i notes
Newsletter from India's Leading Insurance Broking House
August 2013

Summary

india insure
The risk managers

Message from the Editor

Dear Readers,

We derive great pleasure in reaching out to you with yet another issue of the *i-notes*.

The proposal of the Government to hike the FDI from 26% to 49% through the automatic route has brought cheers to many players in the insurance market in India. While the insurance companies wait with a great deal of suspense for Parliament to give its nod to the Bill, 'industry watchers' are forecasting a shakeup in the insurance market in terms of competition and market share duly facilitating or adversely impacting the fortune of a few insurance players. Whether the hike in FDI will increase the competitiveness among the Insurers through increased capacities to underwrite inter-alia compelling certain insurers to explore newer markets is being discussed and debated. Let us wait and watch the sequence of events that is likely to unfold in the near future as a direct impact of the hike in FDI.

The construction industry is fraught with high degrees of Physical, Financial and Liability Risks. While great care is taken in respect of the insurance of physical and financial risks, not much of thought goes into the buying of adequate covers for Liability Risks. We feel that while buying insurance covers for any construction/erection project, due care should be exercised in getting proper protection against potential liabilities.

In this issue of the *i-notes*, we have endeavoured to highlight on the liability risks associated with construction projects and also the insurance covers that can address such risks.

The interview section carries excerpts from the discussions that we had with Mr. James Amberson, Head Global Risks Division, Bajaj Allianz General Insurance Co. Ltd; Mr. K Murali, Sr. Vice President, IL&FS Ltd; Mr. B.Vara Prasad, Vice President (Insurance), Reliance Infrastructure Ltd; Mr. Praveen Sethia, Founder & Director, Infrastructure Advisors Pvt. Ltd; Mr. K.S. Parasuram, General Manager, F&A, Punj Lloyd; and Mr. Sobhanbabu Vadde, Vice President, SEW Infra. Their opinion on the liability risks relating to and their impact on the construction industry as well as the insurance covers available thereof have been captured.

A claims case study, carried in this issue, quite clearly, brings out the travails of a project promoter, in the aftermath of a loss, where the insurer views a repair as an improvement in the design of the project.

In the 'Readers Speak' column of this issue, Mr. M. Ravichandran, President, Tata AIG speaks on the ways & means of 'Increasing Insurance Penetration in India'.

With best wishes.

V G Dhanasekaran
Editor - *i-notes*

Liability Risks in the Construction Industry

- *7 February 2013: 3 killed as Mumbai airport flyover collapses - The Hindu*
- *10 January 2013: One killed as girder collapses at Metro construction site in Chennai - ndtv.com*
- *5 September 2012: Project delay led to Rs 874 loss for NHAI - Indian Express*
- *22 June 2010: Design defect in Zirakpur flyover makes roads beneath accident prone - Indian Express*

Introduction

The construction industry is quite complex with high degrees of risk and potential liability. The sheer size, scope and timing of today's projects pose significant risk management challenges including identifying risks, determining the allocation of risks among the parties involved and developing risk mitigation plans.

Risks in the construction industry may be broadly classified into 4 categories:

- **Conventional Risks:** such as fire, lightning, explosion, etc.
- **Catastrophic Risks:** such as storm, flood, hurricane, cyclone, earthquake, landslides etc.
- **Liability risks:** Third party property damage or bodily injury arising out of faulty workmanship, faulty design, faulty materials, negligence, fraud, errors & omissions, pollution etc.
- **Other Risks:** Loss of profits, delay in completion, terrorism, etc.

The main focus of this article is on Liability risks and the corresponding insurance coverage available for risk transfer. In drafting the insurance requirements of a construction contract, the owner, architect/engineer and contractor must clearly understand project work scope and project risks, as well as the proper allocation of liability and property damage exposures and costs.

Review of Liability Coverage available in the market

Commercial General Liability (CGL)

The CGL policy provides coverage for liability arising from bodily injury, personal injury or damage to property of third parties. Additional coverage provided by a CGL policy includes Advertising Injury and Medical Payments. This policy also needs to include the interests of the other partners of the project because of the 'no blame' contractual environment between them; hence the policy needs to be drafted accordingly.

Completed Operations Coverage: The possibility of an unforeseen event arising after a construction project has been handed over to the owner is not remote. The contractor's work stays behind and can be a source of grave liability claims. Consequently, abundant caution should be paid to the completed operations coverage provided by the CGL policy.

Consider the following examples:

- Seven months after a roofing contractor finishes work at an IT company, rain water enters through the roof and ruins several network servers.
- A railing installed by a metalworker collapses as a man leans against it. The man falls ten feet and is turned into a quadriplegic.

The CGL policy's completed operations coverage pays for any property damage a contractor may be liable for, if damage takes place once the contractor has finished his work or the project has been put to its intended use. The standard CGL policy provides that completed operations coverage "includes all 'bodily injury' and 'property damage' occurring away from premises you own or rent and rising out of 'your product' or 'your work'...."

The Insurer will provide the contractor with legal defence and pay for any settlement that results from accidents arising out of completed work. It is important to note that, the insurance will also pay for the restoration,

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repair or replacement of any third party property loss made necessary because the contractor performed his work incorrectly.

Completed operations coverage is usually not a problem with a contractor's annual CGL policy, which continually provides this cover for all projects which the insured previously completed. However, when project specific insurance policies are used, completed operations issues can get complicated. Some projects are massive and involve so many contractors that it is easier for the owner or general contractor to sponsor an insurance program specific to that project. These are commonly known as wrap-up policies usually either as an owner controlled insurance policy (OCIP) or a contractor controlled insurance policy (CCIP), depending on whether the owner or contractor sponsors the insurance program. Owner controlled insurance programmes ensure that whilst there are multiple contractors, liability/disputes between contractors does not eat away policy limits such that principal is left with no cover. The major issue with completed operations coverage in wrap-ups is providing the coverage for a sufficient period of time after the project is completed.

Unfortunately, in the Indian scenario, the contractor does not purchase CGL insurance in a majority of cases because they rely on the Third Party Liability (TPL) insurance provided under the CAR (Contractors All Risk) policy. However cover provided under TPL is very limited and narrow when compared to a CGL policy. Besides, TPL covers liability only during the construction period and once the project has been handed over, this exposure is left open.

Professional Indemnity (PI)

In traditional project delivery (design-bid-build), an architect or engineer provides design services while actual construction or implementation of the design is carried out by the contractor. In this scenario, the potential liabilities facing the design professional and contractor are fairly well defined. However, as the complexity of projects increases and new construction contracts are introduced, design responsibilities are becoming more fragmented. Not only is it common to have multiple design firms involved in a single project, but some or all of them may routinely contract directly with a construction manager or a contractor, rather than the owner, to provide design services. Hence, project owners are requiring their contractors to take on additional construction management activities and, with greater frequency, are looking for the contractor to provide a single point of responsibility for design and construction. So, Professional liability coverage has become just as essential to a contractor as it is to an architect or engineer.

In this situation, the following list of professional liability exposures runs the gamut, from pure design exposures to contractor/ construction management-related exposures:

- Negligence in preparing plans, drawings, designs and specifications

  (Eg- An engineer, miscalculated the cooling needs of the building and specified an inadequate ventilation system. The building owner demanded Rs. 3.8 lakh to replace the poorly performing system.)
- Errors involving site surveys, soil testing, subsurface conditions, elevations and grading
- Failure to design a structure per minimum local building codes
- Negligence in selecting or recommending building materials
- Use of incorrect materials or failure to use materials in appropriate mix
- Failure to detect faulty workmanship on the part of a subcontractor

  (Eg- A contractor failed to detect the faulty workmanship of a masonry contractor who placed hollow concrete block without proper re-bar reinforcement as specified in the plans. Once discovered, the structure had to be torn down and rebuilt at a cost of approximately 12 lakh plus resulting delays in project completion.)
- Suits relating to costs or quantity estimates

  (Eg- The contractor made a cost estimate of Rs.20 lakhs for a warehouse project. A loading platform was later found to be inadequate to meet the stated needs of the warehouse. With the revisions, the project cost Rs.25 lakhs. The contractor was held liable for the 5 lakh difference.)
- Negligence in rendering professional services causing Third-party bodily injury or property damage

  (Eg- A design engineer improperly designed an HVAC system and it was installed in an office complex. Mold formed in the chillers and the air in the building made people ill. Multiple claimants filed suit against the owner who in turn filed it against the design engineer.)
- Negligence related to construction management leading to cost over-runs & delays

However in practice, construction related Professional liability insurance is often underinsured relative to the exposures created when commencing a new project. Again the trend in India is to rely on the design defect (DE) cover provided under the CAR (Contractors All Risk) policy which only pays for the damage to property arising out of the defective condition. Also the Third party liability under CAR policy will not cover liability arising from the faulty part (related to DE extension).

The critical aspect to be noted here is that the professional liability damages generally break down as follows:

- 60 percent: Economic Loss
- 25 percent: Property Damage
- 15 percent: Bodily Injury

These percentages are significant because CAR policies typically cover only bodily injury and property damage — not economic loss. Hence the necessity of a separate PI policy needs to be underscored.

Professional indemnity policies cover any damages that arise from the rendering or failure to render professional services. Costs and expenses incurred to investigate, defend or settle any claim are also included. PI insurance is 'claims made' insurance which means that the policy only responds to claims first made against the organization during the policy period, irrespective of when the act of negligence actually occurred.

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Interview – *Corporate*

What in your view are the Liability Risks that your industry is exposed to and what might be their impact?

Typically in the infrastructure industry we are exposed during the execution of our work to the Principals, the Authorities and the General Public, in and around the site of execution. The insurance for the project are dependent on the obligations under the contract , we make to take all or some of them like, Professional Indemnity, Third Party , CGL, Employers Liability or Pollution Liability.

*– **Mr. K.S.Parasuram,** General Manager, F&A, Punj Lloyd*

Financial Institutions have strict compliance rules and regulations to follow, as demanded by clients and more so by regulators. In this rapidly evolving financial environment, professionals and managers of financial institutions are exposed to a myriad of potential exposures for the directors and officers, for the errors and omissions as also general liability risks under common law. The new information age brings in cyber liability risks as also employer liability risks. These risks unfortunately cannot be quantified accurately and one has to keep the general award trends to estimate the impact.

*– **Mr. K Murali,** Sr Vice President IL&FS Ltd;*

Public liability, Product liability, Pollution liability with specific coverage for waste management, Professional liability, Employers liability, Land acquisition liability, Liability due to delay in completion of project etc. Regarding the impact from the above exposures, it is difficult to quantity in general sense, as it will vary from each exposure and type of risk.

*– **Mr. B. Varaprasad,** Vice President (Insurance), Reliance Infrastructure Ltd;*

In my view the biggest risk, which the Infra industry is facing today is implementation risk and delay caused by counter party performance. Counter party includes government authority, contractors / sub-contractors and local issues. Another risk is the environmental approval and impact risk. Negligence claims can also arise relating to design, workmanship or defective materials.

Key commercial factors are price volatility risk of key commodities and interest rate

*– **Mr. Praveen Sethia,** Founder & Director, Infrastructure Advisors Pvt. Ltd;*

The following are the risk exposures under liability insurance in infrastructure industry:

- Third party liability under CAR/EAR policy
- Public liability
- Commercial general liability
- Employer's liability
- Directors and officers liability
- Professional Indemnity

EDLI and Gratuity policies covering future gratuity of employees (Life covers) are also very useful.

*– **Mr. Sobhanbabu Vadde,** Vice President, SEW Infra*

There are several Liability insurance policies available in the market (eg: Professional Indemnity, Employer's Liability, Third Party/ Public Liability, Commercial General Liability, Pollution Liability etc). Which of these are relevant for your industry and does it / do they meet your specific needs?

KSP : The policies are not tailored to the specific needs of the Contract Obligations, most of the times they are standard which are juxtaposed.

KM : The insurers have devised these covers based on the exposures that arise from time to time. But these are generic and are not customised after a study of the clients' business and risks. There is a need for an extensive involvement of the broker/insurer with the client to understand his business and suggest one umbrella liability cover instead of offering a slew of independent products.

BV : The Policies mentioned are all relevant. However, fine tuning of the following at the local level would be advantageous. The following aspects of liability need to be tailor-made to meet our industry specific needs:

- Delay in completion of the project due to delay in acquiring ROW (Right of Way) for a Metro Project.
- Design and Construction defects impacting upon the operation of the completed project.
- Advise on design cost not being economical during the construction phase.
- Deficiencies in other services, upon which the successful operation of the project depends e.g., feeder roads are not constructed or urban development does not proceed as anticipated.
- Market risk, e.g., switch by potential users to public transport reducing the reliance on the toll way resulting in less than predicted turnover.
- Political risk, when there is a change in priorities of government resulting in change in the policy for BOT projects and lack of political support for the government of the day to support the completion of an on-going project.

Do you believe the PROFESSIONAL INDEMNITY policy available today meets your requirement completely? If not, what improvements would you suggest?

KSP: Professional Indemnity also needs to be fine tuned so that it's altered to meet the specific requirements of the client.

KM : The PI cover available today covers most of the known liabilities. However new exposures like Tax opinion liability for mergers and acquisitions are arising and I am not sure whether an insurance policy can be extended to cover these.

BV : The cover is adequate. In case of large projects, where there is need for specific requirements, we do ask for those inclusions in the policy coverage.

PS : The policy available in the market is good enough but more than availability of PI policy, effective coverage under the available product is very important. Whatever assumed or believed to be covered gets jeopardized due to interpretation of the policy or the cumbersome process. The insurance industry has a long way to go in terms of keeping the wordings simple and the claim process more transparent.

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Professional's PI insurance

The commonly adopted approach is for the Principal to rely on the design professional's PI insurance by specifying the limits of insurance to be maintained. However relying only on the design professional's annual policy has significant limitation from the principal's perspective including:

- Principals share the design firm's PI policy limit with many other firms. A single claim from any other principal can erode or exhaust the limits of liability.
- Many professional liability claims arise well after project completion. An owner has to depend on a design firm to stay in business and continuously renew its insurance for a number of years after completion of their work.
- Difficult to get the name of the Owner as an additional insured on the policy. Most professional liability underwriters for design firms do not prefer to name owners as additional insured as the policy limits could get exhausted by a single claim.

Eg- A contract was issued to construct a school. The architect was responsible for procuring all design services and was required by the owner to evidence a limit of INR 20 lakhs PI as per the contractual agreement. On completion of construction, several problems were discovered in the HVAC and electrical systems- all attributable to the design team and rectification of these took another 3 months (because of which the students had to be accommodated at another place) and an additional expenditure of 5 lakhs incurred. The total damages alleged by the owner caused by time delay & cost over-run were INR 17 lakhs. During litigation, it was found that the architect had only INR 5 lakhs remaining in its PI policy because of defense and claim payments on another project of the architect. The school owner had to settle for the balance 5 lakhs and incurred a 12 lakh loss to its bottom line.

In order to fill this gap; alternative methods to insure professional liability have evolved.

Purchase Project-Specific Professional Liability Insurance

Project-specific professional liability insurance is purchased by the owner and insures claims arising out of the work of all professionals providing services related to a specific project. The policy is written for the term of the work and for an extended reporting period following issuance of a certificate of occupancy. The project policy automatically replaces the annual practice policy of the professionals because the PI policy generally excludes all projects insured by a project policy.

The advantages of a project specific professional liability policy include the following:

- Coverage, premium and limits are dedicated to the project
- Coverage for all professionals
- Single source of responsibility for all claims

The downside is the relatively high cost of this insurance. Also it is important to purchase a cover which not only includes design errors/omissions but construction mismanagement as well. Architects and engineers are not the only parties who need this insurance. Design/ builders, construction managers and even general contractors provide certain professional services and so should be included under this policy. It is also important to build in a primary / non-contributory clause to ensure smooth claims processing. Since the cover will include multiple insured, cross liability clause also becomes critical to ensure non erosion of limits.

Purchase an Owners Professional Protective Indemnity (OPPI) Policy

The Owner's Protective Professional Indemnity (OPPI) policy was developed to provide owners of construction projects an alternative to project specific professional liability policies. The OPPI extends coverage to the owner only, for damages arising out of professional liability created by the design team on the project. The owner still requires the design firm to evidence its PI policy for minimum limits as per contract conditions and the OPPI policy will sit as an excess over the design firm's PI policy.

OPPI insurance is usually purchased on a project-specific basis but can also be placed for a group of projects undertaken by a single owner on an annual basis. For project specific policies, a 5 year extended reporting period is generally provided beyond the construction period.

The OPPI policy is a first party indemnification policy and third party professional liability policy intended to indemnify the owner for economic damages, bodily injury or property damage due to the negligent performance of its subcontracted professionals and provide coverage for the owner from third party claims. In a first-party loss situation, the owner notifies its insurer at the same time that it brings a claim against its design professional. The OPPI policy is then triggered when the design professional's PI policy limits are exhausted. For a third-party claim, the owner notifies the insurer when it receives notice of a claim from a third party which activates coverage under the OPPI policy directly.

The major attraction to the OPPI is usually cost. Coverage is typically written on an excess and difference-in-conditions basis, so protection may be afforded for claims that are excluded in the annual policies of the design firms. If the underlying coverage is not available (due to depleted limits or cancelled coverage), the OPPI policy responds as primary coverage but may be subject to a deductible. So under OPPI, the design professional's PI policy is supplemented instead of replaced, thus improving the owner's potential recovery.

	Professionals Annual PI	Project Specific PI	Owners Professional Protective Indemnity (OPPI)
Insured	Professional firms	Professional firms working on the project	Project owner
Policy Period	Claims made Annual policies covering all work performed by Professional firms	Project-specific policy term + an extended reporting period for claims	Project-specific policy term + an extended reporting period for claims
Policy Limits	Limits shared by all projects undertaken by the Professional firms	Limits dedicated to the project	Limits dedicated to the project
Claims	Owner must make demand against Professional firms who in turn provides the notice of claim to their insurer	Owner or Third Party must make demand against Professional firms who provides the notice of claim to the project policy insurer	Owner must make demand against Professional firms and then file a claim directly with the OPPI insurer
Claims Defense	Insurer owes a defense to Professional firms	Insurer owes a defense to Professional firms	Insurer owes a defense to Owner

Latent Defects Liability

Latent defects are normally defined as faults in the design, workmanship, materials, supervision, construction, installation or site preparation of a new building that remain undiscovered at the date of practical completion,

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Report Card - June 2013

Gross premium underwritten by non life industry for and up to the month of June 2013* (Rs. In crores)

INSURER	JUNE 2013	JUNE 2012	GROWTH OVER THE SAME PERIOD OF PREVIOUS YEAR (%)	APRIL - JUNE 2013	APRIL - JUNE 2012	GROWTH OVER THE SAME PERIOD OF PREVIOUS YEAR (%)
New India	921.82	854.93	7.82	3,055.93	2,743.50	11.39
United India	796.13	738.05	7.87	2,657.67	2,423.32	9.67
National	793.68	751.18	5.66	2,466.39	2,241.62	10.03
Oriental	607.89	562.73	8.03	1,958.70	1,750.89	11.87
ICICI-Lombard	498.22	367.01	35.75	1,776.12	1,401.76	26.71
Bajaj Allianz	350.31	313.90	11.60	1,086.28	929.44	16.87
IFFCO-Tokio	233.85	174.24	34.21	773.43	585.99	31.99
HDFC ERGO	174.54	151.44	15.25	771.50	570.08	35.33
Reliance	203.26	172.09	18.11	698.91	560.05	24.79
Tata-AIG	175.89	160.95	9.28	685.11	563.19	21.65
Cholamandalam	151.27	146.30	3.39	480.15	400.21	19.97
Bharti AXA	100.67	91.83	9.63	401.88	303.78	32.29
Royal Sundaram	117.50	160.84	(26.94)	396.18	394.11	0.53
Shriram	128.75	112.51	14.44	364.02	327.95	11.00
AIC	179.82	53.47	236.34	354.38	170.33	108.05
Future Generali	86.89	86.99	(0.11)	306.42	276.16	10.96
ECGC	104.54	96.71	8.10	289.97	251.10	15.48
SBI General	85.90	36.66	134.28	270.89	126.25	114.57
Star Health	71.29	48.28	47.64	188.46	179.83	4.79
Universal	53.41	48.06	11.14	154.67	130.34	18.67
Apollo Munich	37.46	33.31	12.45	110.35	101.68	8.53
Magma HDI	28.63			71.09		
L&T General	21.82	12.15	79.66	65.38	47.83	36.69
Max BUPA	21.32	12.22	74.47	59.76	36.39	64.24
Religare	9.92			51.36		
Liberty	6.41			13.98		
Raheja QBE	1.68	1.02	65.25	6.22	3.79	64.29
PRIVATE TOTAL	**2,559.00**	**2,129.80**	**20.15**	**8,732.14**	**6,938.81**	**25.84**
PUBLIC TOTAL	**3,403.88**	**3,057.06**	**11.34**	**10,783.04**	**9,580.77**	**12.55**
GRAND TOTAL	**5,962.88**	**5,186.86**	**14.96**	**19,515.18**	**16,519.58**	**18.13**

* Source : IRDA

Observations: Performance for April - June 2013

- The non-life industry has registered a growth rate of 18.13% upto the month of June 2013. Total premium collected by the general insurers upto the month of June 2013 was Rs. 19515 crores vis-à-vis Rs. 16520 crores last year.
- The accretion achieved by the PSU's during the period April - June 2013 is Rs. 1202 crore while the private players have achieved Rs. 1793 crore towards the overall market accretion of Rs 2995 crore.
- The PSU's have registered a growth rate of 12.55% during the period April - June 2013 vis-à-vis 19.37% last year while the private players have registered a growth rate of 25.84% vis-à-vis 15.26% last year.
- The major contributors have been ICICI Lombard with an accretion of Rs. 374.36 crore, New India with an accretion of Rs. 312.42 crore, United India with an accretion of Rs 234.35 crore, National with an accretion of Rs. 224.77 crore and Oriental with an accretion of Rs. 207.81 crore.
- In terms of growth during the period April-June 2013, SBI General registered a growth of 114.57% followed by AIC at 108.05%, Raheja QBE 64.29%, L&T General 36.69%, HDFC Ergo 35.33% and Bharti AXA 32.29%.
- In terms of growth amongst the health insurance players during the period April-June 2013, Max Bupa registered a growth of 64.24% followed by Apollo at 8.53% and Star Health at 4.79%.
- The market share of the PSU's has decreased collectively from 58% to 55.25 % for the period April - June 2013 while the private players have increased their market share collectively from 42% to 44.75%.

but come to light afterwards by virtue of physical damage. This can be an area of great concern to owners, tenants, developers etc. For structural defects discovered a few years after completion, contractors usually carry a legal responsibility towards the owner to rectify the problem. However, this requires proof of liability which can be a lengthy process. Due to the number of different parties involved, it can be very difficult to prove negligence.

Inherent (or latent) defects insurance provides cover to the policyholder (builder / owner of property) for the cost of repairing a property should an inherent defect in the structure cause damage or threaten imminent damage. Typical policy period runs from 10-12 years from the date of practical completion but should normally be sought prior to the start of construction. Cover operates on a reinstatement basis. The highlight of the policy is that there is no need to prove negligence or establish fault of the builder/contractor to obtain the claim. Unfortunately, this product is not yet available in India.

Conclusion

The execution of major construction projects presents owners with enormous challenges. Often complicated, fast-paced and risky endeavours, construction projects are prone to cost overruns, time delays, and rework from faulty design/ negligent construction management, technical mishaps, accidents and natural catastrophes. In this demanding and constrained economic environment, it is essential that project owners, contractors, subcontractors and other parties ensure that their liability risks are adequately insured when beginning a new project. While liabilities in a project environment cannot be totally eliminated or transferred, it can be monitored and minimized or mitigated wherever possible. Purchasing the right insurance is a viable solution to protect your project and bottom line and should be considered well in advance of contract development.

News TitBits

Project insurance affected by slowdown in infrastructure development

Source: Asia Insurance Review

Project insurance is seeing a lower uptick in getting new clients, due to a slowdown in the commencement of new projects that is in turn the result of investors waiting on the sidelines for the outcome of the 2014 Indian general election. Industry experts say that there is at least a 20-30% fall in the number of new projects that are covered under the policy. Meanwhile, the premium rates have also remained flat.

Insurance premium for hydel units may be reviewed

Source: The Hindu

The general insurance industry may need to re-examine the premium rates of hydroelectric projects in disaster-prone areas like the Himalayas, in the wake of the Uttarakhand disaster, according to a senior official of an insurance company. The total loss of the industry has been assessed at Rs. 1500 crore, of which 80% was on account of the hydel projects in the area.

Readers Speak

"What according to you would best resolve the problem of lower insurance penetration levels in India and help to increase the penetration levels? "

In the last issue of inotes, we had invited our Readers opinion on the above topic.

Response from Mr. M. Ravichandran, President, Tata AIG (Opinion)

Insurance penetration in India is way below its peers and unfortunately on the non life side this has not increased over the years.

Even the privatization of the Industry has not helped in achieving higher penetration.

In my view the Industry, Regulator and the Government would have to work together to ensure that the benefits of Insurance reaches the masses. This could be done through both short term and long term measures.

In the short term with a view to achieve inclusiveness in Insurance the following steps may be taken:

1. Ease opening of new Branches.
2. Introduce mono line agency concept with easier norms to get the agency – Travel, Auto and Health lines of business lend themselves for mono line agency concept. Easing the norms to get mono line agency would possibly attract more people and which in turn would increase Insurance penetration.
3. Design Low cost Insurance for Dwellings (on the lines of RSBY) with subsidy from Government particularly for areas which are prone to catastrophic events like Earthquake, Flood and Cyclones.
4. Make D&O Insurance compulsory for at least listed companies.
5. Increase tax concessions to make certain types of Insurances (Householders, Medical and Personal Accident) more attractive.
6. Increase awareness of Insurance through aggressive advertisement (the Industry would do well to take a leaf out what the EC did to increase voting %).
7. Have long term Insurance products for 2W, CV's and Private Cars.

The long term measures would be:

1. Include Risk Management and Insurance in curriculum from early stages- so that young people understand Insurance and get into the habit of buying Insurance.
2. Introduce simple and easy to understand Insurance products in vernacular languages.
3. Avoid mis-selling and thereby increase the confidence of people on Insurance as a mechanism to hedge themselves.
4. Standardise treatment costs and encourage Insurers, Pharma companies and Hospitals to have tie ups so that Insureds would get better rates.

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

Claims Case Study: *'Necessary Repairs' or*

Background

NLI was the subcontractor responsible for the construction of a diaphragm wall. The wall was constructed to protect a land area called a berm (A berm is a level space, shelf, or raised barrier separating two areas). The berm consisted of 2 concrete diaphragm walls with an empty space in between, which was filled with sand. Unfortunately, there were voids and gaps in the wall which meant that the sand escaped from the land area into the newly built dock. It was also discovered that there were gaps and voids between adjacent panels which had permitted the sand to escape.

NLI claimed on its CAR policy. It alleged that it suffered the following losses:

1. rectification of the gaps and all voids in the diaphragm wall;
2. the removal of sand fill from the dock bed;
3. grouting and filling behind the diaphragm wall of the voids caused by the escaping sand.

The insurance contract included the following insurance clause:

"Insurers will indemnify the insured for any amount not exceeding the limit of indemnity in respect of physical loss of or damage to the property insured howsoever caused occurring during the period of insurance and arising from any cause whatsoever except as hereinafter mentioned."

The CAR insurance also included the following exception:

The Insurer shall not be liable in respect of…

Next Issue:

Creation of a NATCAT Pool

From floods in Uttarakhand to earthquakes in Kashmir, we appear to be in a period of unprecedented natural catastrophes, both in terms of scale and frequency. The continuous spate of these disasters are denting the balance sheets of insurance companies while reinsurance rates to cover them are hardening. The Government as well as the insurance industry is looking at solutions to handle this risk with one of them being the creation of a NATCAT (natural catastrophe) pool that will provide the required capacity to underwrite these risks.

Will creation of this pool provide the much needed respite? By separating cat risks from non-cat risks, will the insurance premiums shoot up for the customer? Is Government support needed to keep the cost manageable? Should the cover be made mandatory and tied to property registration to avoid adverse selection? Are there any other viable options for natural catastrophe risk transfer?

Your opinion is solicited.

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

News TitBits

Insurers see rising interest in cyber liability insurance

Source: Business Standard

Cyber liability insurance has attracted greater interest with the rise in incidents of online data theft and cyber crime in India. Companies are not only taking efforts to tighten online security but are also looking to take precautionary measures to prevent high liability inherent in such incidents. General insurers say that while there has been a 30-35% increase in demand for these products, the number of pure cyber liability covers is few in the Indian market as such covers are often provided as a rider to other policies.

'Improvements'

1. *The cost of replacing or rectifying the defects in design, materials or workmanship unless the property insured suffers actual loss, destruction or damage as a result of such defect. However,*
2. *Additional costs of introducing improvements, betterments or corrections in the rectification of the design, material or workmanship causing such loss or damage shall always be excluded. (similar to LEG 3)*

The Issues

The insurer agreed to pay for the costs of removing the sand and the backfilling of voids caused by the escaping sand, but refused to accept liability for the cost of rectifying the defects in the diaphragm wall.

The insurers had two arguments, which were:

1. The walls were not damaged but were defective in their original state. Therefore, they did not fall within the insuring clause.
2. Where the walls were defective, the indemnity does not cover the defective rectification costs. This was clear from the last sentence of the defect exclusion.

The matter then went to Court.

The Court's reasoning was as follows.

- The Hon'ble Judge observed that it is possible to regard the cost of rectifying a defect which caused the physical damage as cost incurred 'in respect of physical damage'.
- Importantly, the Court decided that it would be impossible to repair the damage which the insurers had agreed to pay without also repairing the diaphragm wall and this did not constitute an improvement of the design.
- The exclusion clearly stated that it excluded the costs of defects unless the property insured suffers actual loss, destruction or damage as a result of the defect. Therefore defects are covered since actual damage is suffered as a result of those defects.

The Outcome

The Court held that the repairs, which insurers alleged were improvements, were necessary repairs of the physical damage, and therefore covered, notwithstanding the exclusion clause.

Interview – *Corporate* Contd. # 3

What additional Liability insurance covers which are not available currently (eg: Title Insurance, Performance Guarantee Insurance etc) would you like the industry to offer to meet your specific needs?

KSP : Overall most of the Insurance requirements under the contract are common and are mostly carried forward from previous contracts, adaptability of which takes time. All contracts have typical liability impositions on the contractor which need to be understood and suitable covers will have to be formulated to give collateral security for them to handle large contracts.

KM : As I said earlier, known exposures would be taken care of either by risk retention or risk transfer. And as the business expands and we enter new areas, we may need specific covers for the new and emerging exposures.

BV : Besides the above mentioned covers, bonds etc; would be useful.

PS : Having a project umbrella policy covering all the risks from property damage to liability would help. This policy should come in excess of all the individual project policies taken. Additionally for builders of residential projects in particular, the availability of Latent Defects insurance would help. As new risks evolve, insurance products to cover them should evolve simultaneously.

SV : Political risk and sometimes foreign companies ask for performance guarantee from the contractors.

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News TitBits

Clinical trial liability insurance to see sustainable growth

Source: Business Standard

The clinical trial liability insurance segment could see a period of stable and sustained growth, as the market is expected to become more professional for trials. General insurers are of the view the recent apex court view on the issue would lead to a more orderly growth. General insurance companies Raheja QBE General Insurance, ICICI Lombard General Insurance, Bajaj Allianz General Insurance and New India Assurance offer the product. The average size of the policies ranges from Rs 1 lakh to Rs 50 lakh and above, depending on the size of the company and the magnitude of their research.

IRDA revises health insurance standardization rules

Source: Business Standard

The definition of Portability has been revised to exclude plans of same insurers. According to the amended health insurance standardization rules by the IRDA, switching from one plan to another of the same insurer has been kept out of the portability definition. Further, the definition of hospital has been amended wherein norms of having atleast 10 in-patient beds in towns (with a population less than 1 million) and 15 in-patient beds in other places have been relaxed. There are several other amendments which IRDA has made to the Health insurance rules.

General insurers report better profits for FY13

Source: www.mydigitalfc.com

Dismantling of the third-party motor insurance pool and prudent underwriting helped non-life insurance companies post higher profits for 2012-13. New India Assurance the country's largest non-life insurance company has seen its net profit rise by 370% to Rs 844 crore for 2012-13. This was the highest reported by NIA in 5 years.

Interview - *Insurer*

Mr. James Amberson, Head, Global Risks Division, Bajaj Allianz General Insurance Co. Ltd;

Can you briefly describe the current conditions in the liability landscape in relevance to the Infrastructure industry in India? How have exposures increased over the past couple of years for insurers writing this line of business?

We are seeing an increased exposure from regulatory activities as opposed to a specific new regulation per se into construction projects, this is against a backdrop of increased regulatory matters across Asia including India.

How has the frequency and severity of Professional Indemnity (PI) losses in the Infrastructure industry changed over the past few years?

The claims frequency against contractors and design professionals has increased since the Global Financial Crisis – more for commercial transactions whereas, infrastructure projects have been more regulatory inquiries in nature.

How has the response been so far for the PI insurance policy for the Infrastructure industry in India? In terms of market size, how large would this market be in India? And what percentage of the potential would be covered by insurance?

We are seeing an increased demand for government infrastructure related projects such as mass transit. The size of the market and the percentage covered by insurance is difficult to gauge. It would appear that the majority of such projects are not yet covered by project specific professional indemnity.

Insurance professionals often say that not all PI policies are created equally- the carriers as well as the policy wordings are important. Your advice to our readers on what are the important aspects to be looked at while purchasing the coverage?

Many buyers are purchasing insurance as a contractual requirement, the extent to which the scope of coverage is critical to the assessment between carriers is not known. A knowledgeable broker or insurance consultant may assure that the insured has a clearer idea of what they are buying and that the terms are suited to their needs. Project specific policies are important in order to respond to contractual requirements however, an annual professional indemnity policy is critical to protect the risks that confront the on-going operations as opposed to solely responding to a specific project.

There is an increasing number of adverse incidents being reported in the Construction industry and presumably the number of liability claims under this has also been increasing. What would you attribute the major cause of Liability claims in the Construction industry arising from?

As mentioned earlier regulatory activities are increasing as opposed to a specific new regulation per se.

What is your opinion about the adequacy of current level of deductibles being opted for under the Project PI?

We have been focusing on large projects which see international level deductibles. However the discussion on deductibles is missing the main point, the deductible demonstrates the level of confidence in a professional's own assessment of the quality of their own organization. The lower the deductible the less financial incentive the insured has to mitigate losses and confidence in their own management and controls.

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