TAKING STOCK

RISK MANAGEMENT INSIGHTS FOR THE RETAIL/WHOLESALE INDUSTRY

UNDERSTANDING THE VALUES AT RISK BEFORE THE STORM

Natural catastrophes are unlike most other risks facing retail and food service organizations. Disasters such as floods, hurricanes, and earthquakes are difficult to predict and impossible to prevent. Stores and restaurants can experience significant property damage losses, since many are large, standalone facilities that are directly exposed to the forces of nature. Understanding the values at risk from natural catastrophes and properly documenting losses can be critical to the protection of finances and operations in the wake of a storm.

LIMITED LOSSES, FAVORABLE TERMS

Several recent storms and floods, including the catastrophic tornadoes and flooding that struck Texas and Oklahoma in May 2015, significantly impacted retailers and restaurants, damaging or destroying facilities, distribution centers, and stores. Damage stemming from the destruction of property, goods, inventory, and vehicles — as well as disruptions to employees or their families — can significantly interrupt and/or suspend a company's operations.

DATA QUALITY

Catastrophe (CAT) models have become key components of property insurance underwriting. Today, they are an important factor in a retail/wholesale company's ability to obtain cost- and risk-effective coverage.

If data entered into a CAT model is incomplete or inaccurate, companies may end up with higher loss estimates, which can translate to increased premiums and less capacity for an individual risk. Conversely, better data can result in significant premium savings.

By thoroughly reviewing and improving the quality of their CAT data, organizations may better quantify and qualify the risk being considered by underwriters. That, in turn, can:

- Reduce loss estimates resulting from inaccuracies in the original data.
- Increase model accuracy.
- Decrease model uncertainty.

Insurance and coverage terms have been generally favorable for retail and food service organizations, due in part to overall limited major catastrophe losses in recent years. Barring unforeseen events, this trend is expected to continue. Companies should expect underwriters to focus on direct and contingent business interruption values assessments and better analyses of catastrophe exposures (see SIDEBAR).

BEFORE THE STORM: ANALYZE RISKS

All businesses impacted by a major storm can experience significant interruptions to their operations. For restaurants — as well as for retailers whose inventory includes food or other perishables — such service interruptions can cause spoilage. This potential issue can be addressed by investing in specific

loss control measures. Backup generators, for example, can provide power during outages, reducing or eliminating spoilage. Generators can often be strategically placed in advance of a major storm, then easily moved to locations impacted by a loss.

It may not be possible, however, to prevent all such losses. These interruptions can affect financial returns and business interruption (BI) insurance coverage limits during the adjustment process — often resulting in complex and protracted insurance claims.

By thoroughly analyzing and understanding their income exposures before a loss, companies can determine:

- The amount of coverage they need.
- Risk retention and transfer options, including captive solutions.
- Appropriate limits — without over-buying.

Typical property insurance policies may have multiple valuations that determine the claim payment amount, with discreet valuations for inventory/stock, building, equipment, and technology. Before placing coverage, retail and food service companies should discuss their policies' property damage valuation clauses with their insurance advisor.

INVENTORY VALUATION IS CRITICAL

Inventory valuation is a critical pre-storm activity for retailers and restaurants. There are various approaches for inventory valuation, which can potentially:

- Reduce probable maximum losses (PMLs) at distribution locations.
- Lower deductibles for CAT exposures.
- Expedite claims payments.

In addition, companies should consider a pre-loss anticipated maximum business interruption loss (AMBIL) study, which can help assess the potential financial impact and necessary valuation methodologies at the time of loss.

STOCK THROUGHPUT INSURANCE

Stock throughput (STP) policies are especially beneficial for organizations with significant catastrophe exposures. STP can:

- Reduce dollar deductibles, versus percentage CAT deductibles.
- Expedite claims resolution, based on the selling price of inventory.
- Reduce PML estimates for both all other perils (AOP) and CAT perils.
- Provide separate limits applicable to flood, earth movement, and named windstorm.

AFTER THE STORM: DOCUMENT LOSSES

A post-loss strategy can help to better manage and expedite claims after storm damage. Properly documenting losses after a catastrophe is essential to insurance claims processing and recovery. Immediately after an event, companies should:

1. **Chronicle damages.** A major storm frequently damages buildings, furniture, fixtures, inventory, technology, data and media, technological infrastructure, and equipment. And, if business operations are interrupted, companies can experience income loss, higher expenses ("extra expense"), or both.

In documenting these losses, it is important to have immediate access to financial records such as:

- Fixed asset register and depreciation records.
- Most recent physical inventory.
- Purchase orders or estimates of all contracts for repair or replacement of damaged assets.
- Profit-and-loss statements for two years prior to the event for all affected locations.
- Budgets and forecasts prepared before the loss to indicate anticipated loss results.

2. **Document conversations.** If you've had verbal conversations with customers or suppliers, for example, the content of those discussions may be material to claim measurement. So it is essential to document them. Likewise, as time passes, memories fade and people change jobs — two more reasons to gather and record every piece of information or recollection of events as soon as practicable.

3. **Be proactive.** Identify potential issues early, and address them with the insurer's entire claims team. Such issues can include required code upgrades, changes to be made to the pre-loss structure, or other impending improvements.

4. **Be ready for accounting.** Forensic accountants and others involved in the claims process recommend that companies create a new general ledger account to capture all expenditures incurred as a result of the loss. In addition, many policies provide coverage for the cost of hiring forensic accountants to prepare your claim.

A thorough understanding of the values at risk, along with a strategy that properly documents losses, can help retailers and restaurants better prepare for natural catastrophe risks — and can help smooth the way to a quicker and easier recovery.

This briefing was prepared by Marsh's Retail/Wholesale Practice, in conjunction with Marsh's Property Practice and Marsh Risk Consulting.

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