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How to expedite payment of earthquake insurance claims

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NOTE

- 1) This total is for household-sector earthquake insurance, which is the topic of this paper.
- 2) After the earthquake, P&C insurers' personnel met daily to ascertain the status of earthquake-stricken areas and identify total-loss areas using aerial and satellite photographs (approximately 23,000 photos). Additionally, the industry deployed over 10,000 personnel to conduct damage assessment activities in the field.
- 3) The MOF's Earthquake Insurance System Project Team advised the P&C insurance industry that it must promptly work on developing new loss assessment techniques (options) in preparation for major earthquakes to ensure expeditious loss assessments even in the event of an earthquake epicentered directly beneath Greater Tokyo.

Executive Summary

To swiftly pay earthquake insurance claims, insurers need to visit damaged homes earlier and more efficiently. To do so, they need to change how they keep track of insured properties' locations and develop a system that facilitates planning of damage assessment activities.

The property and casualty insurance industry has paid over ¥1.2 trillion in claims¹⁾ (760,000 claims) in connection with the catastrophic earthquake that struck northeastern Japan on March 11, 2011. The industry won public plaudits for settling claims extremely expeditiously. However, the industry's swift response was mostly attributable to its own efforts²⁾ (deployment of massive human resources), not a systematic mechanism for processing and settling earthquake insurance claims.

The P&C insurance industry must devise and build such a mechanism to swiftly pay claims to be prepared for the next catastrophic earthquake, even one epicentered directly beneath Greater Tokyo³⁾.

How to expedite payment of insurance claims

To pay earthquake insurance claims, insurers must almost always send claims adjusters to visit damaged homes, talk to the policyholders, assess the degree of damage, and agree to a settlement with the policyholder. This process obviously requires a huge amount of manpower. P&C insurers will have to continue to settle claims in this manner unless they radically change their existing claims payment standards and procedures.

Other possible approach to swiftly settling claims is to shorten the time required to assess damages and reach a settlement with the policyholder. Another is to develop a system that enables claims adjusters to visit damaged homes and reach settlements earlier and more efficiently.

The first approach could be realized through a simplified damage-assessment procedure or a technological solution. However, in the case of single-family homes of conventional wood-frame construction, the process of diagramming the insured

property, inspecting the damage and calculating the settlement amount takes less than half of the time required to conduct a single damage assessment (approximately 1 hour). Accordingly, whatever time savings could be realized through the first approach would not be enough to significantly improve overall efficiency.

For outwardly visible disasters like earthquakes, P&C insurers should be able to conduct dynamic damage assessment activities even before policyholders file claims. If insurers had a system that facilitates planning of damage assessment activities (e.g., prioritization of geographic areas), they would likely be able to visit damaged homes earlier and more efficiently. However, this approach would require advance preparations (to develop the system).

Revision of insured property location management method and development of new system

I propose that P&C insurers keep track of insured properties' locations using GPS coordinates⁴⁾ (longitude and latitude) and develop an industry-wide system that estimates damages and lists the estimates by insured property (insurance policy) for each insurer.

4) Assuming that they do so on a block-by-block basis.

The P&C insurance industry currently uses neighborhood-level address codes to manage insured properties' locations, including for damage assessment activities. However, even in the event of a large-scale urban fire that spans several city blocks, the burnt-out area would be only a fraction of the area encompassed by a single address code. Damaged properties are consequently not easily identifiable with address codes. Additionally, in nonurban areas, address codes each encompass a broad area and cannot easily be used for tsunami damage assessments.

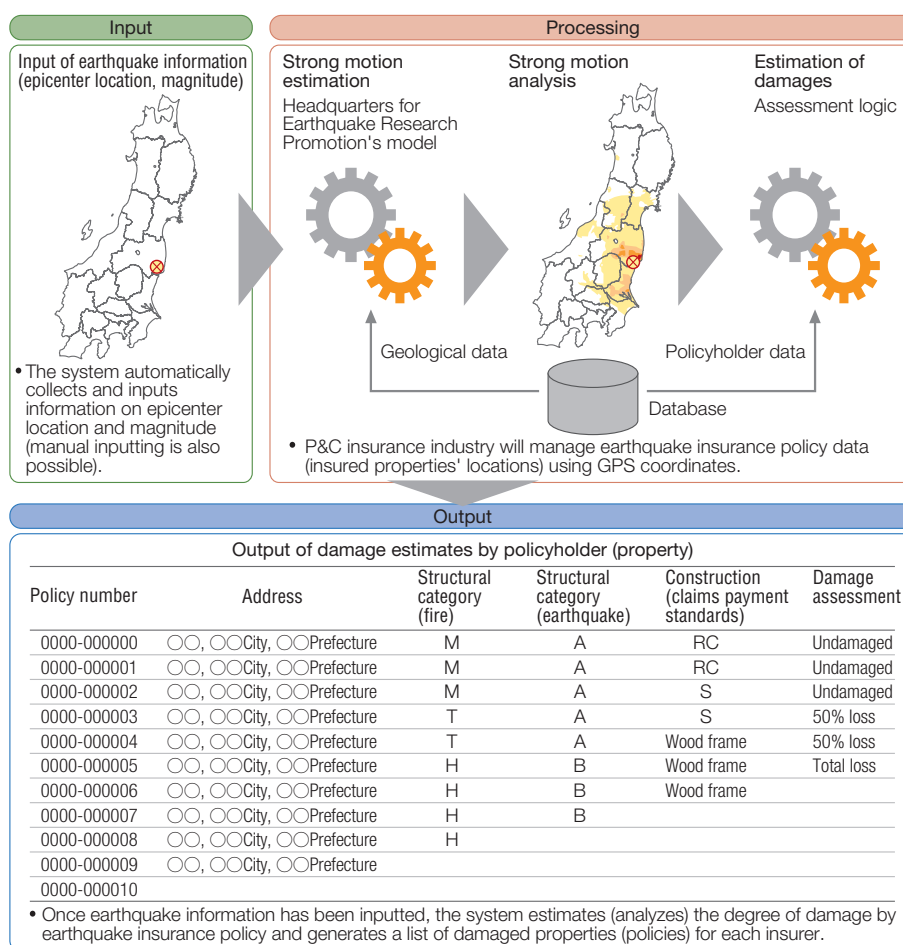
If insurers switch to using GPS coordinates to keep track of insured properties' locations for new earthquake insurance policies written every month, they should be able to easily identify the properties that they insure within areas designated as total-loss areas⁵⁾ by joint inspections⁶⁾, thereby greatly reducing their workload. Such an approach could also reduce the number of properties that claims adjusters have to actually visit to assess damage and negotiate settlements.

5) When an area is designated a total-loss area, insured properties in the area are presumed to be total losses and insurers compensate policyholders for the full insured value of their properties without conducting an on-site damage assessment.

6) A joint inspection is a technique for certifying damages by identifying "total-loss areas" through (1) interpretation of aerial photographs or (2) on-the-ground reconnaissance based on information from aerial photographs.

Additionally, if insurers had a system that models strong seismic-motion distributions based on epicenter and magnitude information released by the Japan Meteorological Agency after a major earthquake and compares the distributions against earthquake

Exhibit 1. Property-by-property earthquake damage estimation system



Source: NRI

insurance policy data to derive damage estimates by insured property for each P&C insurer (Exhibit 1), such information would be useful for planning post-earthquake damage assessment activities. Because earthquake insurance is exempt from Japan's antitrust laws, P&C insurers must standardize their earthquake insurance services among themselves. The system described above should be developed as a collective industry-wide initiative and, when a disaster occurs, it should provide individual insurers with sufficient information to determine how many personnel to deploy in the field, who to deploy, and where and when to deploy them.

Resolving other challenges facing the P&C insurance industry

Development of the above-describe system, including property location management, will not only expedite earthquake insurance claim processing and settlement, it should also help resolve other challenges facing the P&C insurance industry.

- 7) Earthquake insurance coverage is subject to a claim settlement cap. Insurers consequently must ascertain whether policyholders have insured their properties in excess of the cap by purchasing policies from multiple insurers.
- 8) If a damage assessment for separately owned condominium unit would be influenced by the damage assessment for the condominium complex's commonly owned components, the insurer must ascertain, before negotiating a settlement with the condo unit's policyholder, whether the commonly owned components are covered by earthquake insurance and, if so, the insurer that issued the coverage and the extent of the assessed damage to the commonly owned components.

One such challenge is identifying properties covered by multiple earthquake insurance policies issued by different insurers⁷⁾. Another challenge is keeping track of condominium complexes' commonly owned and separately owned components⁸⁾. Identifying properties covered by multiple policies is not too difficult because the policyholder and the insured are generally the same party. The second case, however, involves multiple policyholders (e.g., a homeowners' association and individual condo owners). In such cases, insurers must aggregate insured properties by their address or building name. While applications for insurance coverage include condominium unit numbers, condo owners, even those within the same complex, often write their addresses in different ways, making it difficult to aggregate insured properties by automated means.

Dealing with such challenges may be required only when an earthquake has actually occurred, but in light of the importance of speed in fulfilling earthquake insurance's purpose, the P&C industry should endeavor to be fully prepared to expeditiously process and settle earthquake insurance claims.

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