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# RISK ALERT

NEWSLETTER FROM INDIA'S LEADING INSURANCE BROKING HOUSE 2017 - 18 - 01

## From the Editor's Desk

### The Year 2016 - 17!!

The General Insurance industry has grown by 32% during the financial year 2016 - 17 to a total premium of Rs.1,27,600 crores. The major growth has been due to substantial increase in the crop insurance premium by about Rs.15,000 crores, which constitutes more than 48% of the total premium increase.

Another 37% growth is due to increase in Motor third party and Health insurance premiums. It is a matter of concern that the commercial insurances of Fire, Engineering, Marine and Liability have shown only a marginal growth, with Marine and Engineering showing a negative growth.

### Pricing - Commercial Insurances

Price correction in the commercial insurance space did not materialize, as the internal competition between the insurers and intermediaries ensured that the pricing continued way below viable levels. The comparison between the market pricing and the IIB pricing\* is scary, with many risks having a rate lower than 1% of the recommended pricing!!

Thankfully, some hope of realistic pricing atleast in the distant future was visible, with rates for large risks going

up, due to an understanding between the insurers to stick to certain minimum rates. How long this would last, is anybody's guess!!

### Competitive Pricing - Good or Bad for Corporates ?

Why do we, as insurance and risk management consultants, keep going on about the premium rates being unsustainable, when in reality, the commercial enterprises are enjoying the lowest premium rates in decades.

In fact, they are on an average, paying less than 1/10<sup>th</sup> of the premium that they were paying in the 90s. What then is the concern?

Obviously, the major concern is the practical inability of commercial enterprises to enforce the insurance contract when they are pushed to the wall by unfair, unreasonable stand taken by the insurers and an interpretation of the policy terms and conditions in many cases, way beyond the contract terms. This is inevitable when the insurance industry is collecting, for example, Rs.10 as premium for a risk, knowing fully well that they need atleast Rs.60 to do what they are supposed to do - settle claims fairly and quickly!!

### The Blame Game

The blame game has been on for many years as to who is responsible for this.

- The insurers' greed for business at any cost (or)
- The intermediaries' (only) ability in many cases, to put the insurance companies against one another, and come up with an excel tabulation of the premium rates (or)
- The insured (in majority of the cases, the finance team), deriving great satisfaction in having squeezed the insurance company to the last rupee for the sacred grain of L1 (or)

a deadly combination of all three!!

The bottom line in all this is, insurance as a tool to protect a commercial enterprise from severe financial stress or bankruptcy in the event of a major accident, has lost out. Commercial enterprises have to settle down to getting zero to a maximum of 30% of their actual losses due to a potent combination of inadequate insurance, badly drafted policies and an insurer not wanting to settle, unless he is forced to.

If it is your commercial enterprise at the receiving end, what are your options?

A legal remedy ??.....in India??

### 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 organization an activity that is used only intermittently guarantees incompetence."

- Peter Drucker

## Claims Study

In the World Bank's "Ease of Doing Business" survey of 2017, India ranks 130 out of 190 countries overall. And in ranking for enforcing contracts, we are ranked 172.

### BEST OF LUCK!!!

\* The Insurance Information Bureau had come out with "Adequate Pricing" for commercial enterprises, taking into account the incurred claims for various industries.

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

### ABC Insurance Company Ltd



Marketing / Sales Meeting



Claims Department Meeting

### ON OUTSOURCING



#### What Peter Drucker means...

The requirement for "Outsourcing" cannot be more critical than in the insurance and risk management areas. Enterprise Risk Management (ERM) has moved way beyond insurance expertise alone, and today requires skills from other domains - both technical and commercial. It is impossible for an enterprise to have in-house expertise for ERM, and more importantly, keep it updated and useful, especially when the usage can only be in the event of an infrequent major claim.

### Sum of Parts - Much more than the Whole!!

The Chennai floods resulted in substantial damages to a castings factory in Chennai. The Material Damage claim was in excess of Rs.7 crores. The flooding was spread over a 20 day period from the middle of November, to the beginning of December.

The Material Damage claim, after many negotiations, was settled at acceptable, if not reasonable, expectations of the insured. The operations of the unit were substantially crippled during the entire period, resulting in serious interruption of the production process, consequently leading to a loss in turnover and profits.

The unit had a Business Interruption cover and was quite confident that the policy will compensate them for production losses. The surveyor requested for various documents pertaining to the actual production during the interruption period, (when partial activity was being carried out), production during the previous year, details of financials of the company etc..

The insured submitted all the details, and to his surprise, received a detailed working from the surveyor, who had interpreted the production loss in such a manner that the entire business loss over the interruption period, after applying the policy excess, resulted in a final claim amount of "ZERO".

The surveyor's interpretation was based on the splitting of the production loss in tonnage terms at 62% for the first incident and the balance for the second. This was based on an assumption of total interruption days as 21 and all calculations based on actual production in this period and the standard output during the interruption period, which resulted in a shortfall in production of an average of only 3 days for the first incident and about 4 days for the second incident, which was within the policy excess.



When the workings of the claim were gone through in detail, the following facts emerged:

The classification of the incident into two separate events in itself was debatable, as the initial damages and the repair process was on-going when the second flooding occurred. However, since the insurance industry was looking at the Chennai floods as two events, one pertaining to the end of November period, and the other pertaining to the beginning of December, the need for bifurcation of the claims could not be avoided.

At the same time, there was a clear overlap between the original flooding and the related repairs and the second incident. For example, assets that were damaged during the first event and which were repaired, were damaged again. Assets which were in the process of being repaired were again affected by the second


**Risk Management**

## Cyber Risk - your business exposed?

flood and assets which were not damaged during the first event were damaged during the second event. A combination of all these resulted in loss of production and loss of business income.

It was obvious that the production loss did not end with the restoration of the machines, as several other factors, including the testing, synchronization and return to normal production went way beyond the time the flood waters receded.

It was a challenge to establish that the indemnity period during which the business of the insured was affected, continued even after the flood waters receded.

After several discussions and debates, the actual interruption period was arrived at about 48 days and not the initial 21 days which the surveyor had contended. Also, the split up of the interruption days between the first and second events were debated during heated arguments and it was possible to establish through production and sales records and the repair time cycle, that the impact of the second incident on the production loss was minimal and the major loss happened only because of the first event.

The surveyor was finally convinced with the arguments put forth to assess the loss due to the first incident at 44 days, and the impact of the second incident at only 4 days. Establishing this fact was crucial in ensuring that a substantial claim amount was payable due to the first event.

If you thought establishing the loss and the indemnity period was a challenge, more was to follow.....

**(Continued as Flooded with Expenses .....page 7)**

As they say, it is not the question of IF but a question of WHEN. More and more of Indian corporates are experiencing some form of compromise of their IT network by many forms of cyber - attacks and computer crimes. They may face data loss or denial of access to their own servers, and in some cases, may lose financially by cost of recovering or rebuilding data, including ransom payment to the hacker, and also face legal action by those whose data was compromised.

Globally, Cyber - attacks are on the increase across sectors - Ponemon Institute which tracks this activity, predicts much higher cyber - attack activity in the coming years, in view of increased dependency of a digital, paperless and cashless business environment.

Take the case of Target Corporation, the second largest discount store retailer in the United States, after Walmart, operating 1806 stores around the USA. In December 2013, a data breach of Target's systems affected up to 110 million customers. The hackers had accessed Target's systems through a login provided to their HVAC contractor to access one of their servers resulting in their entire system being compromised. The private information like credit and debit card details, names and addresses etc., have been compromised. Target had to comply with US Federal regulations on handling this breach. As of 2017, Target had ended up spending \$300 Million already and may have to spend more - in the form of compensation to customers, breach handling costs, investigation costs, defence costs for appearing in investigations and court cases, fines and penalties imposed by multiple regulators, suits files by banks, financiers and retail investors etc..

Closer home in the year 2016, three of India's most respected Banks faced breach of their systems and millions of credit/debit card data were breached and leaked on the internet. Investigations by Government and regulators are still on going. When the Indian government brings in tougher legislation and the Indian judicial and legal system finds worthwhile pursuing the cases, the subject will become priority.

The now famous Wannacry attack and later Petyaransomware attack which hit recently, are signals of what is coming and why a typical Indian corporate should wake up and try to mitigate the impact of a severe cyber - attack. Today business organisations think mere Virus protection applications and some initial fire walls installed is sufficient security for their systems and their data. What they do not realise is that if White House, Pentagon or some of the world's biggest corporates who have spent millions of dollars on cyber security lose their data and face a shutdown, why are business enterprises trusting their low level mitigation efforts?

Codespaces.com was a software escrow services company, who used to store software code written by a software development company and release it as an escrow agent to Corporates, as and when payments are released to them. In 2014, an unauthorized person-not believed to be employed by the site-gained access to Code Spaces's Amazon EC2 control panel. When the team fought back, the hacker deleted most of their data, backups, machine configurations and offsite backups. The Company could not face the investigations, the regulatory action, legal action from their customers for negligence in service, cost of engaging third party service providers etc. and had to shut down their operations.

If ultimately the IT systems are breached and data, software, financial data, design information etc. are lost or held back for a ransom, or the hacker is able to shut down operations as it happened to APM terminals, one of world's largest container terminals resulting in millions of dollars of business loss - it will be a severe balance sheet hit which many midcap or SME corporates cannot afford.

## What is then the solution ?

As hackers are more sophisticated than anyone else, there may not be a permanent fool proof technical solution but there is a financial solution to withstand the severe impact of a cyber attack. A well designed Cyber Security insurance cover can be put in place, where, if the hacking event occurs and data is compromised or lost, the insurance company would pay for first party costs such as cost of retrieving and rebuilding data, cost of getting back control of the servers by paying a ransom, breach handling costs etc and third party costs - such as liability exposure by way of a suit filed by owner of the data or information which results in an award and also incidentals like legal defence cost, investigation costs, regulatory and civil fines and penalties etc.



## Bharat RE view

It is our belief that business organisations, irrespective of the sector or domain in which they operate, should take this risk seriously and obtain cover for Cyber Security risk which can save them from financial crisis or bankruptcy.

Our Emerging Risk Practices team is at your service (support@bharatre.in) to help you design a comprehensive Cyber Risk protection program. In addition, our Associates in this field will be able to audit your company's preparedness for a cyber-attack and plug the gaps!!

## T. L. Arunachalam

*B.A.B.L. Associate member of the Insurance Institute of India - With New India Assurance in various capacities for a decade, Head of MNC marketing team - Japanese and Korean business, Business Head - Chennai Operations and Commercial Lines with IFFCO - TOKIO, Executive Vice President - Monarch Insurance Company - Philippines, Expertise in Marine and Liability risks.*

## Carried Away by Bankruptcy

A South Korean liner carrier's bankruptcy, which resulted in hundreds of thousands of shipments around the world being delayed, was the biggest in the container shipping industry since the 1986 bankruptcy of U.S. Lines. This has thrown ports and retailers around the world into confusion, with giant container ships marooned.

Hanjin was the largest Korean container carrier and the seventh largest in the world before filing for court receivership.

The company's collapse resulted in hundreds of thousands of shipments around the world being delayed, and the initial estimate by Korea's maritime ministry was 540,000 TEUs. Some shipments were stranded on Hanjin ships just outside of ports or inside terminals for months while the company, shippers, and others haggled over who would pay the cost of unloading the carrier's ships, delivering them beyond the port, and the detention and demurrage charges.

Hanjin represents nearly 8% of the trans - Pacific trade volume for the US market and the bankruptcy was having "a ripple effect throughout the global supply chain".



"Retailers' main concern is that there [are] millions of dollars' worth of merchandise that needs to be on store shelves that could be impacted by this. Some of it is sitting in Asia waiting to be loaded on ships, some is already aboard ships out on the ocean and some is sitting on US docks waiting to be picked up. It is understandable that port terminal operators, railroads, trucking companies and others don't want to do work for Hanjin if they are concerned they won't get paid", as quoted.

## Bharat RE view



Source - Media

The Bankruptcy would have had serious consequences if materials in transit for a commercial enterprise was lost or damaged, if the Institute Cargo Clauses of 1982 were being used, where "insolvency or financial default of the owners, managers, charterers or operators of the vessel" is an exclusion. This was subsequently modified in 2009, to cover such instances, only when "at the time of loading of the subject-matter insured on board the vessel, the Assured are aware, or in the ordinary course of business should be aware, that such insolvency or financial default could prevent the normal prosecution of the voyage".

The above is a significant change in wordings to provide protection to insureds who have no control over such a situation.

If you thought you were safe, **Think AGAIN**. Many of the policies that we have seen, still use the 1982 clauses.

As they say "**The DEVIL is in the DETAILS!!**"

 **Claims Study**



**The bRE Promise for Small Enterprises**

It is our mission to insure the uninsured.

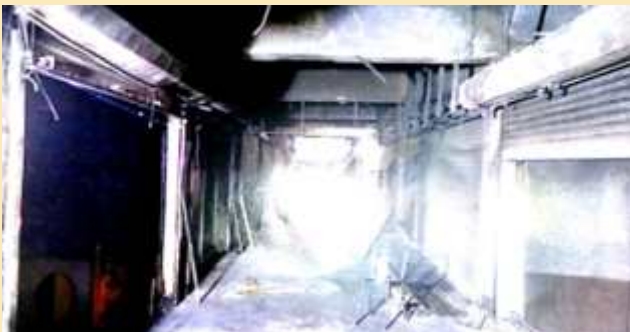
We have been insuring small commercial enterprises, who, in many cases, are taking insurances for the first time. This has been possible through our broking assignments with a trader association with more than 3 lakhs members, a commercial bank and a small enterprise financing company through which we are insuring more than 20,000 SMEs per annum



A Garment factory in Andhra Pradesh was gutted by a fire and was a total loss



Retail shoe shop and warehouse completely destroyed by fire in Punjab.



A Silk Saree shop in a shopping complex that deals with old zari for silver has been totally affected by a fire in Chennai.

 **Claims Team, Bharat RE**

While this business may not be financially lucrative, it gives us immense satisfaction that we have been able to prevent entrepreneurs from going out of business simply because they have not been convinced earlier to go in for insuring their assets. In many cases, the premium payable was less than Rs.3/- per day. It only required a little persistence and the team to do it.....


**Claims Study**

## The Art of Reading between the Lines - PERFECTED!!

An industry in the food processing sector, involved in the manufacturing of flavours, was saddled with a Product Liability claim of almost Rs.1500 lakhs.

The unit was sourcing inputs of raw materials and was doing two main processes, raw materials screening and separating, to ensure desired size particles and uniformity and blending of various ingredients including chemicals, the finished product being in the form of a powder.

This material was used by their Customer A in manufacturing another product which involved additional ingredients being added. The finished product of this Customer A was then supplied to the final client, Customer B who used it in his product.

Customer B, during the manufacturing process, noticed certain contaminants in the materials. On further investigation and analysis, the cause of the contaminant was traced to the materials supplied by the insured. The following were the fallouts:

- 62 tonnes of material supplied to Customer A by the insured, was rendered useless - a portion being used by Customer A, and the balance lying with him.
- Customer A used the material supplied by the insured to manufacture 108 tonnes of his finished product. This material was supplied to Customer B - again a portion used by Customer B and damaging his product and the balance lying with him.
- A month's sale of Customer B was affected severely impacting his margins.
- Customer B also had to incur expenses towards loss minimization by reworking some of the stocks and also air freighting for replacements.

As expected, Customer B claimed from Customer A for all his losses, who in turn made a claim on the insured, for

the amount claimed by Customer B, in addition to his own losses.

The insured had a Product Liability policy with extensions for Product Recall, Guarantee and Financial Losses. This policy was being taken by the insured for decades with the same insurer and they were confident that the claims would be settled in full.

A Surveyor was appointed to assess the loss and after months of providing detailed information on issues pertaining to manufacturing process, quality management systems, discussions with the quality assurance team, detailed information on food safety standards, internal hazard analysis manuals, details on quality standards approved and permitted by the customer, quality policy, food safety management system certificates, product data sheets, shelf life / storage conditions, certificate of analysis, vendor audits, customer complaints handling etc., the Surveyor came to the conclusion that only 15% of the total claim was payable and even this 15% he felt was excluded under a specific section in the policy, and left it to the insurer to decide if they were willing to settle even this percentage of the claim.

The stunned insured had to deal with the opinion on the inadmissibility of a major portion of the claim by the Surveyor, based on:

- The problem of contaminants has been a perennial issue as can be seen from the communications exchanged between the insured and Customer A well before the present problem. An analysis of the quality control and manufacturing process by the Surveyor showed that the systems were defective and there was no structured and documented system for the entire process.

**} The insured has been in this business for decades and has not had any such issue so far. The present material itself was being manufactured for many years and**

***almost 500 tonnes of this material was being supplied every year, without any complaints.***

- It cannot be clearly established without any doubt, that the contamination happened at the insured's end and could have occurred anywhere along the supply chain.

**} A detailed root cause analysis and traceability reports by three large organizations namely the insured, Customer A and Customer B which traced the contaminant to the insured, was conveniently ignored.**

- A detailed analysis on the various communications between the insured, Customers A and B, established contamination, but it did not automatically mean that the material was unusable. The conclusion arrived at, based on communications, was that it is likely that the rejection of the material was due to the unacceptable level of the contaminant, rather than the presence of the contaminant itself.

**} This contention of making a distinction between a "contamination" and a "damage" seemed weird, especially when the policy was issued to a manufacturer of food products!!**

- The Surveyor also contended that reprocessing was a viable proposition, which was not attempted. The ingredients are basically a mixture of various components, and since there was no manufacturing process or chemical change but only a physical process of mixing solids, it would have been easy to remove any contaminant.

**} While the possibility of removing contaminants was theoretically right, provided the insured product had not been mixed with other products, the final mixture which was used by Customer B had more than 15 ingredients, which made**

*the process of reprocessing by removing the contaminant, impossible!! Another fact conveniently ignored.*

Even after having listed out so many issues, it did not stop at that!! Every attempt was made to bring all the expenses under a particular section of the policy to ensure that the limits of the other sections are not used, and the limit of sum insured under that particular section was exhausted.

Recall expenses was interpreted as “Financial Loss” expenses by trying to make a distinction between the product supplied and recalled which was absurd, as the product supplied had been mixed with the product recalled and it was not possible to separately recall the insured’s product. Product Liability claim, which was clearly proved in this case, was also interpreted to come under “Financial Loss”, even though damage to tangible property of Customers A and B was proven beyond doubt.

**Vi. K. Subramaniyan**  
Director - Operations

*All, was with the National Insurance Company. Nearly two decades as an insurance broker, handling portfolios of large and multinational corporates.*

## Bharat RE view

A Product Liability claim, especially in India, is quite difficult to establish as the awareness of the insurance coverage and its extensions are still being (mis)understood and interpretations vary from “reasonable” to “ridiculous”!!

The competence of the loss assessment fraternity in dealing with an insurance policy which is more legal oriented rather than assessment oriented, is still a “Work-in-Process”, with the consequence that almost all claims are getting into complications without a practical approach.

## Flooded with Expenses.....

(continued from page 2)

Apart from the production loss, the client incurred the following:

- After the flooding, substantial expenditure was incurred on expert consultants to study the electrical infrastructure of the factory, before grid restoration could take place.
- } ***Whether this formed part of the Material Damage claim or was to be part of the Business Interruption claim was a matter of contention. At one point of time, the possibility of expenditure not being paid under both the coverages was a likely outcome.***
- Hire charges for gensets and lighting equipments were incurred both for dewatering and repair and reinstatement of assets, and for the actual production, till grid power was completely restored. Apart from the hire charges mentioned above, there was also substantial expenditure in acquiring motors and other equipment for dewatering, lighting etc. as they were simply not available for hire.
- } ***These assets having become permanent assets of the company, how does one compensate under the policy - as expenses incurred for restoration activities under Material Damage or under the Business Interruption claim, or is it restricted only to the notional hire charges? Debatable!!***
- Diesel and oil expenses for maintaining production and for repair and replacement activities were substantial.
- } ***These expenses were relatively easier to claim as the bifurcation between Material Damage and Business Interruption claim was the only concern, as expenses were incurred for actual production activity like furnace oil for melting furnaces and holding furnaces, and also ancillary activities like running the canteen.....***
- A portion of the production activity was outsourced to sub contractors to maintain production. Substantial expenses were incurred for these activities including outsourcing of casting manufacturing, heat treatment operations and short blasting activities. Overtime charges for workers in the factory were paid in order to ensure that production was maintained. Also, substantial cost was incurred in payments to executives who had to work on holidays as well.
- } ***The surveyor accepted the overtime charges for the workers, but considered the payments to executives as notional. Even if the actual payment had been made, it would be treated as a departmental supervision for restoration, a fixed cost which only can fit in the material damage claim and will again be set off as saving in Business Interruption.***
- Transportation and infrastructure expenses for additional labor and for existing staff, as the normal transport system was affected and movement of materials to various sub - contractors.
- } ***Here again issues arose as to whether these expenses can be claimed under Material Damage or Business Interruption and how much of the expenditure were normal routine expenses and how much was due to the effects of the floods?***



 In The News

- Substantial expenditure was incurred in airlifting materials to customers to meet the production schedules, as against the normal process of sending materials through sea freight. The additional cost was almost six times.

**3** *Even though the cost incurred was substantial and claimable under the increased cost of working, almost 40% of the expenses were not claimable, as they exceeded the contribution saved by maintaining production.*

**3** **R. Srinivasan**  
*B. E. (Civil), AIII (Fire)  
 Technical Director with more than 30  
 years experience in Insurance  
 industry, covering Risk Management,  
 Underwriting, Reinsurance & claims.*


 Safely Unsafe

If you thought that bank lockers are the safest place for your valuables, then think again. For, even the Reserve Bank of India (RBI) has now said that “banks have no liability for loss of valuables in lockers.” This means that you should not expect any compensation for theft or burglary of valuables kept in safe deposit boxes of banks as the locker hiring agreement absolves them of all liability. This bitter truth was disclosed in an RTI response by the RBI and 19 PSU banks.

Worse, even the private sector banks are not better in this case as even their locker hiring agreements are almost similar in nature. For instance, the locker hiring agreement of a leading private sector bank says, “The Bank shall not be responsible or liable for any loss or deterioration of or damage to the contents of the Locker whether caused by rain, fire, flood, earthquake, lightening, civil commotion, war, riot or any other cause/s not in the control of the Bank and shall also not be liable or responsible for any loss, sustained by the Hirer/s by leaving any articles outside the Locker.”



Source - Media

 Bharat RE view

Transforming a claim from zero to more than Rs.8 crores before the policy excess, requires technical and commercial skills of the highest order. Our unmatched professional competence in the Business Interruption segment where our conceptual, practical and legal acumen has helped our clients to rightfully claim a reasonable compensation as per the terms and conditions of the policy and its interpretation.

Hoping to replicate this skill for an organization through its internal resources would not be practical, simply because the opportunity to use these skills will be very limited, while we handle these situations repeatedly for more than 1500+ commercial enterprises that we currently advice.

 Bharat RE view

Insurance covers are available for jewelry in lockers under the Householder's Policy, including possibilities of insuring on an All Risk basis, which covers the jewelry even during transit. The availability of the policy does not automatically mean a person will insure, as we are a society not enthusiastic to take insurance!!

Recently, an Association of a flat complex constructed a temple at a cost of Rs.3.5 lakhs out of the Association's funds and the great efforts made by the flat owners in collecting donations. The flats were severely affected by the Chennai floods with water upto the second floor. Many residents suffered losses to their contents which were not insured.

The total premium payable for insuring 84 flats would have been approximately Rs.35/- per month for each flat owner. Efforts to convince them to insure even after they have actually suffered losses was in vain.

**This is what they mean, we suppose, by “God will take care”!!**

Considering the fact that we don't even take a flood insurance, imagine insuring jewelry in lockers!!