INSURANCE ARCHAEOLOGY GROUP

Protecting the Future Against The Past: Disaster Planning to Preserve Historic Insurance Coverage

By Sheila Mulrennan

Risk managers know that theirs is a fundamentally counterintuitive art. That is, they know that commonplace, low-profile risks (driving in a snowstorm) are often more of a threat than high-profile risks that have most people's attention riveted (flying, since Sept. 11). Yet even savvy risk managers, rightly focused on disaster recovery in the wake of the terrorist attack on the World Trade Center, may not recognize that their efforts need to focus on more than ensuring that current operations can continue as smoothly as possible following an attack or disaster.

Often, the greater threat to a company's long-term financial health is not short-term operational disruption, but loss of long-term institutional memory - specifically, the loss of insurance records documenting decades of coverage distributed among dozens or even hundreds of policies. Insurance records are more vulnerable to permanent loss in a disaster than virtually any other institutional files, for several reasons:

- Insurance documentation still relies mainly on hard copy. While more recent policy history may turn up at least indirectly in electronic files, insurance recovery still usually requires that the insured furnish a copy of the original policy document.

- Insurance records remain relevant longer. As many companies have learned to their cost over the past thirty years, there is no statute of limitation on liability. Fortunately, there is also no expiration date on most forms of commercial liability insurance, if the alleged damage occurred within the policy period. Thus, in the event of physical destruction of buildings containing key documents, companies literally have more to lose in their insurance files than anywhere else, since decades worth of records are still valuable. And the older the lost policies are, the less likely they are to show up in any electronic record.

- While policies can frequently be reconstructed through secondary sources, it can be difficult and costly. In many cases, courts have accepted secondary evidence of policies for which the original documentation is lost. While such evidence can ultimately be effective in securing coverage, the cost of conducting research years after the policy expiration date or in the event of a disaster should be a significant consideration in planning to preserve insurance assets.

The Long Arm of Past Liability

When risk managers and disaster recovery planners do think about insurance in the context of terrorist attacks and other sudden catastrophic events, they are likely to think mainly about buying adequate coverage and effectively filing claims to recover from their immediate losses. While these concerns are valid, the counterintuitive likelihood is that exposure to liability for past occurrences will endanger far more companies' financial health than damage stemming from terrorist attacks. And if a company is in fact damaged by disaster, the long-term effects of liability exposure resulting from a hole being blown in the company's historic insurance records may prove even more devastating than the immediate loss.

Liability threats on multiple fronts have been proliferating for decades and show no sign of abating. The cost of civil liability as a percent of GDP has climbed from 0.6% in 1950 to 1.4% in 1970 to 2.6% by 1995, according to a study by Tillinghast-Towers Perrin -- and has doubtless climbed further in the years following. Here is a brief sampling of the multiple liability traps threatening organizations of all kinds at the current moment:

Asbestos Unabated: The asbestos liability tsunami, which has driven more than 50 companies bankrupt, has not yet crested. The effects of asbestos exposure will not be fully manifested until 2049. While some 500,000 people have filed asbestos damage claims against thousands of companies, experts believe as many as 2 million more claims will be filed. The eventual cost to companies is estimated at $275 billion. A recent California court decision asserting that insurance companies are liable now for estimated future as well as current claims against their policyholders highlights the critical importance of historic insurance coverage to many companies threatened by multiple asbestos claims.

CCA Emergent: Alleged danger to consumers arising from arsenic routinely injected into pressure-treated wood may prove to be 'the next asbestos.' Virtually all pressure-treated wood is preserved with a pesticide called chromated copper arsenate, or CCA, which has been used since the 1940s. Tests show that CCA-treated wood leaks arsenic, which can cause cancer and

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other health problems. After a period of defensiveness, the $4-billion-a-year treated-wood industry has started edging away from CCA, and lawsuits are beginning. Last March, a class action suit filed in Miami named CCA manufacturers, treaters, Lowe's and Home Depot. Given the ubiquity of pressure-treated wood in decks, playgrounds, and a host of other external wood structures, a huge liability net may be looming for manufacturers, lumber dealers, treaters, contractors and property owners.

Mold Uncontrolled: Mold liability claims are proliferating nationwide, according to a new report from New York-based Guy Carpenter & Co., recently summarized in *Risk and Insurance.* According to the report, approximately 9,000 mold and mildew claims have been filed in the United States and Canada in the past 10 years. Noteworthy settlements include a $32 million award in Texas and an $ 18.5 million settlement in California. Claims are not limited to property owners: a New York employee is seeking $ 65 million.

It's All Paid For:
The Value of Old Insurance Policies

The primary defense against these potential threats is comprised by a company's pre-paid historic insurance assets. As a rule, the older a policy is, the less restrictive and more valuable it's likely to be. CGL policies issued before 1970 are particularly valuable because they generally contain no pollution exclusions, no aggregate limits for environmental claims, and unlimited defense cost coverage. Policies from the 1970s, which contain a so-called "sudden and accidental" pollution exclusion, are easier to apply to Superfund liabilities than policies purchased after 1985, which contain a less ambiguous "absolute pollution exclusion."

In the event of disaster, the struggle to recover damages directly related to the event are just the tip of the iceberg. The complete challenge, given the high risks posed by retroactive liabilities and the high value of old insurance policies that cover those liabilities, is to maintain access to the full range of a company's historic insurance coverage.

Step One: Preserving Current Records

The first step for disaster planners seeking to preserve insurance coverage is to organize and properly store existing records, those that readily come to hand. In order to preserve current records, disaster planners should:

- image all policies and store discs off site, preferably in more than one location
- maintain basic coverage details for all commercial policies in a database which can be hosted on the Internet for immediate access in the event of a natural disaster or catastrophic loss
- in addition to policy terms, include in the database any information necessary to report claims, such as, names of contacts and addresses for the brokers, insurers, consultants, as well as any claims handling facilities

Digging Deeper: The Historic Insurance Audit

Most organizations that take these steps will find that existing records are incomplete, and that their task entails first filling gaps in the coverage record and then organizing the entire complex history.

The older a policy is, the less likely it is that its documentation will be readily accessible. The accelerating corporate downsizing and merger and acquisition activity in the 1980s and 1990s, coupled with the relocation of many corporate headquarters from the Northeast to the Sunbelt, displaced both people and records and shortened institutional memory.

Locating documentation of past policies generally involves mining the internal and external sources described above. Reconstructing decades-old policies and programs of predecessor companies requires even more complex digging.

To begin an historical insurance audit, companies will have to address the following questions:

- How many times has the company changed hands?
- How many new companies have been acquired in the last two decades or two years?
- How many times has the company relocated or caused newly acquired subsidiaries to relocate in whole or in part?

Companies also need to evaluate the liability threats that they may face, including the retroactive liability of acquisitions and predecessors. A long list of actual or potential liabilities may include claims involving asbestos or environmental cleanup or for events that occurred decades ago.

Internal Records

A search for historic policies begins with an examination of computerized indices of records in storage and a review of record retention information maintained on a departmental level, which could potentially provide more in depth information. The search would also include departments where records might document missing or incomplete policies, for example, risk management, accounting, and safety. Records of other departments such as legal, contracts, real estate, and corporate secretary may also provide leads to possible outside sources of information.

Former Employees

In this era of short term institutional memory, it is imperative to track down former employees to discuss their recollections of former domestic and London brokers, additional insureds, certificate holders, claims adjustors, and outside counsel, as well as details of major claims or litigation.

External Sources

If needed information is not available in company records, then publicly available outside sources need to be explored. They could include old Moody's reports, SEC filings, or web sites on the history of certain industries. The information gathered from these areas could help to identify crucial sources of more detailed information such as former owners, outside counsel, major contracts, customers and names of former employees. A thorough review of outside sources would include the following:

- All insurance brokers, including surplus lines and UK brokers, to report claims and to request copies of policies and other secondary evidence of coverage as far back as possible.
- Past insurers, once they have been identified through preliminary research.
- Additional insureds and companies that required evidence of insurance such as government entities, leasing companies and other financial institutions.
- Professional firms, such as, outside counsel, auditors, consultants and claims adjustors.

Special Challenges

A challenge facing companies that attempt to track down their former brokers is the difficulty in identifying the current corporate successor. This can be a research project in itself, particularly with small-to-medium-sized domestic brokers and their correspondents in London. Insurance libraries, state insurance departments, insurance archaeology consultants and old timers at existing brokerage firms may be able to help to identify the current entity that may have retained records.

A commonplace practice among retail insurance brokers is the use of specialty brokers to place excess coverage in the surplus lines market. Since these firms (or their successors) may be a source of records, they should be contacted. Former employees of these firms may be able to identify their London correspondent if excess coverage was placed with Lloyd's. Traditionally, the London brokers have been among the best sources for U.S. policyholders to find documentation of missing policies.

Reconstructing the pre-acquisition coverage for predecessor companies can pose the most difficult challenges because all of the records may have been lost when the operations were spun off or discontinued. It is not uncommon for the closing documents to have disappeared along with operational records. If this is the case, the search can begin by exploring outside sources. Identifying those external records is one of the most crucial steps in an historic insurance audit.

In Conclusion

We began this article with the counterintuitive claim that liability for past events comprises a greater risk to most companies' financial health than does exposure to future terrorist attacks or other disasters. Paradoxically, the threat from the past reinforces the need for disaster planning -- because the worst effect of a future disaster could be the destruction of protections against the past. Like the family gods of old, an organization's old insurance policies safeguard its continued prosperity in a dangerous world. The wise disaster planner will safeguard those precious relics –which, like the household gods, embody a protective power that never expires.