

★AmWINS RiskReporter

A publication for NAB Members presented by AmWINS Program Underwriters



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Impact of the Japan Earthquake on the Insurance Market

We look at the short-term and potential long-term effects of the disaster in Japan, and how the insurance marketplace is reacting to losses.

The next AmWINS Risk Reporter will focus on contractual risk transfer.

ABOUT THE RISKREPORTER

This publication is a service of AmWINS Program Underwriters and is intended to provide information about general risk management and insurance marketplace issues to NAB members. Your risk depends on your exposure, experience and other factors. Contact your insurance agent for risk management advice.

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MARKET UPDATE

Japan Earthquake Impact on Insurance Market

Given the unprecedented and epically tragic losses following the historic 9.0 earthquake off of Japan's coast, many clients are looking for direction in where the insurance world might be headed given the repercussions from such a large event. Most experts are stating that it is too early to tell, but there will be some fallout with rates in Europe, London and Bermuda firming and capacity decreasing in the short term.

DETERMINING LOSSES Historically, catastrophic losses are difficult to quantify with precision until there are boots on the ground to tabulate the actual damage. Until then, loss estimates remain hypothetical and model-based. The basic calculations assume that X amount of shaking in an area with Y amount of exposure (buildings, commercial activity, population, etc.) will result in Z amount of damage. For the Japan earthquake, the initial numbers from the modeling agencies are split between insured loss (\$15B to \$60B out the gate) and economic losses (\$100B to \$200B+ estimated); however, given the magnitude of the event and the lack of a clear correlation between actual vs. theoretical data, the ultimate number is still difficult to know. Even with actual events to serve as reference points for model results (such as the many major hurricanes hitting North America over the past 20 years), the models continue to miss the mark – sometimes by orders of magnitude. These tools are useful, but only for rough estimates. Another factor that will surely weigh into the ultimate insured loss is that the people of Japan have not bought as much earthquake coverage as one might expect from such an earthquake-prone area.

Other than the far reaching impacts from the earthquake itself, the tsunami damage to life and property was truly unprecedented. While there have been tsunamis of like magnitude, none have hit such a dense, first world economy. Tsunami damage is an aspect of modeling that is, compared to wind and earthquake, not fully evolved. However, the videos and aftermath pictures show destruction miles from the coast. It is obvious that losses might be, in statistical terms, well to the right of any bell-curve.

LINES OF BUSINESS IMPACTED Some of the variables for the sum of the loss in this event are more nuanced. With such a large, first world economy, one that is integrated into the world as much as any other, widespread economic and insurance repercussions are certain. One of the prime areas of concern is Contingent Business Interruption (CBI), where losses to locations in the chain of manufacturing for supply or end use (especially in the high-tech, engineering and auto manufacturing industries) will have significant knock-on effects for businesses relying on production or end use in Japan. One only has to look at past catastrophic events to see how losses have multiplied due to lack of supply. The telecommunications industry is a good example, where lack of supply due to catastrophic loss in the past has led to huge claims. Given the size of the manufacturing base and interconnectivity, the ultimate exposures are tremendous and difficult to quantify. As underwriting restrictions for CBI have been relaxed due to the prolonged soft market, underwriters will have even more exposure.

Other losses from so many interconnected risks will evolve as more information becomes available. Among these risks are life insurance, auto, homeowners, injury claims, marine and cargo where there is direct loss and delay. On top of these is the unprecedented nuclear



damage and liability cost which, while borne predominantly by the government of Japan, will still greatly increase the loss of economic activity that may find its way to the insurance market.

MARKET IMPACT The local Japanese insurers and the government of Japan will bear the brunt of paying losses. While Japan has opened up to outside capital in recent times, it is still dominated by domestic insurance capacity. It is apparent that the direct loss to global insurance carriers (and cat bond underwriters, to a degree) will be impacted more by losses to commercial risks than personal lines where the domestic carriers prevail.

The global insurance market, aside from direct losses payable and reduction in reserves, will be impacted by several other factors:

- There will be spikes in demand for coverage in Japan and elsewhere as a nervous population takes a closer look at their earthquake and flood exposures.
- Pricing pressure worldwide will increase as we enter into the heaviest catastrophe season (U.S. Hurricane Season - see AmWINS' reports on RMS 11.0 wind load changes).
- Many reinsurance programs provide coverage for two or more events, protecting insurance companies from multiple catastrophe events. With one event now triggered and covered following the Japan earthquake, and other covers stressed by the recent New Zealand earthquake, underwriters are now more exposed to future losses and are scrambling in a difficult reinsurance market to recover those limits lost.
- Meanwhile, the global insurance markets are assessing the financial impact to their portfolio of exposures and the reaction of their competitors. This means that, despite some indication of markets taking a stance on rate reductions, the full impact of the rate and capacity changes will take months, which could sow the seeds for a new market cycle. With many of these additional factors all converging towards a market hardening, only time will tell if the potentially large payout will breach a still overcapitalized insurance marketplace or be absorbed.

FORECAST Current rates will show flattening with fewer reductions from North American markets and much noise will be made of an imminent hard market. Hardening will take place in London and Europe for at least a couple of months while the assessment of losses continues. Large global programs, in the short term, might have holes in coverage. California earthquake pricing will flatten out and, depending on the ultimate insured loss to the world's reinsurers, might show increases by 7/1. If the losses are truly significant, 1/1/12 will be the key date for pricing changes. In the worst case scenario, total market impact could rival the 9/11 terrorist attacks.

We will continue to monitor the market and use our worldwide resources to provide ongoing updates and direction to our valued clients.

This report is from the AmWINS DIC/Earthquake Practice Group with primary content provided by practice co-leader Shane Palmer.

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