

# Buyers Look To Close Property Gaps

Hard to pinpoint, prove or quantify collateral exposures covered by 'transurance'

BY BRUCE B. THOMAS AND WARE PRESTON

**D**ESPITE THEIR BEST EFFORTS, organizations still face many uninsurable costs when a covered property loss strikes. Many expenses are too difficult to describe or quantify to include in a traditional insurance policy. Other costs are not provable or are deemed too discretionary to be covered by traditional insurance.

These "collateral damages" typically range from 15-to-40 percent of insurance recoveries, and they have been increasing as companies become more operationally and financially leveraged. Property "transurance" is a new type of property coverage that provides companies with funds that can be used to pay for these costs—as they see fit and without qualification—in

a simple and cost-effective way.

Buyers specify an amount of money they would like to receive in addition to their property insurance recovery. This amount is specified in terms of a percentage of the loss paid by their property insurance policy.

For example, an insured that buys 20 percent transurance coverage will receive 20 percent more than the amount it receives from its insurance policy to pay for the anticipated collateral damages.

The premiums charged for property transurance are typically the same percentage multiplied by the buyer's insurance premium. Thus, in the previous example, the company would pay 20 percent more in premiums to buy 20 percent transurance coverage.

Transurance provides coverage for a new class of risk on the same economic basis as traditional property insurance, but without all the hassle and limitations, since the underwriting and loss adjustment processes are largely administrative.

## DO THE MATH

### WHAT ARE THE COVERAGE OPTIONS?

ABC's Property Insurance Program  
(\$ Thousands)

#### ► Property Insurance Policy

Insurance Deductible	\$50
Insurance Premium	\$400
Loss Pain Threshold	\$1,000
Business Continuity Threshold	\$5,000
Lower Of MFL Or Insurance Limit	\$100,000

#### ► Collateral Damage Estimates

Claim Settlement Shortfall As % Of Insurance Recovery	10%
Business Continuity Expenses As % Of The Insurable Event	10%

#### ► Proposed Transurance Policy #1

Transurance %	20%
Transurance Deductible	None
Transurance Premium	\$80

#### ► Proposed Transurance Policy #2

Transurance %	20%
Transurance Deductible	\$1,000
Transurance Premium	\$48

► **ALTHOUGH TRANSURANCE POLICY NUMBER TWO** costs 40 percent less, policy number one does not carry any deductible, so coverage kicks in quicker.

No proof of collateral damages is required, because transurance claims are automatically paid as a percentage of losses paid by the referenced insurance policy.

The value of transurance is obvious to risk managers who know they will have significant collateral damages if they have a property loss. Not buying transurance, now that it is available, would be the equivalent of taking a quota-share retention, which is not typically recommended.

Transurance also offers risk managers an opportunity to reassess and restructure

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their current property insurance programs to better suit their companies' needs.

Risk managers often set policy limits (for layered programs) by considering worst-case loss scenarios. They set deductibles by thinking about their company's "pain threshold." Below this threshold, the company is able to manage losses without having any insurance. Above this amount, the company will find it increasingly difficult to finance the costs of an insurable event.

Using this same thought process, risk managers can now consider the impact of collateral damages on their company as a way to help them structure their transurance coverage.

#### Consider the following example:

ABC Inc., a manufacturer, pays \$400,000 for a policy with a deductible of \$50,000. The company has multiple locations, and although it has a blanket limit of \$200 million, the company's maximum foreseeable loss is \$100 million, which would involve the destruction of its main plant. The upper bound of ABC's pain threshold is \$1 million.

Because of her experience with large property losses and collateral damages at her previous employer, Sue Brown, ABC's risk manager, is interested in transurance.

Although ABC has the most comprehensive coverage available, Sue recognizes that a portion of any sizable claim that ABC may have is likely to be disputed—particularly as it relates to business interruption and extra expense coverages.

Despite her best efforts, she knows that ABC is likely to receive 10-to-20 percent less than the amount it submits in its proof of loss. Based on her knowledge of the company, she also is concerned that ABC would experience business continuity costs of 10-to-20 percent of any insured loss events in excess of \$5 million.

At this point, manufacturing operations would be significantly impaired, management would be distracted, revenues would be lost and many additional expenses incurred as the company attempted to recover from the loss.

Although Sue believes that ABC's risk management practices are sound, the com-

► *continued on page 30*

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