

White Paper

Insurance: "The Disaster Recovery Plan of Last Resort"

By Tari Schreider

In 1995, global catastrophic disasters cost the insurance industry \$180 billion dollars and that amount is expected to double by the year 2000.¹ Disasters such as the Kobe earthquake, Hurricane Opal, the Oklahoma bombing, and many others contributed to 1995's record losses, three times the previous record setting year of 1994. Businesses are especially hard hit when it comes to disaster; in fact, 70% of insured losses come from the business sector versus the residential sector.

This seemingly disproportionate amount of insured loss is due in great part to the value of the assets and the fact that many residences are not adequately insured. However, insured losses pale in comparison to the economic costs of disaster. According to insurance industry estimates, every dollar of insured loss is accompanied by three dollars of uninsured economic loss, e.g., lost profits, lost business opportunities, etc.

This suggests that companies are only insured for one third of the potential consequences of a disaster and that insurance truly is a *Disaster Recovery Plan of Last Resort*.

Disaster recovery plans protect against the economic and intrinsic loss suffered by a company while insurance policies protect against the physical and tangible losses. If insurance is your company's only recovery strategy, then this article can help you get the most for your insurance dollar.

Mixing Technology Assets

Originally, insurance policies treated computer equipment the same as any real property, e.g. machinery, furniture, etc. However, under property policies, computer equipment is covered for the same perils as the buildings in which they're housed. Unfortunately, computer equipment often suffered from unique perils such as power outages, accidental halon discharges, and damaged electronic data. Subsequently, these loss occurrences were not covered. To compensate for these policy shortcomings, "EDP" insurance policies were introduced. Although these policies did provide coverage for

unique computer risks, they provided no coverage for the consequences of the loss of computer equipment or its inaccessibility. An inherent problem with these types of policies was that the coverage focused on the repair and/or replacement of the computer equipment. What companies needed was a policy that would not only replace the damaged computer equipment, but would also subsidize the cost of alternative processing while the computer equipment was unavailable. Realizing companies were only partially insured for a computer related disaster, insurance companies underwrote specialized policy riders for "Business Interruption" and "Out-Of-Pocket Expenses." These two important riders form the foundation of an insurance policy which provides adequate subsidies to finance the recovery and restoration efforts following a disaster. Understanding the type of insurance policy that your company has is as important as having an insurance policy itself. Many companies have been left financially devastated after learning their insurance policy was woefully inadequate to meet the needs of their company's recovery and restoration costs. You should thoroughly review your policy and understand what is and what is not covered.

How Does Your Policy Rate?

Rating the adequacy of your insurance policy in advance of a disaster will eliminate many unpleasant surprises when it comes time to place a claim. Answer the following questions to determine how your policy rates:

Is the information technology infrastructure covered by a separate policy?

Does a detailed itemization of corporate assets exist?

Does the policy pay for the restoration of electronic data?

Are clearly defined loss claim procedures documented?

Are operations which are performed at an outsourcing facility covered?

Does the policy have a "utility service interruption" grace period?

Disasters Causing Significant Insured Losses

DISASTEREVENT:	DATE:	LOCATION:	INSUREDLOSS:
Hurricane Andrew	August, 1992	Fla. Gulf Coast	\$24 Billion
Earthquake	January, 1994	Los Angeles, CA	\$20 Billion
Floods	April, 1992	Midwest	\$12 Billion
Earthquake	October, 1989	San Francisco	\$5.9 Billion
Hurricane Hugo	September, 1989	Carolinas	\$4.4 Billion
Riots	May, 1992	Los Angeles, CA	\$2.0 Billion
Blizzard	March, 1993	24 States	\$1.8 Billion
Wild Fires	October, 1991	Oakland, CA	\$1.7 Billion
Hurricane Iniki	September, 1992	Hawaiian Islands	\$1.6 Billion
Flood	April, 1992	Chicago, IL	\$1.2 Billion
Hurricane Bob	August, 1991	Northeast	\$1.0 Billion
11 Disaster Events			\$75.6 Billion

Does your insurance carrier have “pair & set” salvage rights over your company?

Does your policy cover all out-of-pocket recovery costs?

Is the process of determining the cost of business interruption identified?

Does the policy exclude priority of payments of legal costs from coverage amounts?

If you answered **NO** to two or more of these questions, then your insurance policy is in need of an adequacy review. Begin by sitting down with your company’s risk manager to determine what your company’s insurance needs are. Then meet with your insurance carrier’s loss prevention representative to review your current policy. An independent policy analysis is highly recommended before you make any final policy changes.

Types Of Insurance Available

There are several types of insurance policies which can be acquired to protect a company. The most common type of insurance package available today is a package composed of Common Policy Declarations and Conditions consolidated with one or more Coverage Parts. Coverage Parts would include Commercial Property, Liability, Crime, etc. Commercial Property Coverage accounts for the majority of the coverage. The following areas need to be addressed in order for a complete policy to be in place:

- Property
- Contents / Stock
- EDP Equipment
- Extra Expense (out-of-pocket)
- Business Interruption
- Boiler & Machine
- Payroll Coverage

The Declarations Page for each of these areas should be reviewed carefully to determine which premises and assets are insured, the limit of the coverage provided, covered causes, exclusions,

deductibles, and other specifics.

There are three basic forms of covered loss policies:

Basic - Covers specific named perils including fire, lighting, wind-storm, etc.

Broad - Covers additional perils such as roof collapse, volcanic action, etc.

Special All Risk - Covers everything except specific exclusions named in the policy.

Ensure that you have a policy commensurate with the most common types of risks to which your company is exposed.

Developing An Effective Insurance Response Plan

The following is a ten-step process for implementing an effective insurance recovery program. Remember, however, that this does not alter or eliminate the need for a comprehensive disaster recovery plan, but rather complements existing contingency planning efforts.

Determine Accurate Corporate Asset Values. There are two primary methods to accomplish this. One is based on actual cash value and the other is based on replacement value. Cash value accounts for the replacement value of the asset minus the time depreciation of the asset. Replacement value (recommended) is based on the amount it would cost to replace the asset.

Estimate Recovery Expenses. Conduct several “what if” scenarios to determine the level of insurance required to cover “out-of-pocket” expenses related to the recovery of the information technology and corporate assets. This would include hot site declaration and daily usage fees, overtime, travel, etc.

Determine Business Income Coverage Amount. If after conducting a Business Impact Assessment (“BIA”) it is determined that your company would not have the cash reserves to meet forecasted operating expense needs, business income insurance may be prudent. This type of insurance is rather expensive, so run your financial models carefully.

Determine Coinsurance Amount. Once an accurate assessment has been made of the amount of insurance to carry, a decision on the amount of coinsurance must be made. Coinsurance is the insurance to value ratio and represents the percentage of recovery subsidy to which your company would be entitled. The industry standard is 80%. Coinsurance is a strategy designed to lower policy premiums.

Request Premium Reduction Review. Many insurance companies provide a discount to companies that have a formalized loss prevention program in place. This reduction can be worth up to 20% or more depending on the level of sophistication of your disaster recovery program.

Properly Insure Electronic Data. One of the most common insurance mistakes made by companies is valuing commercial software for its face value. The definition of media coverage is to pay for the cost of replacement and/or reproduction only. Commercial software is easily replaced for a nominal fee from the software vendor.

Review Policy Exclusions. Many companies have made insurance claims only to find that their policy specifically excludes coverage for their most common risks. Policy exclusions can be altered with a rider; however, you have to understand what's excluded first. Look for the fine print regarding utility failures, media restoration, earthquake, and other exclusions. Additionally, review exclusions for computer equipment used during travel or at employee's homes; many policies specifically exclude equipment at locations not listed on the policy.

Verify Over Insurance Amount. Today many hardware manufacturers (machinery, computers, etc.) provide recovery and restoration insurance built in to their lease agreements. It is not uncommon to find that a company can be doubly insured on their hardware platforms. Additionally, the insurance provided by the hardware manufacturer may be more robust and should be considered as the primary carrier.

Put The Policy Out For Competitive Bid. Currently there are over 50 major companies which specialize in underwriting IT and business recovery policies. Placing your company's insurance needs out for competitive bid could save you as much as 40% off the premium amount.

Develop An Insurance Response Plan. The best precaution against an insurer taking advantage of the insured is a well documented response plan. Simply following the procedures set forth by the insurance carrier could allow them to adjust the claim as necessary, and once agreed to, would automatically waive your company's rights to dispute the claim.

There is no substitute for having a well documented Insurance Response Plan. In the event that a disaster strikes your company, this will be one of the most vital documents you can ever have. It identifies the insurance company's as well as your own company's

roles and responsibility following a disaster event.

Tips For Placing A Loss Claim

If your company finds itself in the position of placing a loss claim to subsidize and/or reimburse for damages incurred as a result of a disaster, the following tips can save you time, money, and grief:

Hire a Reputable Claims Adjuster. They have the experience to deal with insurance company claims adjusters and in many cases can increase your loss settlement substantially.

Document The Loss. Insurance companies require extensive documentation of the loss prior to releasing any settlement claims. It is not unusual for a final settlement check to be sent years later. Proper documentation will speed up this process.

Arrange For Special Loss-Payable Clause. Frequently, insurance policies cover several interests under one policy. Placing a claim under those circumstances and issuing a settlement check could require as many as 10 or more endorsements

in order to negotiate a claim. Arrange a power of attorney or waiver from those parties in order to simplify this process.

Reduce The Loss. Insurance companies will pay for the physical damage to the described property for the peril insured against. However, if additional damage occurs after the event and your company was in a position to reduce that loss, they may not pay for the subsequential damage.

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Summary

The average company spends approximately \$3.00 to insure every \$1,000 of corporate assets, and this cost continues to increase. Insurance companies have become a significant driving force in the development of disaster recovery plans by tying policy renewals and premium amounts to the level of disaster preparedness a company has.

These reasons are compelling arguments for developing and maintaining a comprehensive Insurance Response Plan. However, companies must remember that insurance coverage is no substitute for a well thought out disaster recovery plan.

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