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DECODING NUCLEAR SEVERITY: IMPLICATIONS FOR INSURANCE PROGRAMS

If you Google "nuclear severity," information about the severity of nuclear events (as in power plants and bombs) will be listed. There will not be a reference to underwriting or insurance, but perhaps there should be.

Frequency and Severity analysis is a foundational tool for evaluating the risk of loss and estimating associated costs (the basis of insurance premium calculation). How frequently is a claim expected to happen, and what will the severity of the associated losses likely be? Good questions, but the answers presume a certain amount of predictability. Severity of a nuclear magnitude is not routinely predicted, nor are its costs easily estimated.

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A nuclear verdict is an excessively large jury award for damages and is often defined as being in excess of ten million dollars. We have seen the hundred-million-dollar mark surpassed for individual plaintiffs (one injured person) in many types of cases, most commonly from automobile accidents or allegations of medical malpractice. These eye-popping jury awards are at best unreasonable and, more likely, simply irrational. It was once believed that nuclear verdicts were only likely to occur in certain "bad" jurisdictions (often in and around large urban areas), but the trend has spread to jurisdictions previously thought to be "safe." The impact has been a significant increase in the cost of excess liability insurance.

We are also seeing dramatic increases in the cost of property insurance. The culprit here is extremely high losses from natural disasters. Premiums have spiked overall and coverage limitations have been initiated not only for hurricanes, but also for forest fires, hail, and floods. In the case of flooding, this includes areas that were predicted to be hit once every century but are now experiencing such events nearly every year. Unreasonable and irrational are not appropriate terms to apply in describing these losses—after all, they reflect actual damage to property, not a jury's opinion about the value of an injury—but the word "nuclear" still seems appropriate. Similar to jury awards, the severity of natural disasters has also become nuclear.

A world with nuclear severity requires a change in how insurance programs are designed. Benchmarking, which involves old data and historical metrics, is a questionable method. Is the fact that one's peer companies purchase fifty million dollars of coverage instructive if there have been multiple nuclear verdicts in excess of that amount? Additionally, the predictability assumptions underlying actuarial work are less valuable, as they too rely on historic claims data and loss projections.

A better approach is to perform a volatility analysis of your insurance program. This involves reevaluating the total limits purchased, taking into account the most recent nuclear verdicts. It also entails testing the assumptions made in the actuarial funding analysis of any self-insurance layers.

If you are interested in learning more about how to perform a volatility analysis of your insurance program, contact your dedicated broker at CAC Specialty.

More information on volatility analysis can also be found in the upcoming episode of our new podcast "What's in your Captive?", hosted by Kevin Carnell, Executive Chairman of Healthcare at CAC Specialty.