

RISK ALERT

Newsletter from India's Leading Insurance Broking Company

HIGHLIGHTS

P2 - OVER SPEEDING KILLS THE WEG!! | P4 - DEVIL IS IN THE DETAILS
P5 - CYBER RISK FOR CORPORATES | P7 - A RIOT!! | P8 - COSTLY NON-DISCLOSURE

THE GAME CHANGER

The Property insurance market for Commercial Enterprises witnessed a paradigm shift in the way the insured and the insurance companies will look at insurance and insurance pricing, going forward.

The General Insurance Corporation of India (GIC), the undisputed leader in the reinsurance market, modified the reinsurance program given to the insurance companies stating that for certain occupancies / industry segments, the premium has to be collected at certain minimum rates that had been prescribed by the Indian Insurance Bureau (IIB) with effect from 01 March 2019.

The insurance industry was in a state of complete confusion for a few weeks with meetings for clarifications including an effort to postpone the implementation, as they felt that they were not prepared for such a drastic change in the scenario very close to the beginning of the financial year, when substantial commercial property insurances fall due for renewal. GIC stuck to its decision except for providing certain clarifications.

For many of the Corporates, the premium increase was anywhere between three to seven times and the industry as a whole moved from denial to acceptance over a period of time. There were representations from trade associations and legal remedies were also tried. A few of the large Corporates also decided to buy time by opting for renewal of the policies for a few months instead of the normal one year.

Even before the new changes had settled down, the IIB published the revised

minimum rates. GIC again modified the reinsurance treaties of insurers mandating that the rates will be applicable to all occupancies with effect from 01 January 2020. While this reduced the rates for the specified occupancies whose rates had increased from 01 March 2019, many occupancies which paid negligible or zero premium for FLEXA group of perils (Fire, Lightning, Explosion excluding Act of God perils like Flood and Earthquake) will pay a substantially high premium, varying between two and five times the existing premium.



Earlier efforts to bring in a sense of a reasonable pricing in the Property insurance market had systematically failed, even though there were attempts by both the insurance companies and the insurance regulator, because the competition ensured that any self-regulatory mechanism or guideline did not last beyond a few weeks / months.

In this background, the GIC's move was completely different as almost all insurance companies in India reinsure a significant portion of their risk with GIC. Without this reinsurance support, it would not be possible for insurance companies to accept any risk. Though GIC's move did not mean that the insurance companies could not charge a lower rate, it meant that the risk would not be covered by the Treaty given by

GIC – meaning that every insurance company would have to abide by the new rates.

The immediate unfairness of the stand taken by GIC was obvious, as this

- ★ Clearly discriminated between occupancies with higher rated risk being insured at 1/10th of the lower rated risk as GIC did not prescribe the minimum rate for all industries, but only for a particular class. (This anomaly has been subsequently corrected, as higher rates are applicable across all industries with effect from 01 January 2020).
- ★ Provided no option of lowering the premium by opting for higher deductible, which many of the Corporates would have definitely considered.
- ★ Was not differentiating between a good and an average risk thereby not incentivising better safety and risk management processes.
- ★ Implemented disruptive changes without consultation with stakeholders.
- ★ Did not take a graded approach which they could have easily done over the last decade.

At the same time, this was probably the only way to move towards rationalising the premium structure. This is essential to ensure a healthy and fair relationship between the insurance company and the insured, without which insurance as an important and critical tool to protect an enterprise in the event of a catastrophic or life threatening incident, is lost.

This was the state of the market in the last decade with pricing being the primary focus with the result that claims, especially the large ones, were being delayed and denied.

We are sure that the insurance market will rationalise the increased pricing to ensure

On Outsourcing

The knowledge needed for any activity has become highly specialized. It is therefore increasingly expensive, and also increasingly difficult, to maintain enough critical mass for every major task within an enterprise. And because knowledge rapidly deteriorates unless it is used constantly, maintaining within an organisation an activity that is used only intermittently, guarantees incompetence. - Peter Drucker

flexibility in deductibles and better pricing for good risks in the days ahead. Corporates would have to reconcile to the fact that the difference between good and average risks including opting for higher deductibles would probably reduce the price by about 20-30% and they cannot expect the zero price market to return!!

The immediate fallout of the increased pricing, as expected, has been a strong resistance to the price increase with many corporates looking at substantial reduction in the values insured and removal of additional covers and policies earlier opted for. In fact, one of the largest premium paying commercial enterprises in India has opted out of Business Interruption cover in their renewal due on 01 January 2020!!

While the insuring corporates may feel that the sudden increase in their premiums multiple times is not acceptable, they will over the next few years, realise that this move has made the commercial insurance sector more viable which will have a significant positive impact on the claim settling scenario.

 **Vijay T**
AICWA, ACS, BL, AIII
CEO & Executive Director

Claims Anatomy

OVER SPEEDING KILLS THE WEG!!

An incident of over speeding of a 1500 KW wind electric generator (WEG) resulted in its complete collapse.

This incident occurred when the grid supply was not available for the windmill. The pitch control system which regulates the speed of the blade malfunctioned, resulting in overspeeding of the blades. The abnormal forces developed due to the overspeeding of the blades, resulted in the blades striking the tower, because of which the tower collapsed along with nacelle, generator and hub and the blades. Consequent to the fall from 65 mts height, the generator, hub and nacelle had severe impairment to their structural integrity as well as damage to internal components, rendering them not useable.

The sequence of events showed that the grid supply had failed initially. The WEG has an automatic switching of power supply from the grid to the pitch control system, which regulates the blades. This system is powered by battery banks.

When the battery bank failed, the power supply to the pitch system got cut thereby disconnecting the power supply to the pitch control system, because of which the control of the pitch of the blades was not possible resulting in out of control speeding and collapse. This simultaneously resulted in excessive voltage supply to the control panels at the bottom of the windmill, resulting in fire damages.

The overspeeding not only resulted in the damages, but also caused over voltage generation by the



Corona Impact on Business Insurance

COVID-19 Pandemic has put a sudden focus on business interruption (BI) losses which were an area often receiving a low priority even for large corporates leave alone the MSMEs and commercial enterprises.

Most enterprises except exempted sectors will be facing shutdowns resulting in production losses which may extend to loss of market and profitability in the months ahead. The current market wordings in India for BI cover require a direct physical loss or damage to property to trigger a BI loss and for insurers to provide indemnity. This direct physical damage in a Fire policy is restricted to named risks like a Fire or a Flood and in an All Risk policy any insured risk other than exclusions.

The bottom line is that without physical loss or damage BI claims are not payable. At the same time, Clients in some of the European markets, affected by Coronavirus, may litigate that contamination of the factory and products manufactured therein is physical damage. They may even extend this logic to say that preventing this contamination by shutting down or Government lockdown directions is a consequential loss and must be admitted as a BI loss.

Apart from business interruption, the other possible areas of concern are:

- ★ Goods in transit may be lost/damaged. The marine clauses clearly state that loss or damage by delay, even though caused by a risk covered, is not payable.
- ★ Denial or Prevention of access extension in certain policies also requires the occurrence of an insured peril/physical destruction or damage as a trigger for a claim.
- ★ Some policies have extensions for BI arising out of accidents in customers/suppliers premises. Again physical loss or damage at customer/suppliers premises is a prerequisite.

GIC, the monopoly reinsurer in India, by way of abundant caution, has asked insurers to include a communicable disease exclusion clause on policies, recently. The point is that neither the insurance company nor the insured contemplated such a situation and the intention to insure such diseases was never there and neither was the premium rates factored to pay such claims.

It could be possible in a Pharma or a Food industry that a few employees are affected by the virus and consequently the stock may be considered contaminated and the factories shut down, for safety reasons. Whether this will constitute physical damage is debatable.

As things stand today, the debate will have to be decided only in the court of law!!

**The above view is a general understanding of the current situation. The terms and conditions of individual policies need to be reviewed for coverage and admissibility on a case to case basis.*

Continues...

generator. This caused an explosion in the converter located in the control room at the ground level, resulting in fire and complete damage to the converter and control systems.

The appointed surveyor visited the site, confirmed in his survey report about the collapse of the windmill and the subsequent fire in the converter control room at the ground level. The surveyor mentioned that the nacelle assembly including generator, got crushed, the hub was smashed and the main frame got deformed. All the cables running to the cable room were burnt, melted and twisted. The PLC based control panel and the power panel were burnt and charred. The PLC system batteries had cracked. The only items that were undamaged were the step up transformer and the transmission lines situated adjacent to the tower.

Based on these damages, the surveyor came to the conclusion that the WEG was beyond repair and required replacement. The surveyor went into the cause of loss and found that the pitch system batteries were in punctured condition on the side and at the top. It was also in burnt, melted and in blackish condition and the nearby control system had also burnt.

According to the surveyor, the battery bank had failed and a flash over from this had resulted in the control system and cables being charred followed by control panels being burnt. This resulted in overspeeding, with the blades hitting the lower portion of the tower, causing structural instability of the other parts, resulting in a total collapse. Though the pitch system batteries were found in burnt / melted condition, there was no fire or explosion marks on the batteries or in the surrounding areas. Also, there was no record or evidence of anyone having observed a fire or explosion in the batteries. The manufacturer's detailed description of damages to various parts of the batteries also only recorded mechanical nature of damages to most of the parts, except for damages to the converter and converter panels and cables by fire. All these clearly established that there was an electrical fault in the pitch system battery, which is a breakdown risk.

The insured had only a Fire policy, covering the windmill. The surveyor concluded that only the cost of the control and converter panels and the power and control cables, which had caught fire, was payable under the policy, and all other damages were the result of a breakdown which was not covered, and allowed about 10% of the total loss of Rs.7 crores suffered by the insured.

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The
Claims
Team



Bharat REview

When Bharat RE Claims Team had a preliminary discussion with the insured and the Original Equipment Manufacturer (OEM), it seemed quite clear that this was a straight forward case of machinery breakdown and the subsequent fire damages which were negligible was only payable under the policy and the stand taken by the surveyor seemed reasonable.

It was only during subsequent detailed discussions, when each aspect of the sequence of events was reviewed, that we were able to identify the root cause of the incident. Once we were able to establish this, it required many more discussions with the OEM and with component experts before we were convinced that the entire damages are payable under the Fire policy.

Getting convinced was one part, convincing the insurance company was another task, especially since the surveyor had released his report and the insurance company had paid the assessed loss. Obviously, the detailed technical analysis and logical presentation of the loss and its coverage under the terms and conditions of the Fire policy did not convince the insurer and the issue had to be taken to arbitration.

Bharat RE team handled the entire arbitration process, with substantial technical inputs and policy interpretations clearly drafted and presented to the arbitrator, which spanned a period of almost six months. A battery expert's opinion was sought for and he was also part of the witness team in the arbitration process.

The Arbitrator finally agreed with our contention and awarded a settlement including interest, of around Rs.5 crores, which was almost ten times the initial assessment of the surveyor.

 **Claims Anatomy**

DEVIL IS IN THE DETAILS

The insured, one of the largest manufacturers of explosive detonators and detonator fuses in the country, decided to increase the manufacturing capacity and revamp the block manufacturing the critical raw material for the finished product. Since this would take a period of six months, the insured accumulated the stock of these raw materials to meet their requirement for this period before they shut down the plant for renovation.

The insured removed the assets of this block from the Fire policy and took a separate Erection All Risk (EAR) insurance for this plant, which was more appropriate under the circumstances.

After the revamping was completed and as trial production was going on there was an explosion in the Plant which killed a few employees and the plant was shut down. Apart from the repairs to the plant, because of the fatalities involved, the restarting of the plant required approval and certification by explosives authorities of the Government of India and the process took a long time.



Image is for representative purpose only

In the meantime, the accumulated stock of raw material was not enough to maintain production of the finished product resulting in production and profitability loss.

Apart from the Fire policy for the operational assets and the EAR policy for the block being expanded and revamped, the insured had also taken a Consequential Loss policy and made a claim under the policy. One of the leading surveyors was appointed to estimate the Consequential Loss claim and he concluded that the claim was not payable as the Consequential Loss policy had a requirement that a claim had to be admitted under a Fire policy for a consequential loss to be payable.



Bharat REview

This claim was handled by the promoters of Bharat RE in the year 1985 and the present value of the claim adjusted for inflation would be about Rs.7.50 crores. Interestingly, this claim was one of the main reasons why subsequently the Material Damage proviso under the Consequential Loss policy was changed by the insurers to specifically mention the requirement for a Fire policy and this condition is still in force!!



Image is for representative purpose only

When the policy was reviewed by the experts appointed as claim consultants, they were able to establish that the policy coverage was available since the requirement was only for the risk of fire to be covered and not that a Fire policy was a requirement. EAR policy taken for the block under construction did cover the risk of fire and the conditions for the consequential loss policy was satisfied.

The insurance company, after consultations with their legal experts, admitted the claim. Having crossed this hurdle, the surveyor contended that there was anyway no production loss because the accumulated stock was enough to take care of production. The claim consultants had to make a detailed analysis of the production and sales data projections requiring extensive discussions with the technical, marketing and the financial personnel of the insured.

The Business Interruption claim was finally admitted for an amount of Rs.1.25 crores.

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The
Claims
Team





CYBER RISK FOR CORPORATES

In the past two years we have been reading about cyber attacks on Indian corporates resulting in either loss of data or loss of money. The hackers are getting more and more sophisticated that despite mitigations put in place by the corporates like fire walls and security protocols, they are overridden by miscreants operating from across the globe.

In the case of a mid-sized Private bank in South India, a hacker group successfully obtained the login credentials of authorised officials and transferred money out via SWIFT platform to bank accounts held by them in China, Dubai and Turkey to an amount of about US\$ 2 Million. In an earlier incident the hackers disabled the ATM switch validation software and withdrew cash of about Rs.33 Crores in over 15000 transactions using cloned debit cards at more than 200 locations in 3 continents.

The Indian cyber insurance market is limited with only 5 or 6 insurers having filed a cyber insurance product with IRDA. However, this appears to be good enough for the first level interest shown by Indian corporates to

cover themselves against Cyber risk. The India insurance community has started engaging clients and prospects as well as prospects to initiate a discussion and make a presentation about this emerging risk.

Currently the cyber liability insurance policies in India cover data related losses and costs as well as data related to third party liability. Some of the Indian cyber wordings also cover loss of money or securities due to a cyber attack or what they call a "Wrongful act". The policies usually cover costs involved in handling or managing the breach event like notifying the government and individuals whose private data has been lost/ stolen. Also, policies are extended to cover costs for investigation and public relations, ransom demands etc.

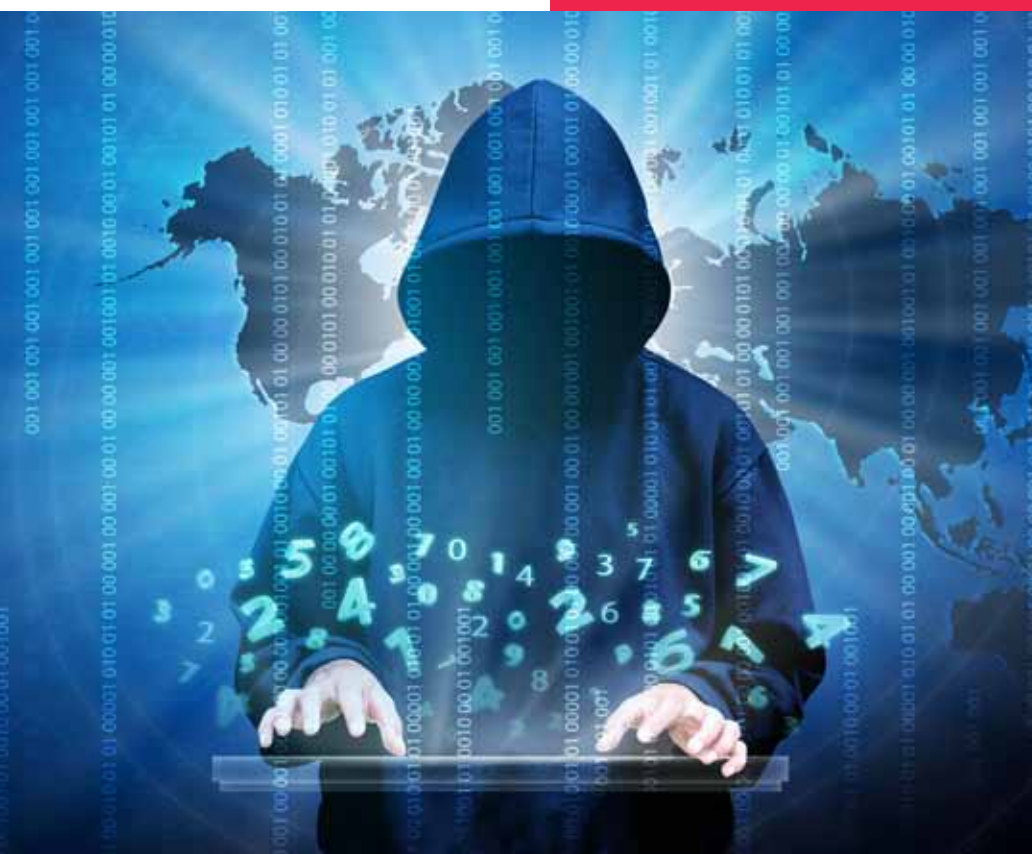
In the much reported Bangladesh Bank incident, hackers had gained access to the SWIFT login credentials of the Central Bank of Bangladesh, sent hundreds of instructions to Federal Bank of New York

to transfer money to an account in Sri Lanka. Same hackers sent SWIFT instructions to the Sri Lankan bank to transfer the money to the bank account of a casino in Manila, Philippines. Then the criminals withdrew the money by cash from the Philippines bank account. The total amount lost was US\$ 81 Million. The intention of hackers was to steal about US\$ 1 Billion.

More importantly, the cyber insurance policies cover third party liability arising out of a cyber attack where the data belonging to a third party was lost or stolen from the IT systems of the insured policy holder – for example credit or debit card information of customers lost by a Bank, proprietary or IPR protected information handled by a research firm or a consulting firm compromised or stolen in a cyber attack would end up as liability action by the third party against the insured. The cyber insurance policy usually covers these liabilities to the full value of limit of indemnity which also includes defence costs, legal representation costs, investigation costs etc within the same limit.

Even though Indian cyber insurance market is in its nascent stage of growth, the cyber-attacks on Indian Corporates has been on the high as reported by CERT-IN, the premier cyber incident records bureau in India. It is expected that cyber criminals from across the globe will focus more on Asian corporates including Banks, especially in the SME or mid-cap segment as their cyber security infrastructure would be basic and would not stand against the onslaught of attacks from highly capable and sophisticated criminals who can wreak havoc on the operations of these Indian companies.

The incident relating to a private bank head quartered in Pune, was much discussed in public as there were two types of attacks on the same day and similar to the earlier private bank incident. Hackers could break the connection between the ATM Switch and the backend/Core Banking System (CBS) and made more than 18000 withdrawals totalling Rs.78 crores using cloned non EMV debit cards of customers. Same day they also entered SWIFT login of the bank and transferred Rs.13.92 Crores to their account in Hong Kong.




What is happening around the world on a day to day basis is Business Email Compromise which has got many variants like CEO Fraud, Fake President Fraud, Social Engineering Fraud, depending on who is the perpetrator and who is the victim. In such instances fraudulent mail is sent by the hacker posing as CEO or MD of a company addressed to the CFO or any subordinate official instructing them to transfer money to bank accounts of a legal

counsel or a third party, mentioning it is a “Confidential operation related to an acquisition and to be kept confidential”. Other instances of Social Engineering fraud are cases where hacker sends a fraudulent mail posing as a supplier or an outsourced vendor attaching fake or doctored invoices with bank account details of the hacker. Insurance markets world over are aware of this challenge and are including cover for these incidents as part of various insurance

products – normally as part of a Cyber first party cover, a CGL cover or Commercial Crime and sometimes as part of a Business package policy. It is our belief that business organisations, irrespective of the sector or domain in which they operate, should take cyber risk seriously and mitigate possible financial crisis or bankruptcy caused by such attacks by taking appropriate insurance protection.



Bharat REview

 **T.L.ARUNACHALAM**
B.A, B.L, All

Emerging Risks Practice having international exposure with specialization in Liability Insurances including Cyber & Commercial Crime Risks.

Our Emerging Risk Practices Team emergingriskpractice@bharatre.in is at your service to help you design a comprehensive Cyber Risk protection program, which we have been doing for Banks, Financial Institutions and large manufacturing entities.

In addition, our Associates in the cyber security field will be able to audit your company’s preparedness for a cyber-attack and plug the gaps!!

Session on Emerging Liability Risks in the Corporate World conducted by Bharat RE in association with Liberty General Insurance in December 2019 at Chennai.




Claims Anatomy

A RIOT!!

During a bandh in the Western state of India, a mob of protestors entered the premises of a large auto components factory and caused extensive damages to the plant and machineries and stocks.

Following the incident, the insured suddenly shut off the main supply of electricity for the plant and machineries, as a precautionary measure. Apart from the damage caused by the rioters, the sudden stoppage of electrical supply caused electrical break down of various machineries and equipment.

The mobsters not only damaged the glass doors and panes, but also computers, furniture and all electronic equipment. They also set fire to various assets and damaged several machineries and quality lab equipment, by throwing them to the ground and breaking them using iron rods and wooden batons.

The main shop floor and the quality control lab were completely devastated. Stocks of semi-finished and finished goods were cracked and broken and scattered all over the plant premises. The rioters also carried away part of the stock. The total damage estimated by the insured ran into several crores of rupees.

During the claim assessment, the following disputes surfaced:



- ★ The loss assessors contended that the damages due to the sudden shutting off of power was not directly related to the riot and would not form part of the riot claim. The insured opposed the stance stating that the shutting off of the power was a direct consequence of the riot and had to be considered as part of the claim. The loss assessor was at most, willing to consider the damages as a breakdown and assess it as a separate claim, which was not acceptable to the insured.
- ★ One of the quality control equipment was badly damaged. Since the original manufacturer could not support in terms of providing a detailed estimate of the loss and the repair cost, the loss assessors deducted 60% towards betterment and obsolescence, which was considered very high by the insured.
- ★ For some of the items, the insured could not provide the exact capitalisation details and the surveyor refused to consider them for assessment.
- ★ Substantial cost was incurred in clearing the damages caused by the rioters. This included additional payments to both the third party vendors and internal resources. This cost was disputed by the assessors.



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Bharat Review

In almost all major claims, there is always a wide gap between the expected loss settlement of the insured and the final assessment by the surveyor. While a policy without gaps is a prerequisite (unfortunately not so in many policies), interpreting the policy wordings and coverages, countering the sometimes unjustified deductions by the loss assessors and the insurer and in some cases balancing the insured's expectations requires technical, commercial and legal skills.

We are proud that Bharat RE's claims management skills across industries and various products is one of its kind. Our claims expertise has proven repeatedly that significant monetary value is added to claims process for our clientele.



Legal Eagle

COSTLY NON-DISCLOSURE!!

The Supreme Court by its recent judgment has absolved insurance companies of the burden to follow up an inadequate disclosure of material facts by the Insured. The Court held that it is not the duty of the insurer to conduct a line of enquiry with previous insurers with regard to the nature and settlement of prior claims, if any.

The insured had purchased a hydraulic excavator which was insured with a public sector insurer. During the period of this policy the excavator caught fire and a claim was made. Since the excavator was under repair the insured did not renew the policy. Almost a year later the insured took a one year policy with another insurer. The excavator again caught fire and another claim was made. The insurance company repudiated the claim on the ground that all material facts which were required to be disclosed by the insured for the insurer to assess the risk profile had not been disclosed. The proposal form had contained a specific question with regard to the details of the claims lodged in the preceding three years. This question was not answered by the insured who had simply enclosed the earlier insurance policy with the proposal form.

A complaint was instituted before the State Consumer District Redressal (SDRC) which allowed the claim of the Insured. The National Consumer Dispute Redressal Commission (NCDRC) in appeal, concurred with the findings of the SDRC and held that as the previous insurance policy was attached with the proposal form, the Insurer could have made himself aware of any prior claims by undertaking an ordinary due diligence and/or conducting an enquiry with the previous Insurer.

The Apex Court dismissing the findings of both the SDRC and NCDRC held that the law of insurance is governed by the principle of utmost good faith, which imposes a duty of complete disclosure on the Insured with regard to material facts. The court discussed the duty of disclosure placing reliance on leading books and held as follows:

“The assured must disclose to the insurer all facts material to an insurer’s appraisal of the risk which are known or deemed to be known by the assured but neither known or deemed to be known by the insurer. Breach of this duty by the assured entitles the insurer to avoid the contract of insurance so long as he can show that the non-disclosure induced the making of the contract on the relevant terms....”

The Court also placed reliance on its prior ruling where it had held that when information on a specific aspect is asked for in the proposal form, the assured is under a solemn obligation to make true and complete disclosure of all the information within its knowledge in that regard.

The Court after considering the facts and circumstances of the matter before it, observed that any information sought for in a proposal form amounts to a material fact. A mere enclosure of the previous insurance policy does not discharge the duty of the Insured to make a full, true and complete disclosure of the claims that were lodged under the previous insurance policy in the preceding three years.

A bare perusal of the previous policy could not have in any way brought to the notice of the Insurer that a claim was lodged under the prior policy which had been settled by the previous Insurer.

Holding that the foregoing suppression went to the root of the contract of insurance and validated the grounds of repudiation, the Supreme Court reversed and set aside the decision of the NCDRC.



Bharat REview

Insured tend to take proposal forms and declarations quite lightly, not realising that they form part of the insurance contract. In many cases, inadvertent or casual information in these forms and declarations leads to disputes and denial of claims.

We are quite used to signing blank proposal forms and documents for many of our transactions, and carry the same attitude to insurance also. While this may not be of much significance in other areas, it could make the difference between settlement of a claim or denial, when it comes to an insurance contract.

