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Insurers Face Claims as Supply Chains Break

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Insurance companies with customers far from Japan could be on the hook for some lost profits of manufacturers whose supply chains were disrupted by the devastating earthquake.

The costs insurers will incur from such "business interruption" claims aren't clear. But the effects of Japanese plant closures, transportation delays and power shortages could reverberate beyond the country's borders and lead to insurance claims, say industry executives, analysts and brokers who arrange business-interruption coverage.

Woes in Japan will "have far-reaching effects, and the business interruption claims can mount very quickly," said Rod Fox, chief executive of reinsurance broker TigerRisk.

Separately, on Wednesday, disaster-modeling company Eqecat said insured losses from Japan's earthquake and tsunami would be $12 billion to $25 billion, an estimate whose high end is significantly lower than an earlier prediction by another firm.

Eqecat said a portion of the costs in its estimate—$2 billion to $4 billion—would be borne by the government's Japan Earthquake Reinsurance Pool, which will reduce the total cost to private insurers.

As for the business-interruption claims, the longer the disruption, the higher they could climb. A prolonged nuclear crisis, electricity shortages or temporary shutdowns of manufacturing plants could affect hundreds of businesses in the U.S. and Europe that use Japanese-made auto parts, computer chips or other components in the production of cars, consumer electronics and other goods.

Most U.S. manufacturers have some form of business-interruption insurance, which generally covers profit lost following damage to their property, in this case, for example, if a U.S. company had a plant directly damaged by the quake. If a U.S. business has to stop production because a supplier can't deliver needed parts, it can only collect from its insurer if it has bought additional protection, called contingent business interruption insurance.

Potential claims are beginning to emerge. On Wednesday evening, ON Semiconductor Corp., a supplier of silicon products that owns or operates several production plants in Japan, in a statement said it is working with its insurers "to assess and recover incurred losses from business interruption, supply chain disruption and property damage" caused by the quake. The company, which is headquarted in Phoenix, said some of its Japanese facilities are likely to be temporarily shut down because of disruptions in infrastructure services, and its revenue for the quarter will be affected as a result.

Several issues complicate any prediction of potential costs for contingent business interruption claims. Businesses that have the added protection may not be able to collect, depending on their deductibles and possible exclusions in their policies. Production may have to be shut down for several days before the coverage kicks in.

A company can generally collect only if the disaster that caused the shutdown at the supplier's plant is an event covered at their own plant, said Finley Harckham, a lawyer at Anderson Kill & Olick. Companies without earthquake insurance, or flood insurance in the case of tsunami damage, may not be able to recover on a claim.

For these types of reasons, some doubt claims for contingent business interruption will be significant. The issue "always comes up [after a big catastrophe], but the losses often are not big" across the insurance industry, said Bryon Ehrhart, chairman of reinsurance broker Aon Benfield's analytics division. "It's not going to be something that moves the needle in the insurance industry."

While the total industrywide exposure to the disaster won't be known for months, estimates from catastrophe-risk-modeling companies like Eqecat give an early prediction of the ultimate costs. A competing firm, AIR Worldwide, estimated Sunday the quake caused insured property losses of $15 billion to $35 billion. Its estimate didn't include the effects of the tsunami, which Eqecat's did. Eqecat also includes potential life-insurance claims. Both firms say they plan to continue to update their estimates.

Even if Eqecat's estimate proves on target, the disaster still would rank among the largest earthquake losses for the insurance industry. The only quakes that rival it are the $15.3 billion earthquake in Northridge, Calif., in 1995, and last month's temblor in Christchurch, New Zealand, where insured costs are still being tallied but could exceed $10 billion.

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