Bring Your Insurance Policy to the Tailor, So Your Insurance Company Doesn't Take You to the Cleaners

By Marshall Gilinsky and Rich Clark

In this article, the authors discuss using "manuscripted" forms for terrorism coverage that are tailored to policyholders' needs.

For decades, insurance companies have sold insurance using "manuscripted" policy forms that they claim are specially tailored to their policyholders' needs. But are your "bespoke" insurance policies truly as well-tailored as they could be?

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For example, the business interruption insurance provided under most standard property policies is triggered by direct physical loss or damage – either to the policyholder's own property or to another's property that impacts that policyholder's business income. But there are many significant risks of business interruption losses that could occur without any clear-cut "direct physical loss or damage," which is why many savvy policyholders, consultants and insurance brokers seek out manuscripted wording to unambiguously address and cover such risks.

Take, for example, a recent report in *The New York Times* noting that many computer hacking incidents directed at U.S. companies appear to have emanated from the vicinity of a building in Beijing that is thought to be associated with state-sponsored computer hackers. If your company suffered a cyber-loss that is traced to China, would it be covered under your property, liability or cyber insurance policies? If the insurance company tried to deny your claim under a war or terrorism exclusion because the hack appeared to have originated from an area suspected of links to the Chinese intelligence service, would your policy include terms that would help you fight back? What if it was not your computer system or data that were hacked, but rather public infrastructure like the power grid, transportation or Internet networks? Such events could lead to widespread business interruption losses in all sorts of industries – but do they involve "direct physical loss or damage" or otherwise trigger coverage under your existing insurance policy?

Changes to Policy Forms

News events and concerns like this are causing many policyholders to rethink and improve their "bespoke" insurance policy forms, in order to be better prepared in case disaster strikes. All too often, insurance companies faced with very large claims tend to adopt strained interpretations of existing policy terms in an attempt to avoid or reduce their obligations to pay such claims in full. Enhanced policy wordings are one way to reduce the chance of that happening you your company. In one example, an insured's property insurance policy had a complicated valuation provision in which the coverage provided was defined to be "the lesser of" X, Y, or Z, given the circumstance of the loss. Upon renewal, the policyholder asked its broker: "Why can't the minimum payout always be X?" Good question. The broker changed the wording to say that losses are valued simply as X and the underwriter accepted the change. When a claim arose, the insurance company's claims handler instinctively began asking questions about Y and Z, but the language in the policy avoided having to answer those questions, and the insured was paid X.

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Changes to policy wording are most likely to be accepted during soft markets like the one that has existed over the past several years. Although in theory, underwriters price policies based on the specific risks being transferred via the actual policy, in practice, due to competition from other insurance companies, lack of effort or both, it is usually the case that requested changes to policy wording do not result in corresponding changes to premium. Essentially, the underwriter agrees to "throw in" the broadened coverage in order to keep the policyholder's business. And here is the best part. One might expect that coverage added for free in a soft market either gets taken out or increases the premium when markets eventually harden. But because underwriters do not always read every word of every policy that comes up for renewal, improvements added during soft markets often remain in policies for years even after markets firm up.

Manuscripted Terrorism Insurance Policies

An excellent example of an emerging risk for which a manuscript form may be called for is terrorism coverage. Most everyone buys it but what are they really buying? When does coverage apply and what is the trigger? Should the policyholder purchase certified coverage, non-certified coverage or both? Do the policyholder and insurance company even have a shared understanding of what those terms mean? Many policyholders use different insurance companies for property, liability, and umbrella insurance, so what would really happen if a catastrophic event occurred (e.g., a terrorist hack that disrupted the power grid, Internet service, and transportation) that triggered coverage under a variety of those insurance products? Probably chaos and gridlock, with everyone pointing fingers at everyone else for delays in certifying coverage, while the policyholder waits and gets increasingly frustrated until it is forced to begin litigation to obtain the coverage it purchased.

When insuring against terrorist attacks or other violent acts with the potential for widespread travel disruptions, policyholders and brokers alike should ask: What would happen if there was a hacking incident at the airports, airlines, or air traffic control system? What would happen if a hacker shut down part of the power grid or water system? Certainly, there would be massive and widespread disruptions to travel and retail, and most everything else in the economy. The prospect of such disruption raises issues that should be a focus of manuscript coverage, including:

- Coverage Trigger – Develop a policy wording that uses "malicious damage" as a trigger of coverage, which would prevent the insurance company from avoiding coverage in the event that the U.S. government either did or did not certify a situation as a terrorist event.
- Scope of Coverage – Any obvious and direct terrorist attack on a facility would be covered, with contingent cyber risk insurance added that covers hacking incidents at remote facilities that impact revenues at the policyholders' business. The policy would also provide general liability and business interruption insurance, subject to relatively few exclusions, but subject to a sublimit for nuclear and biochemical attacks.

Policyholders ought to be prepared for a catastrophic attack scenario, which unfortunately is likely to strike the U.S. in some form or another before too long. Although the standard insurance products available in the marketplace do provide coverage for a wide variety of losses that would result from such an attack, manuscripted insurance policies can provide the greatest certainty for policyholders in the aftermath of such a loss event, and give those policyholders a leg up in maintaining and rebuilding their businesses following the loss.