i notes
Newsletter from India's Leading Insurance Broking House
January 2011

Summary

India Insure
The risk managers

Message from the Editor

Dear Readers,

New Year Greetings from the India Insure family!

As the curtains close this fiscal, it marks a significant end to the first decade of liberalization of the Insurance Industry in India. It indeed has been an overwhelming decade for all the stakeholders with regulations, JVs, TPAs, brokers, detariffication, mergers, acquisitions, partings……we have seen it all, together!

With the market showing a stable growth rate of over 22% all through this fiscal, we anticipate the general insurance industry clocking an over ₹ 50000 crore year end figure, thus achieving an average growth rate of 16% for the decade and the market having grown fivefold during this period! The second decade, we believe would be more focused on innovative products, mergers and probably the insurers looking at top line growth.

We at India Insure have been reaching out periodically to corporates and insurers across the country and coming up with various industry reports. The message which came out in the recently concluded exercise is that a lot more needs to be done to propagate the grossly under marketed *Fire Loss of Profits* policy. The halo around this product led us to spend time and in this issue we have made an attempt in demystifying the product.

Our sincere thanks to Mr. Laxman Prakash, Supply Chain Leader, Owens Corning for sharing his views and experiences in handling the FLOP policy.

Our best wishes to all for a financial year end that meets your targets planned!

V Ramakrishna
Editor – *i-notes* & Chairman – India Insure

Demystifying Fire Loss of Profits (FLOP) Insurance

Introduction

A textile mill is gutted in a fire. The property loss was quickly recovered as it was insured but the business never really recovered from the accident. During the several months taken to rebuild the factory, arrange for imported spares and start production again, the fixed costs – salaries, rent, interest and work costs escalated. As the fire insurance claim was just enough only for meeting the capital expenditure, the company lost its valuable employees, watched helplessly the landlord and bankers getting edgy and competitors gnawing into its market share.

What went wrong? Well, although most business owners do cover their properties, where most of them err is in insuring the most important part – the bottom line of the company. It wasn't until a few years ago that importance was attached to risks that posed a direct risk to income, presumably because such risks are less obvious.

Following the horrific tsunami that stuck South East Asia on 26th December, 2004 many hotels and medium sized businesses surrounding the coastal area went out of business. It was not the direct losses that forced them under, for most had property insurance. However, they were not able to withstand the loss of income that came with shutting down for an extended period of time. It is in such situations that Fire Loss of Profits insurance can make all the difference.

Fire Loss of Profits (FLOP) insurance is one of the most tempting, yet elusive, product segments in the insurance market because of inadequate marketing by the insurer on one hand. On the other hand, corporates often overlook the policy because it is easy to forget that income cannot be produced without an operating business or the business owner believes property insurance will cover all losses or they are not aware of the existence of an FLOP policy.

Susceptibility to disruptions

Every business whether large or small is prone to a possible disruption. The question each organization should ask itself is "How long would my business survive an interruption"? It is very common for organizations to fall into the trap of thinking that only large scale disasters like a tsunami, an earthquake or a flood can interrupt the business. However, while these threats are very real and would indeed have a major impact on normal operations, it is very interesting to note that in fact the most common reasons for an interruption are mundane incidents like a

- Short-circuit in the factory
- Internal plumbing leaking and
- Underground power and communication cables being damaged

There can be internal as well as external factors that can cause an interruption to the business. The product, type of production and the conditions under which goods are manufactured determine how susceptible a company is to business disruption. Apart from the physical arrangement and capacity utilization of the production plant, the following factors are also important in determining the extent and duration of a disruption:

- Repair times for damaged machines, installations and buildings
- Procurement times for spare parts or replacement machines
- The degree of dependency on:
  - Certain interrelated operational premises
  - Special work conditions such as dust-free or temperature-controlled climates
- The possibilities of substituting one machine with another

For example, recovery from a disruption for companies involved in manufacturing pharmaceuticals, food products etc. requires time not only for the damaged machines to be replaced, but also time for cleanup as hygiene is given top priority. A fire in the production area can pollute an entire building with smoke, so thorough cleanup is required to meet the relevant production standards and public health requirements which takes time and delays production further adding to the overall cost.

There have been literally hundreds of examples where businesses have suffered contingent losses because of external factors like the premises of a key supplier /customer getting damaged resulting in inevitable disruption or loss of business. Unfortunately, as economies contract, lean manufacturing becomes the name of the game, either through Just-in-Time inventory management or through moving to single suppliers in order to generate economies of scale. Such an approach might be highly efficient

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when things are running smoothly, but in the event of a major disruption event, it can lead to significant delays in key materials being delivered or in a worst case scenario to a systemic failure in the supply chain.

Other external factors include the breakdown of public utilities like electricity, gas or water supply which causes a production stoppage. A strike causing hold-up in the supply of raw materials can also bring production to a complete standstill.

As small and medium-sized enterprises have fewer production facilities, they are less complex than large ones in terms of lower dependencies. But on the other hand, it is precisely in such firms that even minor disruptions to business processes may threaten their very existence. This is because they do not have the necessary resources to be able to absorb business interruption losses.

Covering the income at stake - *Items to be included in the Sum Insured*

Fire Loss of Profits insurance essentially covers three main areas:

a. **The net profit**: that would have been made if there had been no consequential loss.

b. The normal **standing charges** that still have to be paid and cannot be reduced. The value of any production flow comprises both variable costs - which depend on the volume of goods manufactured – and fixed costs such as capital costs, rent, maintenance etc. These fixed costs which are not reduced proportionately when business comes to a stand-still after the loss are also called as standing charges and should be included in the Sum Insured. All the insured standing charges should be well defined and quantified. The variable costs which are reduced in the same proportion as turnover need not be insured because the reduced turnover still bears the same proportion of those charges.

c. The '**increased costs of working'** or extra expenses incurred in order to reduce the duration and extent of the business interruption loss. When estimating extra expenses for 'increased costs of working', organizations should factor in the extra costs they would incur if they have to relocate to alternative premises and also additional personnel costs plus other likely expenses. For example, if you need to run your business from a rented location for a month, but the only one available is far away, the FLOP policy could cover the cost of transporting your workers there, if the result is that your business is able to resume at least partial operations sooner.

Variable Costs include

raw materials, factory supplies, purchased semi-finished products, commercial goods, depreciation associated with plant operations, packaging, freight costs and third-party services related to production.

Selecting the FLOP sum insured is critical as it dictates the ultimate liability of the insurer. FLOP insurance is a full-value insurance, which means that the value of the net profits and standing charges must be determined as accurately as possible in order to fix the sum insured. At the time an FLOP policy is arranged, it is only possible to refer to values of previous business results, although these can increase in subsequent years through the expansion of business activities or higher sales. Hence, the future profits must be forecast and adjusted upwards. Though this may appear to invite over insurance at times, it is alright since FLOP policies include a *premium adjustment clause* where at the end of the year, the premium is adjusted taking the actual gross into account.

Fixed costs include

employee salaries, rent, interest on loan, maintenance costs for machinery and buildings, licence and inspection fees, taxes, insurance premiums, administration and marketing overheads, capital costs and advertising costs

An important point to remember is that net profit and standing charges are indemnified only to the extent that the policyholder could not earn them as a result of the interruption.

Criteria for cover

Businesses can suffer loss of sales or increased expenses for many reasons, typically the normal commercial risks of supply and demand, competitors' activities, buoyancy of economies, a flu epidemic that reduces the workforce for several days, scarcity of raw materials, labor disputes, adverse weather etc. However, the purpose of fire LOP insurance is only to cover the consequences of a company's impaired business performance following property damage. In other words, FLOP insurance should reimburse the company with the amount it would have earned had the insured incident not happened.

Before liability can be admitted under an FLOP policy, the following criteria must usually be met:

- It must be established that there is in force a fire insurance policy to cover the damaged property from that peril and
- Moreover that the fire insurers have paid or admitted liability for the said property damage.

This is significant since FLOP insurers would be interested in knowing if monies would be available from property damage insurers to enable the insured to speedily reinstate the property thus minimizing the interruption of business. Also note that it is always better to have the fire policy & FLOP policy taken through the same insurer as this gives the insurer control of the claim process for the property damage enabling it to avoid delays, which might impact the FLOP claim.

Indemnity Period

What is often termed the 'indemnity period' is probably the most crucial component of FLOP insurance and has to be selected carefully as this focuses on the total time estimated to full recovery from an insured loss. This usually ranges from 3 to 36 months depending upon the average time required in a particular industry for restoration of the operations. The period commences when the damage by fire occurs and will continue to apply till the completion of indemnity period or until actual resumption of operations whichever is earlier. While arriving at the Indemnity period, the insured should take into consideration aspects like time required to reinstate or rebuild the premises, replace the plant/machinery/ stocks and time to restore the business to its full pre-loss turnover. It would also be prudent to allow a further margin of time for the unpredictable events which have an unhappy knack of turning up when most inconvenient and delaying still further the resumption of full operations.

From date of damage: Another important point to note is that the number of months for which indemnity is provided is measured from the date of the damage. It must not be confused with the term of the insurance. Should damage occur resulting in a period of interruption overlapping the renewal date or expiry date of the policy, the indemnity is not affected by the latter and continues up to the limit of the indemnity period from the date of damage whether the policy is meantime renewed or lapsed. It is always advisable that the Policy period should either be identical to the financial year or should commence from a date representing the commencement of

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a quarter to avoid unnecessary complications in calculating the gross profit at the time of a claim.

Deductible: Time deductible in the form of a standard waiting period of *3 days* applies to all FLOP policies which mean that operations must be suspended for at least 3 days before FLOP benefits are available. In other words, the claim is payable only for the period exceeding 3 days.

Extensions under the Policy

In today's complex economic environment, no business can operate in isolation. Because there are many inter-dependencies, damage elsewhere than at the insured's premises can interrupt the insured's business. FLOP policies are frequently extended to insure some of these inter-dependencies as explained below:

- Suppliers' premises extension
- Customers' premises extension
- Utilities extension - Damage to utilities like electricity stations, gas works and water works
- Prevention of Access

Suppliers, customers' and utilities extensions have been around for a long time and coverage is usually triggered by physical damage to customers' or suppliers' property or to a utility on which the insured company depends on to sustain its operations. These extensions reimburse the policyholder in each of these situations, covering the interruption to the insured's business caused by a peril specified in the policy causing physical damage or loss elsewhere. It is not necessary that the customer or supplier property be totally shut down - all that is necessary is that an insured loss occurs at the location covered under the policy and that the insured's business be interrupted as a result.

Supply chain risk was thrust into the headlines by the eruption of the Icelandic volcano early last year. This did not only cause serious travel disruption, it also had a major impact on the supply chains of many companies. Car manufacturers were some of the hardest hit, with Nissan and BMW both having to reduce production because of shortages of critical parts.

Another classic example often quoted is the fire that engulfed the Philips factory in Mexico that changed the course of history in terms of market leadership for the mobile phone industry. In 2000, two companies – Nokia & Ericsson vied for market leadership in the emerging mobile phone market. As part of the manufacturing process, both companies relied on a critical component called radio frequency chips. These were supplied by the Philips electronics company and were manufactured at a semiconductor factory in Albuquerque, New Mexico. On 17th March of that year, fire broke out at the plant and the subsequent smoke and water damage meant that almost the whole stock of radio frequency chips was contaminated. Nokia responded by quickly re-contracting supplies from other Philips plants and from alternative suppliers, effectively taking the vast bulk of available supplies for itself. Ericsson responded more slowly and could only purchase a fraction of the number of chips that it needed. Consequently, Ericsson could no longer effectively service the mobile phone market, giving Nokia the opportunity to take a significant market-share lead. A lead that it still maintains.

Prevention of access extension applies in situations where say if a company is denied access to its building and is unable to work due to a physical incident in a neighbouring building but has suffered no material damage itself, it would not be able to claim on its FLOP policy unless that policy specifically covered prevention of access. Following the Sep 11 attacks on WTC, access was prevented to many surrounding localities thus causing an interruption to businesses in those areas though no physical damage was caused. Despite the fact that many businesses had FLOP insurance, they were not entitled to a claim because of not having opted for the prevention of access extension.

A few important points to be kept in mind when buying FLOP Insurance:

- The policy will cover you for loss of income based on your previous financial results. So make sure that all your paperwork and accounting is up to date, so there is no dispute on the amount of compensation due to your business.
- Make sure that the indemnity period is enough to cover your business in a worst case scenario - often getting back to normalcy can take longer than imagined.
- Also keep in mind that there is normally a 3 days waiting period before the policy comes into force.
- The premium is based upon the average fire rates as well as the Indemnity period. For example, a fireworks factory will pay a higher premium than one that makes shoes.
- Figure out whether you need to opt for any of the extensions under the policy.

Conditions for a valid claim

- Loss by insured peril
- Loss at insured premises
- Loss must cause interruption of business
- Interruption only on account of damage to property
- Fire policy is a must
- Claim must be admitted under fire insurance policy

Claims

In the event of a loss, once the policyholder has notified the insurance company of an FLOP claim, a surveyor is quickly appointed, since much depends on the loss reduction measures that must be taken immediately.

In order for a claim to get admitted under FLOP, the insured bears the burden of proving three separate elements in a causal chain namely,

(1) Is there an interruption to operations?

(2) due to physical damage to covered property?

(3) caused by a covered cause of loss?

In addition to establishing an interruption of operations, an insured must also show that it has suffered an actual loss of income. It is not enough to merely show a loss of sales or production. Rather, the insured must establish that but for the suspension of its operations, it would have earned income. If the insured cannot prove that it would have been profitable during the period of interruption, there can be no recovery.

Any and all information that is relevant to the claim should be provided to the insurer. This will range from production and sales records to annual budgets and forecasts. Virtually every FLOP claim is audited by chartered accountants appointed by the insurer. The purpose of these audits - which can last anywhere from a few days on a simple claim to many months on a major one - is to verify the claim for conceptual and measurement accuracy. But auditors do not operate in a vacuum. They rely on the policyholder to provide the necessary information and documentation to verify the claim and hence the importance of cooperating with the auditor cannot be overstated.

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Interview – *Corporate*

Today, businesses exist in a highly competitive world and the threat of business interruption because of a disaster – large or small contributes to the need for a comprehensive FLOP policy to better manage the interruption. FLOP insurance remains vitally important for firms looking to safeguard against loss of profits and choosing the right coverage requires concentrated attention because it cannot be altered after a disaster occurs.

In this issue we speak to Mr. Laxman Prakash, Supply Chain Leader, Owens Corning on his views and experiences in handling the FLOP policy.

Owens Corning has been in operation in India since 1998. At what point in time did the Fire Loss of Profits (FLOP) policy become part of your insurance program and why?

Mr. Laxman Prakash: The FLOP/MLOP was part of our coverage since the inception of the facility. I feel it is very critical for insured like us operating on continuous process.

What are the extensions you have opted for under the policy and how have you benefitted by opting for these extensions? Further, would you be considering any other extensions?

LP: We have not found this very relevant for our industry at this point in time and have not opted for any extension under FLOP i.e. to be specific the customers or vendors risk. It is also important to balance between the premium and the exposure of risk.

The importance of selecting an adequate indemnity period under an FLOP policy cannot be overemphasized. Can you please advise our readers on the points to be taken into consideration while deciding on the Indemnity Period?

LP: First of all for any business operation having manufacturing facility it is critical to assess the need for having Loss of Profit coverage. The nature of industry has a great bearing on having LOP in the portfolio. Continuous process and complex manufacturing facilities must have LOP to my mind. You are right, choosing the right Indemnity Period is a challenge by itself and it is basically driven by the gestation period in rebuilding the facility to get it up and commercially running. Again it is a decision that will be influenced by the annual premium involved and the risk coverage. It is conditional for the insured to get the facility back in operation within the indemnity period to ensure all damages get paid for.

Having handled an FLOP claim, how would you describe your overall experience and what has been the learning from the claim?

LP: Yes we did have a major claim in the floods of July 26, 2005 and fortunately our risk was adequately covered and we also had LOP coverage. The claim settlement experience was an experience by itself and really brought to the fore the lack of full understanding of the policy document at the time of placementl. The policy inclusion and exclusion understanding is very critical else one shall be left to interpretations and there is risk of not getting paid for. It is important for Insured to spend quality time while taking the policy and have a good understanding of each and every clause and seek clarification from the insurer to have aligned understanding. One learning that I would like to share is the methodology of calculating the gross profit under the FLOP/MLOP and the normal GP calculation in business parlance. It is important to customize the standing charges with your insurer and based on your P&L of past pattern clearly define the variable and standing charges and have an understanding with the insurer. Do not leave it open without customizing as invariably you would end up finding yourself underinsured and it is rather hard learning.

At the time of Interruption, did you think that it was not necessary to insure certain standing charges? What were they & why did you think so? Also were there any standing charges that you thought should have been included under the policy?

LP: Yes I would not re-iterate the importance, answer to earlier question would suffice.

Do you believe that the FLOP policy available today is aligned to completely meet your requirement? If no, what are the areas of improvement you would look for?

LP: I think the product is good but there is still ambiguity in terms of GP calculation, standing charges and there is scope to simplify this for the benefit of the insured.

"Views expressed herein are purely personal and do not reflect the views of the Company"

Demystifying Fire Loss of Profits Insurance . Contd. # 3

When calculating the loss, the following criteria are taken into account (the list is not exhaustive):

- How long did the business disruption last? The actual loss of turnover attributable to the damage is determined by applying the rate of gross profit to the turnover actually achieved while the damage is experienced. The rate of gross profit represents the ratio of net profit plus standing charges to the turnover.
- Pre-loss trends of production or sales
- Selling prices of the product
- The amount of expenses incurred to reduce loss

Remember that good claim documentation is one of the cornerstones to effect a positive claim settlement.

Conclusion

A company's profits are exposed to risks from a number of quarters, which is why its actual results often deviate from its business plans. Nevertheless, experience shows that most companies are not prepared for business interruptions and have not thought enough on the need for having an FLOP policy. Decision-makers very often misjudge the losses caused by a disruption to business and underestimate the benefits of an FLOP policy in ensuring a company's continued existence in an emergency.

Avoiding FLOP insurance is undoubtedly false economy, in case something happens to your business, you'll suffer from a financial disaster. It's easier to walk the tightrope if you know there is a safety net. So, prudence calls for securing your prized balance sheet before disaster strikes!

News TitBits

Citibank to compensate duped investors
Source: Times of India

Citibank is likely to dip into its global insurance policy to compensate customers defrauded by its wealth manager. In addition to following the money trail, the bank would also pursue a claim with its insurers.

Somali pirates closer to India; premiums up
Source: Livemint

Somalian pirates appear to have expanded their reach to Indian maritime waters and insurers are responding by increasing premiums, resulting in higher costs for shipping firms.

Report Card - November 2010

Gross premium underwritten by non life industry for and up to the month of November 2010* **(Rs. In crores)**

INSURER	NOVEMBER		GROWTH OVER THE SAME PERIOD OF PREVIOUS YEAR	APRIL - NOVEMBER		GROWTH OVER THE SAME PERIOD OF PREVIOUS YEAR
	2010-11	2009-10		2010-11	2009-10	
New India	478	420	**14%**	4667	3932	19%
United India	508	411	**24%**	4045	3277	23%
National	470	338	**39%**	3768	2891	30%
Oriental	378	335	**13%**	3446	3031	14%
ICICI- Lombard	271	221	**23%**	2814	2135	32%
Bajaj Allianz	214	181	**18%**	1867	1603	16%
IFFCO-Tokio	132	110	**21%**	1185	983	21%
Reliance	125	170	**-27%**	1075	1386	-22%
HDFC ERGO	96	66	**45%**	836	588	42%
Tata-AIG	87	59	**47%**	793	583	36%
Royal Sundaram	98	65	**50%**	738	585	26%
Cholamandalam	83	54	**54%**	647	531	22%
Shriram	68	37	**83%**	453	211	115%
Future Generali	39	25	**55%**	388	222	75%
Bharti AXA	44	22	**98%**	340	148	130%
Universal Sompo	21	20	**6%**	188	99	91%
SBI General	1			12		
Raheja QBE	1	1		5	1	381%
L & T	1			2		
PRIVATE TOTAL	**1280**	**1031**	24%	**11345**	**9076**	25%
PUBLIC TOTAL	**1834**	**1503**	22%	**15926**	**13132**	21%
GRAND TOTAL	**3115**	**2534**	23%	**27271**	**22207**	23%
Credit Insurance						
ECGC	73	64	**14%**	559	521	7%
Health Insurance						
Star Health	8	14	**-42%**	789	644	22%
Apollo Munich	21	12	**73%**	124	71	76%
Max BUPA	2			12		
Health Total	**31**	**27**	**18%**	**926**	**715**	30%
Agriculture Insurance						
AIC	112	118	**-5%**	1248	1128	11%

* Source : IRDA

Observations: Performance for Apr-Nov 2010 Period

- The industry (incl stand alone health insurers) have collected premiums of Rs. 28197 crores recording a growth rate of 23% for Apr-Nov period compared to Rs.22922 crores collected during the same period last year.
- The private players have registered a growth of 25% during this period compared to 7% during the same period last year.
- The PSU's have registered a growth rate of 21% during this period compared to last year's 11%.
- The accretion achieved by the PSU's during this period is Rs.2794 crores; the private players: Rs.2269 crores and stand-alone health insurers: Rs. 211 crores towards the overall market accretion of Rs.5274 crores.
- The major contributors for the performance in the period Apr-Nov 2010 have been National with an accretion of 876 crores, United India with an accretion of 768 crores, New India with an accretion of 735 crores and ICICI with an accretion of 679 crores.
- Reliance (-21.87%) has recorded negative growth during this period.
- At the end of this period, the private players have collectively increased their market share from 40.87% to 41.60%.

News TitBits

Third party motor cover to cost more

Source: Hindu Business Line

IRDA has proposed hikes ranging from 10% to 80% in premiums for third party liability cover, to address losses in the motor segment. The hikes are proposed in an exposure draft on a review of motor insurance premium rates for third party liability cover. Statistics compiled by the Insurance Information Bureau show that the third party insurance portfolio for commercial vehicles is consistently making losses.

India's Religare gets in-principle nod for Health Insurance Joint Venture

Source: Trading Markets

India's financial services group Religare gets in-principle nod to establish a stand-alone health insurance company as a joint venture with Union Bank of India and Corporation Bank.

Reliance General, Royal Sundaram merger hits roadblock

Source: Economic Times

The proposed merger of Reliance General Insurance and Royal Sundaram Alliance has hit a roadblock, with differences over valuation. Reliance General reckons that its valuation is well over Rs 2,000 crore, but this has been disputed by the Chennai-based Royal Sundaram Alliance. Both the companies are likely to inform the regulator that the merger, in the form currently proposed, may not go through.

IRDA lets companies offer credit insurance, but not for securing bank credit

Source: Economic Times

The regulator has allowed companies to provide limited trade credit protection. Credit insurance will, however, not be available for securing bank credit. In September, the Insurance Regulatory and Development Authority (IRDA) banned all forms of credit insurance except for the cover provided by the Export Credit Guarantee Corporation. The new guidelines enable insurance companies to provide cover for trade, but the credit insurance policies cannot be assigned to banks.

IRDA plans to set up investor protection fund

Source: Business Standard

Following in the footsteps of the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority plans to set up an investor protection fund. The fund will work to protect the interests of policyholders and spread awareness about insurance.

Nine in race to partner PSU TPA

Source: Mydigitalfc

Nine players including renowned international health insurance players, existing third party administrators (TPAs) and domestic companies are in the reckoning to partner with General Insurers Public Sector Association of India (GIPSA) to form a TPA company. US-based Aetna International Corporation, United Health International, Cambridge Solutions, Paris-based Coris International and Abu Dhabi-based Nas United Healthcare Services are in the race for the partnership. Indian players such as Patni Computers, Chennai-based Lason India, E-Meditek TPA and Medi Assist TPA are also in the race.

Readers Speak - *PSU Cartelization for TPA*

In the last issue of inotes, we had asked

"With TPA's currently handling around 80% of the PSU's health insurance business, what will be the impact of the common GIPSA TPA on consumer and the health insurance industry? Will claims costs come down? Will the service levels improve? Will the lack of competitive spirit after formation of common TPA cause a decline in performance? Who will eventually bear the brunt as the industry pushes for increased efficiency? Will not the lack of regulatory guidelines for providers (hospitals) again act as a roadblock in achieving the very purpose for which the common TPA is created to bring down claims costs?"

Below are some of the responses we received

Response from **Ms. Geetha Parameswaran, HR Head, Success Factors**

The insurance industry's current turmoil can be attributed to any normal business lifecycle with its periodic up's and downs. If the *General Insurers Public Sector Association of India (GIPSA),* goes ahead with its plan for independent TPA which will over a period of time take over the entire claims processing, there would definitely be some benefits and if not rightly monitored then huge losses too. The independent entity could most definitely bring the spiraling medical costs to a more acceptable level and affordable to common man in a short period of time. What remains to be seen is that over a period of time due to monopoly, situation that exists now [fraudulent practices] should not repeat itself.

The move to a common independent outfit may in short term mean loss of jobs and businesses but in the long run, this would bring about a more disciplined approach towards patient care. The independent outfit apart from belonging to the consortium of the four state owned PSU's, need to be overseen by a neutral 3rd party which might help keep corruption in check. Let's not forget with all the infighting between the TPA's and Insurance company, it is the "Consumer" who might bear the brunt. By keeping a long term view of things, decision made in this regard would benefit all greatly.

Response from **Mr. Amit Sharma, Chief Insurance Officer, Robert Bosch Engineering and Business Solutions**

This is very hard to answer - I think it should not have any impact on the consumer because if the claim is payable, it will be paid by any one. Only thing is how fast the common TPA will respond and will settle the claims - that is something we need to wait and watch. At least I can see the health claims ratio coming down because now the role of TPA will change from Administrator to Management and insurance companies will be having better control on the processes. I don't know how far this can bring down the cost as it will purely depend on the underwriting, medical inflation, consumer behavior and provider malpractice because the moment you say you are insured -hospitals will raise their bills by 20-25%.

On service level I can't comment but I have my own doubt that a common TPA can deliver its best as

- Common TPA will be serving all clients (assureds) of 4 PSU and looking at the size of lives it puts me in the doubt.
- This will result in monopoly and if there is a dip in the TAT, the consumers may move out to other insurers despite of the premium rates.

The biggest hurdle is the absence of a regulatory framework for hospitals - so no matter what efforts you make, it will not work. From business point of view we can't escape from the current situation saying there are no guidelines as it is a joint responsibility of consumer and insurer to bring in good measures like tie up with some hospitals and package rates etc.

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Claims Case Study: *Loss of Profits due to Riots*

Background: M/s Roads & Roads was awarded a contract for strengthening of an existing 2-lane road and upgrading it to a 4-lane by Andhra Pradesh Government. The project to be taken up on build, operate, own, transfer (BOOT) basis covered the entire stretch of national highway from Konthapalli to Variwada spanning 152 Km and the project cost was estimated at 783 crores.

On completion of the road construction, the Insured took the Standard fire insurance policy for the entire road project along with FLOP (Fire Loss of Profits) policy covering 9 months Indemnity period & specification on Toll Revenue basis.

Four months after the road was operational, an agitation broke out in nearby villages near the highway area demanding a separate statehood for the people of Sangipatnam region. The agitation intensified and culminated in the rioters attacking the highway & nearby areas from 10 Sep 2010. Police in Konthapalli town fired at protesters to control the mob and some of them lost their lives in the incident. Agitators along with the dead bodies lay siege of the highway - stopping all vehicular traffic -they also burnt some vehicles on the road.

The Police occupied the toll plaza on the Highway to cordon the agitators to one side. During all this agitation, the rioters destroyed the property fitted/installed at the toll plaza such as anti-glaziers, emergency call booths, pedestrian railings, road sign boards etc. In fact, a 25 feet high Mast Light was also destroyed from its foundation and kept as a barrier on the highway to block the traffic. The entire agitation came to a close in about 28 days after an agreement with the Government and thereafter the road was open to Public after a repair work of about 3 Hours.

Next Issue: *Motor Pool – to be done away with?*

Since April 2007, all premiums collected on third-party insurance issued to commercial vehicles go into a common pool called Motor third-party pool. The pool system was formed as private non-life insurers declined to cover commercial vehicles on grounds of high claim ratios and the burden of the loss-making portfolio fell on the four PSU's. The claims involving the insured vehicles are now paid out of the Pool and the losses are shared between participating insurers according to the proportionate amount of their entire market share. But the losses are still spiraling and as per actuarial valuation the loss ratio is likely to be 185 percent.

Now, many insurers believe that the pool has outlived its purpose and want it to be disbanded. Some players are of the opinion that the pool is having an adverse effect on their balance sheet and it would be difficult to accurately quantify the pool's impact because of its long term liability where claims are filed many years later.

But would disbanding the Pool be beneficial to the insurance industry? Will it not return to the previous scenario of cherry-picking where third party cover for commercial vehicles is denied? Or will all companies actively underwrite commercial vehicles and there will not be any supply side constraint? Your opinion is solicited!

Please send your responses in 200-300 words to knowledge@indiainsure.com

The agitation resulted in heavy loss to M/s Roads & Roads in terms of material damage and the toll revenue collection also came to a standstill due to the road blockage.

M/s Roads & Roads submitted the claim to their Insurance Company. The loss under material damage was estimated to Rs. 1.28 Cr and the same was also admitted by the Insurance Company under insured peril of "Malicious Damage". The insured estimated their claim under FLOP in respect of loss of Toll revenue to Rs 1.48 cr based on the approximate toll collection of Rs. 5.3 Lakhs per day.

The Issues: However in case of the FLOP claim, the Insurer took the stand that Material Damage happened to the installed property on the road i.e. the Toll Plaza and not directly to the road. The road was not damaged in any way that stopped the flow of traffic on the highway. In fact, it was the prevention of access to the highway by the protesters that restricted traffic & caused a loss of toll revenue. Further the insurer also pressed on the exclusion in the policy stating that "Loss occasioned by the Temporary dispossession resulting from the requisition by any lawfully constituted authority", as the Police had taken control of the Toll Plaza for more than 25 days during riots. The Claimant disagreed and the main issue of dispute was how the policy should respond to the situation where both damage to the Toll Plaza by rioters and prevention of access to the road by rioters were causes of the FLOP losses.

Now the question is whether the claimant's loss would not have arisen but for the damage to the Toll Plaza. The insuring clause in the FLOP policy provided cover for business interruption "directly arising from damage", defined as "direct physical loss, destruction or damage to the Insured Property". The policy did not provide cover for business interruption arising as a result of prevention of access.

The Insurer was of the view that M/s Roads & Roads could only recover if it could establish that but for the physical damage suffered by the Toll Plaza, there would have been no business interruption loss. The Insurer in his decision was influenced by the fact that even if the Toll Plaza had not been damaged, sitting as it was in the midst of such an agitation, the Company would have nonetheless suffered the same business interruption.

Since the prevention of access to the road by the rioters was the concurrent cause of the business interruption loss, i.e. M/s Roads & Roads would have suffered business interruption loss even if the Toll Plaza had not been damaged as a result of denial of access by rioters and the police cordoning, the Insurer held that there could be no indemnity under the FLOP policy.

Takeaways / Learnings: The case considers some key principles governing the recoverability of FLOP losses, specifically in relation to circumstances where an interruption results from both damage to insured property and prevention of access. Would the claim have been payable had there been a 'Prevention of access' extension taken at inception of policy? Or does the policy require to be worded more explicitly such that it is clearly mentioned that any business interruption loss caused by physical damage to the property would be covered under the primary indemnity provision, but other losses not so caused would be recoverable only if the appropriate extension cover has been opted for? It probably is the right time for our policies being more explicit so that there is not much scope for differential interpretation or opinions.

News TitBits

Eight life insurers post profits in 2009-10
Source: Hindu Business Line

Eight life insurance companies out of 23 in operation have reported profits in 2009-10 as per IRDA annual report. They are: Life Insurance Corporation of India (LIC), ICICI Prudential Kotak Mahindra, SBI, MetLife, Bajaj Allianz, Sahara India and Aegon Religare.

Swiss Re scouts for life and health partners
Source: Economic Times

Reinsurance giant Swiss Re is looking for an Indian partner for its proposed venture into life and health insurance. The group is also keen on developing a market for its insurance-related offerings, which include agricultural cover and capital management solutions to help companies fund their new business strain.

IOC fire to hit ICICI Lombard, GIC
Source: Business Standard

Private insurer ICICI Lombard, along with national reinsurer General Insurance Corporation of India (GIC), is likely to take a hit over the fire that broke out at the Indian Oil Corporation's (IOC's) oil storage depot in Taloja at Navi Mumbai. Though final estimates were not available yet, the claim could range around Rs 10-15 crore. The fire is reported to have destroyed 40,000-50,000 litres of lubricant oil. With a 50 per cent share, ICICI Lombard leads the policy. Reliance General has a 25 per cent share in the policy while Oriental holds 15 per cent. National India has another 10 per cent.

Rules on outsourcing by insurers to be released
Source: Hindu Business Line

IRDA is in the process of finalising guidelines for outsourcing by life and general insurance companies. IRDA will clarify services that insurers, aiming to cut costs, can outsource. The guidelines are expected to be issued by the end of this month.

Edelweiss Tokio Life Insurance gets initial approval from IRDA
Indian Bank to enter life insurance
ICC World Cup 2011 gets insured for Rs. 600 crore
UCO Bank scraps plans for general insurance foray
GIC working on insurance pool for nuclear accidents
Liberty Mutual & Videocon teaming up to create a non-life insurance company in India

View Point

MOTOR THIRD PARTY INSURANCE – *isn't it killing the industry?*

Motor insurance constitutes 40% of the General insurance business underwritten in India and a fact well known to all of us is that this has been a highly loss making portfolio thus actively contributing to the unhealthy underwriting profits of General insurance industry in India as a whole.

Multiple reasons have been attributed to the increase in claims experience in India and they include low premium, escalated claims, corruption, litigation and compensation awards! Very interestingly in UK the main reasons for increased claims experience is due to uninsured drivers as well as fraudulent claims. Reasons apart, the strain on insurers on the underwriting of mandatory third party motor insurance is almost crippling the entire industry. Incidentally, apart from numbers, there has also been a steady increase in the claim size each year by over 25%.

On drawing a comparison between India and the other countries, it is observed that like in India, in most of the other countries too, the third party premium is regulated. However, the major difference is that the increase in premium according to the claims ratio happens much more periodically in other countries and it is not as long drawn a process as it is found to be in India. For instance, the hike in premium proposed in the year 2007 did not take place entirely due to the representation from various commercial motor owners associations. This despite the fact that insurers have been making regular pleas urging the regulator to enhance the third party premium.

The Motor Pool, set up in the year 2007 was done in the right spirit so as to make available Third party insurance to all commercial vehicles at reasonable rates and terms. This has however led to several private insurers ending up in a tight spot because premium and losses get ceded to the pool and the net results of the pool are shared by all insurance companies proportional to their market share in all lines of business combined. So irrespective of an insurer's appetite for underwriting motor insurance, a share of premium and losses are necessarily transferred to them.

Statistics reveal that there are about 4 crore uninsured vehicles plying on the Indian roads. The RTA having their arms spread out and a complete database of registered vehicles, can there be a process worked out to have the insurers and RTA working together in tandem to identify the uninsured vehicles plying and have them insured to increase the premium base available to support the losses.

The New Year gift given by IRDA to the industry has come in the form of the 'Exposure draft on review of Motor insurance premium rates for third party liability cover'. This report, based on the statistics compiled by the Insurance Information Bureau reveals that the Motor Third Party portfolio commercial vehicles is making losses that are only spiraling year on year! While the 'Own damage' section has been just about viable, it is the 'Third party' section which has been unviable and particularly the Commercial vehicles segment has sent the entire industry in a tizzy. As per the regulator, "The long-term liability of the motor insurance pool is threatening to run to 197 per cent (of premium collected)." Another proposal to reduce the claims experience has come in by recommending a limited liability restoring it to its original status as per the original Motor Vehicle Act.

With the alarming situation in the backdrop, IRDA has finally proposed an increase in third party premium by 10% for personal vehicles and by 80% for commercial vehicles. We presume this just marks the beginning of a series of meetings between various associations/ parties to debate and discuss. While the move to increase the premium is going to be welcomed by the entire insurance industry, this is undoubtedly going to cause enormous dissatisfaction among the consumers.Well, how quickly this will get accepted and implemented still remains a million dollar question, but it's a sincere hope that it gets implemented quickly and we get to see the smile back on the insurers face.

R. Chandrasekaran
SBU Head- West

Disclaimer

Contact us

India Insure Risk Management & Insurance Broking Services P Ltd.

Ahmedabad 105, Sears Towers,Opp. IIPM, Off C.G. Road, Gulbai Tekra, Ahmedabad- 380006. Gujarat, INDIA. Tel: +91 79 32422007, Fax:+91 79 26406044 (M) +91 98250 66044, +91 97255 04381
Mr. Pawan Kumar Mediratta email : pawan.mediratta@indiainsure.com

Bangalore H M Geneva House, Property No.14, 401, 4th Floor, Cunningham Road, Bangalore - 560001, Ph: 080-41128056-57. Fax: 080-41128597
Contact: Mr. Rajendra Naidu, e-mail : rajendra.naidu@indiainsure.com

Chennai Building No.824,Bhandari Towers, 1st Floor, Opposite to Kilpauk Medical College, E V R Periyar Road, Kilpauk, Chennai – 600 010
Ph: 044-42661540 Fax: 044-42023799,
Contact: Mr. V.G. Dhanasekaran, e-mail : dhanasekaran.vg@indiainsure.com

Kolkatta 4th Floor, Larica , 7 Red cross Palace, Kolkatta- 700001
Ph: 033-64602097 / 98
Contact: Mr. Dilip Burman e-mail : dilip.burman@indiainsure.com

Hyderabad # 405, Archana Arcade, St John's Road, Secunderabad - 500025
Ph: 040-27822989/90/91, Fax: 040-27822993
Contact: Mr. B.N. Prasad, email: bn.prasad@indiainsure.com

Mumbai **Branch & Corporate Office :** Gala # 16,1st floor, Mehta Industrial Estate M & T Studio Compound, A.K.Road, Andheri (E), Mumbai - 400 093
Tel : 022-66791416 /17/18, Fax : 022-66791421
Contact: Mr. R. Chandrasekaran, email: chandrasekaran.r@indiainsure.com

New Delhi # B-3/6, 2nd Floor, Asaf Ali Road,New Delhi - 110002
Phone No: 011 43538760/61
Contact: Mr. P. Srinivas Rao email: srinivas.rao@indiainsure.com

Pune Office No.592/2, Deccan Gymkhana, Off J M Road, 2nd Floor, Next to Hotel Central Park, Pune - 411004.
Ph: 020-66030713, 020-66016676. Fax: 020-66030713
Contact: Mr. Suresh Subramanium,
email : suresh.subramanium@indiainsure.com