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Newsletter from India's Leading Insurance Broking House
February 05

Summary

India Insure
The risk managers

Message from the Editor

Dear Readers,

We were rudely awakened, the day after Christmas, to learn that a catastrophe in the form of deadly Tsunami waves struck South Asia without warning, bringing with them death & destruction to property, rendering millions homeless.

Fortunately, the people of the world are united in their effort to ensure that the affected, irrespective of caste or creed are rehabilitated to resume their normal lives.

We extend our profound sympathies to all those who lost their loved ones, friends and property. Importantly, during this hour of crisis, we hope that as a human race we should work together, so that in future we are forewarned of any such occurrences to take protective measures.

We thought it only appropriate that we should share with our readers some information on Tsunamis and have dedicated a chapter to it, although much has been written on the subject.

It may also be an opportune time to remind those of our Readers who may have their Insurance programmes due for renewal on 31st March that *'a stitch in time will save nine'*.

With warm regards,

V Ramakrishna
Managing Director

De-Tariffing

History of Tariff & Recent Developments

The Indian Non-Life Insurance Industry is one of the few in the world still governed largely by Tariff. The Tariff Advisory Committee, which controls all rules, regulations, rates, terms and conditions relating to more than 70% of business in India, was set up in 1968 to impart stability and prevent unhealthy competition.

Even today, Tariff extends to Fire, Motor, Engineering, Workmen's Compensation and Marine Hull (all other lines of business are considered Non-tariff – where markets can determine both price and terms, although only after filing the same with IRDA). Marine Cargo was de-tariffed in 1994, which led to a crash in premiums – this was arrested beyond a point only because all the players (PSUs only) decided to work together.

Ever since the sector was liberalized in 2000, there has been serious talk of de-tariffing the entire portfolio. Given the extent of deregulation in other industries like telecom etc, financial services modernization and economic globalization, continuance of Tariff is considered anomalous. The Malhotra committee (1994) recommended a progressive dismantling of tariff. More recently, the AC Mukherjee committee also endorsed the same and the Justice Rangarajan committee recommended the same for Motor Own Damage.

Pros and Cons of having a Tariff

Although it is fashionable now to push for de-tariffing, it had (and maybe still has) some merits. Protaganists talk of tariff's ability to instill stability in market and prevent unhealthy competition, minimize underwriting expenses, encourage business growth with price certainty and also protect consumers from insurer failures.

On the other hand, abolishing Tariff has its merits too.

- De-tariffing would lead to innovation and flexibility in product design and pricing
- Rating would be more realistic and risk-based – loss-control measures would be rewarded
- Underwriting skills would improve
- Customers would benefit from lower prices and shift towards efficient insurers
- Consumers would have wider choice of companies and products
- Cross subsidies would vanish

Tariffs have been based more on assumptions rather than on an analysis of claims data. Consequently, they do not reflect international market trends. For example, TAC had set reinsurance tariffs when global rates were very low. India's reinsurance pricing was completely out of sync with the world market when global reinsurance rates surged after the September 11 attacks. Therefore Indian Insurers were forced to sell their products at low tariff rates despite the hardening of international reinsurance rates.

It appears anachronous to continue operating in a liberalized sector without liberty to decide on the terms and conditions to be offered by the insurers.

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The TSUNAMI Disaster

On December 26, 2004, an earthquake of 9.0 Richter magnitude, off the Indonesian Island of Sumatra sent 500-mph waves surging across the Indian Ocean and Bay of Bengal, impacting countries across Asia and Africa, and killing more than 1.7 lac people in its wake.

What is Tsunami?

A tsunami is a natural phenomenon consisting of a series of waves generated when water in the sea is rapidly displaced on a massive scale. Earthquakes, landslides, volcanic eruptions and large meteorite impacts all have the potential to generate a tsunami. The effects of a tsunami can range from unnoticeable to devastation.

The term *tsunami* comes from the Japanese language meaning *harbour* ("tsu") and *wave* ("nami"). The term was created by fishermen who returned to port to find the area surrounding the harbour devastated, although they had not been aware of any wave in the open water.

History of Tsunami

Tsunamis are not a rare occurrence. There have been 790 tsunamis the world-over in the last 100 years.

Tsunami risk quantification effectively is the aggregate of both local and far-field events. For example, Hawaii could experience tsunamis from events in Alaska, Chile, Japan, or the Northwest Coast of North America.

One of the most infamous volcanic eruptions, Krakatau in 1883, generated a tsunami that occurred in the same region as the present one. Krakatau's eruption occurred in the Sunda straits in Indonesia between the islands of Java and Sumatra. At least four main waves were generated from the eruption. The waves reached 30 to 40 meters above sea level, and in some areas the water swept through 8 km inland, including through dense jungle.

According to Applied Insurance Research (AIR), there have been three events in this region over the last 200 years with magnitudes of Mw8.5 or greater that generated a tsunami: 1833 Mw8.7-9.0, 1861 Mw8.5 and 2004 Mw9.0.

Insurance Implications of the Tsunami

Surprisingly, although the economic cost of the disaster is expected to be substantial (around $ 10 billion – according to a Munich Re estimate), loss to insurers has not been very high. This is primarily because insurance penetration is relatively low in the countries that suffered the most. Per capita spending on non-life insurance premiums in the region ranges from a low of US$3.50 for India to a high of US$87.20 for Malaysia. As against this, per capita spending is US$1,980.20 for the United States and US$1,441.40 for the United Kingdom and US$768.00 for Japan.

The insured losses are most in the commercial arena, notably for resorts, hotels and other tourist facilities.

Magnitude of Insured Losses

The estimates of insured losses, as in Mid-January are as follows:

Thailand: US$1.25 billion

Sri Lanka: US$1.0 billion

Indonesia and India: US$1.0 billion each

Malaysia: US$100 million

In Thailand and Sri Lanka losses, are mainly from Hotels/Resorts, whereas in Indonesia and India, insured losses are expected from government buildings and the Telecom/Power sectors.

The largest single risk insured loss was reported from Indonesia. It is a large cement plant, with a total insured loss of US$50 million.

Estimates of losses to insurance majors:

- Swiss Re about US$88 million
- Munich Re about US$135 million
- Hannover Re about US$10 million

Does your Insurance cover Tsunami?

Internationally, tsunami is insurable specifically (more about this later), but in India, thanks to its non-occurrence, it does not find specific mention in most insurance policies. However, it is covered – as can be seen from the discussion below:

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The TSUNAMI Disaster - Contd.... # 02

Property Insurance

In India, Commercial property policies follow the British practice. The basic fire policy covers fire and Special Perils like lightning, explosion, implosion, aircraft damage, etc. It automatically covers Storm, Tempest, Flood and Inundation (STFI). The Insured has the option to exclude STFI. This policy can be extended to cover other perils like earthquake.

As per All India Fire Tariff, which governs the rates and terms of business written in our country, for a Tsunami claim to be admissible, STFI peril should not be deleted and Earthquake cover should be included. (However, interpreting the clauses, one of the Insurers in India has taken a stand that if **either** flood or earthquake – and not necessarily both - is covered then the losses are payable under the policy.)

An All Risks policy provides cover against all the perils except those specifically excluded. It is a well-known fact that tsunami is never specifically excluded.

Motor Vehicle Insurance.

There are 2 types of policies available in India to cover motor vehicles; ***Liability only Policies*** and ***Package Policies***. The package policy provides earthquake and flood covers automatically. But there is scope to delete the coverage and get premium reduction. If earthquake and flood are not excluded then tsunami cover is available.

Personal Accident Policies

Personal Accident policies cover would cover injury or death due to natural perils, including tsunamis.

Marine Hull Policies

Typically, Marine Hull policies would provide protection from all perils of the sea – including tsunami.

It is therefore strongly advised, as a matter of financial prudence, to ensure that both STFI and Earthquake perils are included in all policies. The cost of cover, even considering the rarity of the occurrence, is far lower than the potential losses. In fact, an ALL RISK Policy, wherever possible, is even safer.

While commercial establishments can plan and minimize losses, it has been seen that the biggest sufferers in such natural disasters (eg: Tsunami, Gujarat & Latur earthquakes etc), are those with the least awareness or access to insurance – the common people. Insurers and Re-insurers are insulated from large catastrophic losses as long as India remains under-insured in this area.

De-Tariffing - Contd.... # 01

International Experience

International experience suggests sharp changes after de-tariffing. A study by AEI-Brookings Institute finds that deregulation of prices will help restore competition and increased economic efficiency.

The detariffication experience in **Japan** has shown that large firms expand their market shares not by price competition but through improved services and advertisements. Similarly **South Korea** has gone through similar price deregulation in motor insurance and a recent empirical study indicated higher loss ratios after deregulation. A study of **Spanish** deregulation by Wharton showed that many small, inefficient, and financially under-performing firms were eliminated from the market and markets preferred relatively large and efficient firms.

De-tariff road map

In response to various recommendations, IRDA had planned to De-tariff Motor Own Damage (OD) during April 2005 and follow it up with Fire etc over the next year or so. However, at last count, they have decided to call off the proposed Motor detariffing, at least for now. This was done following the feedback from insurance companies who felt that the entire motor portfolio including the third party portion of motor insurance should be detariffed!

Judging from the one-step-forward-two-steps-backward progress we have been witnessing, it is anybody's guess as to when this move will actually happen. The reasons for delay are obvious. The immediate fall-out of any de-tariffing is normally a price war – which Indian insurers can ill-afford till their balance sheets become more resilient. The regulator is obviously concerned. Moreover, an important pre-requisite for de-tariffing – reliable premium and loss statistics – is not yet available within the industry.

While we wait for de-tariffing to happen, the need of the hour is to develop a database of reliable premium and claims information upon which insurance pricing can be based. All the stakeholders – insurers, customers, brokers and surveyors – need to prepare for the event. Corporate customers, especially, can review their loss-control measures and improve overall house-keeping – and reap the benefits by commanding a healthy discount to market.

In Lighter Vein

- What's the difference between an actuary and a mafia don?

  The actuary can tell you how many people may die this year. The mafia don can tell you the names of all of them.

- A man wanted to buy some insurance for his car, so he went to the insurance company and asked for the list.

  First there was anti-fire, which has a $200 premium. Then, there was anti-theft, which had a $150 premium. At the end, he noticed that there was an "anti-fire and anti-theft" policy for only $50!

  He asked the receptionist, 'Why in the world would you price a policy for two problems less than that for one problem?'

  The receptionist replied, 'Because nobody steals a burnt car.'

Risk Management Tips (Spray Booths)

Spray painting operations which are part of most manufacturing concerns are also a nightmare for a factory risk manager. An accumulation of overspray in the paint spray booth, on the fan blades, on the filters, and in the duct is subject to ignition and will contribute to the rapid spread of any fire. This hazard can be effectively controlled when the operation is restricted to a standard paint booth that is cleaned regularly, and that has a properly installed and maintained automatic sprinkler system.

Provide Adequate Sprinklers or Other Protection

Automatic sprinkler protection must properly protect the interior of the booth, the area behind the filters, and the interior of the exhaust duct. Place sprinklers in booths on extra hazard spacing of 90 square feet. In ducts, install sprinklers every 12 feet. In cold places, use dry-pipe sprinkler systems in ducts that are subject to freezing. The system should include a separate indicating shut-off valve so that the entire sprinkler system does not have to be shut off if there is a fire in the booth. In non-sprinklered buildings, domestic water lines can be used as the water supply. The water supply should have adequate volume and pressure to supply an appropriate number of sprinkler heads to protect the operation.

Where automatic sprinkler protection is not available, or where another type of extinguishing means is better suited to provide the required protection, spray areas may be protected with a dry chemical, carbon dioxide, or a gaseous agent extinguishing system.

Place an adequate supply of approved portable fire extinguishers near spray areas and mixing rooms.

Inspect and Maintain Sprinklers

Improper maintenance of the sprinkler system can cause a delay or failure of the sprinkler head in the event of a fire within the booth. This failure could allow the fire to spread beyond the booth, resulting in more extensive damage to the surrounding areas. Inspect the sprinkler heads in all paint spray booths to check for accumulation of overspray residue. Replace any heads that have been painted or coated with new listed sprinklers. Protect the new sprinklers from future accumulation by covering them with cellophane bags or thin paper bags [.003 inches (.076 mm)]. Inspect the coverings at frequent intervals and replace them as necessary to limit the accumulation of residue.

Provide Adequate Ventilation

Equip all spray areas with mechanical ventilation adequate to remove flammable or combustible vapors or mists to a safe location, and adequate to maintain the concentration of flammable or combustible vapors or mists in the exhaust stream below 25 percent of the Lower Flammable Limit (LFL).

Be sure that the spray booth filters are properly fitted into their mountings. Overspray deposits in the duct are difficult to clean, and may cause a rapidly spreading fire due to spontaneous ignition.

Proper Booth Construction and Maintenance

The spray booth should be constructed of noncombustible materials. The interior surfaces should be smooth and designed to prevent pocketing of residues and to facilitate ventilation, cleaning and washing. To clean the interior of the spray booth, use solvents with flash points above 100°F and non-sparking scrapers and tools. Operate the booth's ventilation system during cleaning. Wet down the scraped-off overspray residues, deposit them in properly approved metal waste containers, and remove them from the building immediately.

Prohibit smoking, and post "No Smoking" signs, in areas where flammable and combustible liquids, solvents, or adhesives are used, sprayed, or applied.

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