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Six Key ERM Preparations for the Next Sandy

One year on, enterprise risk management continues to feel the effects of the super storm…

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A year after striking the East Coast of the United States with unimagined force, Super storm Sandy continues to impact enterprise risk management (ERM). Its impact is still felt, not simply because the physical recovery remains underway in many places but because it caused ERM to evolve further in two key areas: (1) it underscored the need to broaden significantly the focus of risk on a company's operations; and (2) it highlighted the need to address vulnerabilities beyond one's control.

In the first case, many companies were unprepared for extended dislocations. The *New York Daily News*, for instance, just returned to its downtown Manhattan offices last month. What's more, the emergency room at NYU's Langone Medical Center won't reopen until next spring.

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In the second case, companies had planned for the disruptions that they incurred but had not planned for vulnerabilities along their supply chain. Their vendors' weaknesses unexpectedly knocked them out of business.

In the year since Sandy struck, we've worked with many companies on their risk management needs. To help ERM managers prepare for the next unforeseen unpredictable crisis with business interruption implications, here are six key suggestions:

1. Read your insurance contracts. This may seem simplistic, but at a recent business symposium, an attendee asked how many people in the room had read their insurance policies. After a show of hands, only 20% of those present had carefully reviewed their corporate insurance policies or contracts. The first, and most important, takeaway from Sandy is to read your policies. If you don't read them, there's no way to know what is and is not covered.

2. Clarify what your coverage includes. Sandy highlighted the importance of focusing on the exclusions as much as the coverage. Is a fuel tank in a basement covered by property insurance, for instance, or does it require a separate environmental policy? Many businesses that were hit hardest by Sandy were unaware of the parameters and limitations of their insurance policies.

3. Develop a plan to mitigate the resulting risk. Once you have clarified your coverage, it is important to look at the gaps and to determine how and where you can mitigate risk. A mitigation plan should then be developed, and it should address not only insurance for damage that your company may suffer directly but also indirect damage. Business interruption can come in many forms, and as many of them as possible should be anticipated. Vulnerabilities along the supply chain are especially complex and multi-faceted.

4. Consider buying broader umbrella policies. Umbrella policies that address business interruption are evolving, and the financial services industry is leading the way in their development. They are emerging in part because risks are becoming increasingly hard to predict, and there is a move toward customizing some of the policies to specifically address business interruptions arising out of a variety of non-traditional "property" loss perils.

Who would have thought that summer flooding in Colorado this year would cause damage estimated at up to half-a-billion dollars, for instance? Many insurers are looking to craft policies that can be bundled or respond more holistically to the broader supply chain risk (suppliers and component manufactures), as well as policies that address more "up-stream" financial and investment-type exposures associated with enterprise risk as a whole.

5. Shift risk to the supply chain. Because of those supply chain-related risks and the difficulty of determining them, businesses are increasingly seeking to shift their operational risk out to the supply chain. Companies should explore opportunities to craft their vendor contracts to mitigate risks wherever possible.

6. Understand your vendors' vulnerabilities. As a part of the risk management process, companies should look at the state of preparedness of their vendors. It's important to explore with key vendors just what their primary vulnerabilities are and what steps they've taken to mitigate them. In many cases, it's also crucial to have back-up vendors identified and to build informal relationships with them so that they are aware that they are part of your back-up strategy.

ERM is constantly evolving, and Super storm Sandy -- just like Y2K 13 years earlier -- has impacted the field permanently. Companies should continue to learn from it and adapt their ERM processes and plans to ensure that they are better prepared, not only for another super storm but also for other business interruptions that haven't previously occurred.

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