessment tools that the client can use to gain a greater understanding of their risk profile and identify possible risk mitigation strategies.
- **To underscore the value of preparedness, insurance industry stakeholders are preliminarily open to consideration of two initiatives:**
 1. **High profile announcement by leading insurance companies of the importance of preparedness.** This announcement would stress the primary value of preparedness to business as well as state that preparedness is considered in the decision to provide insurance, set the premium price and other terms. It would also reference NFPA 1600 as a valuable guideline for preparedness programs.
 2. **Develop a common preparedness self-assessment tool for companies to complete and provide to their insurers during the underwriting process.** Such a self-assessment could be cooperatively developed based upon fundamental, checklist-oriented guidelines reflecting core elements of the Preparedness Standard NFPA 1600. The development process could involve participation by the U.S. Department of Homeland Security, industry associations and other stakeholders.
- **Insurance saving may be a motivator but is minor relative to overall benefits of preparedness.** Participants agreed that risk management through insurance provides one important component of all-hazards preparedness. At the same time, they emphasized the point that with respect to the benefits associated with developing a truly resilient enterprise, savings in the cost of insurance is a relatively minor item when compared to mitigating impact on an organization's people, property and processes – the core of its operations.
- **Industry-leading large firms generally employ a comprehensive risk management strategy in which insurance is a component.** Roundtable participants agreed that industry-leading firms make decisions about preparedness-related investments, including how much insurance to purchase, based on a focus on

operational risk. These firms identify threats, vulnerabilities and business impact. This information informs strategic business decisions about how to manage their risk exposure. For example, a firm with properties subject to hurricane risk can determine what the maximum acceptable loss would be, and then try to mitigate that loss potential by investing in hurricane preparedness efforts (including property improvements as well as supply chain resilience) and/or by purchasing insurance to help manage losses that extend beyond the threshold of acceptability.

- **In general, small- to medium-sized enterprises (SME's) continue to lag behind large firms in their preparedness efforts.** A great deal of the roundtable discussion focused on the differences between large, multinational firms and SME's. One key difference cited was that SME business leaders frequently do not perceive preparedness as a priority, perhaps because they are preoccupied with managing their operations, perceive a low risk of crisis or perhaps because they lack a clear business rationale for preparedness. Participants noted that while basic business interruption insurance is included as a component in most policies, this coverage typically only applies to events that directly impact the firm's operations. However, few SME's purchase contingent business interruption policies to cover events that indirectly impact the firm including events that impact key suppliers or other factors. For example, participants noted that a number of small businesses in lower Manhattan failed after 9/11 not because their operations were directly impacted, but because the pace of the overall economic recovery in the area left them without sufficient customers for too long.

As referenced earlier, participants also noted that insurance industry norms dictate that SME's do not typically engage with their insurers in the kind of in-depth conversation that is typical of larger firms. Consequently preparedness-related information can get lost in the translation from a smaller firm through its intermediaries (i.e., brokers, agents) to the insurance carriers. Conversely, SME's are less likely to receive information from their insurers about the relative benefits of preparedness from the insurance carrier and they less likely to present their preparedness-related activities as inputs to the underwriting process, even when they may have significantly mitigated the loss potential.

- **There is a substantial need for education and awareness, especially among SME's but also among larger firms, about the value of preparedness for business operations.** Roundtable participants all acknowledged that despite the fact that events such as 9/11, the 2003 blackout in the Northeastern U.S. and Hurricane Katrina have heightened, at least temporarily, the perception of risk, nonetheless business preparedness efforts are insufficient, especially among small and medium sized enterprises.. Even among larger firms, there is concern about sufficient preparedness, particularly as globalization has allowed firms to extend their footprint yet at the same time also subjected firms to a wider range of risks. At an organizational level, historically distinct disciplines such as physical security, data security, emergency preparedness, business continuity, and financial risk management are interacting more than before but not necessarily in a strategic and integrated manner. These various dynamics contribute to the situation in which all-hazards preparedness is increasingly critical yet its value is often poorly understood.
- **Greater research on the financial impacts of preparedness could drive increased investment.** Roundtable participants agreed that expanded research efforts are needed to define more specifically the linkage between preparedness and benefit to the corporation. There is a continuing need to move beyond the anecdotal and develop the foundation for more robust ROI analysis to evaluate investments in preparedness.