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Message from the Editor

Dear Readers,

"i-notes", the first Newsletter from a Broking house in India is gaining its foot firmly in the Indian Insurance market. Owing to its acquiescence, we had to virtually double the print order to meet the demand for it.

In our last issue, we started the debate of having a specialized rating for Broking firms, which was well received by several corporates. In this issue, we continue our pursuit on issues of concern to the insured. Insurance policies are traditionally famous for "fine print", which misses the attention of a normal reader. An important example of this is the infamous "Cancellation Clause" – which provides the insurer a right to cancel the policy mid-stream. We debate the propriety of this clause in this issue.

In the liberalization initiative of the Government, Indian insurance sector is entering the second phase, wherein it is proposed by the Regulator to break the shackles of tariff in a phased manner, planning to complete the exercise by April 2006. In this environment, the role of Broker is going to be more responsive for clients and to act as their knowledge hub. Since the risks are to be looked in totality, enterprise risk management techniques are going to be the order of the day. I am happy to state that we at India insure are getting ready to face this situation once the market is opened up.

I wish the readers a happy and prosperous Dussehra & Diwali

Warm Regards



Ramakrishna V
Managing Director

Cancellation Clause - The Damocles' Sword

Insurance being a commercial contract, gives both Insured and Insurer the right of mid-term cancellation of policy without assigning any reason. Since the policy document is drafted by the Insurers, they may protect their interests by inscribing appropriate wordings in their defence which almost makes it a one sided affair and insured becoming a weak partner without any say.

Further, owing to the complexity of the policy wordings, the insured may not read the policy at all. Thus, they are often under a misapprehension as to the Insurer's rights to cancel the insurance. They think, not unreasonably, that an Insurer cannot cancel the Policy unless they as the Insured stop paying premiums or otherwise breach a term or condition of the Policy.

Unfortunately, the exercise of this right by the Insurer can bring about a situation which severely affects the Insured's ability to replace the insurance cover elsewhere. The proposed Insurer will surely seek information about previous claims or losses, and about cancellation of a previous Policy – once this is revealed, he will tend to refuse the risk.

When asked about the necessity and justification of mid-term cancellation, Insurers confide that they do not cancel the policy for flimsy reasons as this would act adversely on marketing front. However, there are instances of cancellations among Insurers in India. The reasons cited vary from detection of moral hazard to adverse change in risk. For risk prone business, insurers normally deny renewals rather than canceling the policy mid-air.

All said and done, the proverbial Damocles' sword still hangs on the insured's neck. He may not be in the same plane as that of Insurer. Sometimes, for no fault of his, he may get cancellation notice. However, the onus is on the insurer to justify cancellation. Avoidance or a cancellation of a policy should therefore be based on facts that the insurer is able to prove in court.

In the absence of any debate on the issue of mid-term cancellation which is like water under a carpet, a realistic view has to be taken in the interest of the

insured, who otherwise is a weak party as far as a contract is concerned. In case of such cancellations, the most desired situation is depicted below - this would at least protect the insured to certain extent.

The ideal situation:

- Specific instances, which warrant cancellation, should be mentioned in the policy.
- In case the business is written for the first time, there should be a threshold period of say, 30 or 60 days, within which the insurers may cancel the policy, if they feel that there is some problem with the insured. In case of renewals, no such provision of cancellation to be there on grounds other than specifically mentioned in the policy.
- There should not be any "loss-linked" cancellations - having underwritten the risk, the insurer has to continue to cover. However, the insurer may exercise the option of advising the insured on loss control measures. In spite of this, if the physical hazard continues because of indifference of the insured, the cancellation becomes imminent and the insured should be given sufficient time for searching cover from alternate insurer.
- Since mid-term cancellation hampers the chances of obtaining cover or renewal, effort should be made for a possible reduction in cover or increase in premium.
- As per provision 7(1)(n) of IRDA (Protection of Policyholders' Interests) Regulations, 2002, there should be a mention about the cancellation in every policy such as "provision for cancellation of the policy on grounds of misrepresentation, fraud, non-disclosure of material facts or non-cooperation of the insured;"

However, it would in order if wordings of such conditions, which are almost common for policies are provided by the Regulator so that there will not be any ambiguity in language and interpretation of policies of different insurance companies.

Directors and Officers Liability Insurance

In the Corporate World, the swanky boardrooms have traditionally been a lure for executives to occupy key positions in the Company. In recent times, however, a flurry of lawsuits, staggering jury awards and an unprecedented attempt to legislate good corporate governance are challenging the business community. Thus, the prospect of enjoying their life has become a sort of mirage because of possible after-effects of various decisions they take in course of their employment or on board. In the wake of the Enron, Dynegy and Worldcom debacles, corporate decisions are more carefully scrutinized, and the conduct of the company's directors and officers is now constantly under the watchful eyes of investors, creditors, and government regulators.

Directors and Officers are facing the soaring cost of settling class action suits, which are growing in number, marking a new trend in securities litigation. In the United States, the passage of the "Sarbanes-Oxley Act" has added to the troubles of already beleaguered Executives. This assumes importance for us, because very soon, such regulation may be enacted in other countries too, including India.

Why D&O Liability Insurance?

When stakeholders file suits against Corporations for negligence or "malafide", they normally implead senior "Directors & Officers" too in their personal capacity. While the Corporation can afford the costs of legal process and possible damages awarded, the "Directors & Officers" will normally find it difficult to fund the same.

As a result, uneasy discussions are being held in corporate corridors as directors are realizing they are vulnerable - resulting in lack of interest in occupying important positions. Although the future belongs to litigation, which is spreading into all possible capillaries of business, this should not deter the talented from taking up critical positions. In the long run, this harms society at large. This issue is well addressed by the Insurance industry in the form of "Directors and



Officers Liability Insurance".

Who Needs Directors and Officers Liability Insurance?

Software Development, BPOs, , Large Market Cap Companies, Companies with D&O and/or related claims, Companies lacking profits, Companies active in the M&A arena, etc are some of the entities which virtually can not do business without a D&O coverage.

Who is covered?

Contrary to perception, D&O cover is not just for Board members - a typical definition includes "any employee of the company... in a managerial or supervisory capacity".

Common Allegations Against Directors & Officers

Most allegations involve decisions, acts, errors or omissions that have lowered stock values, compromised competitive industry position, wasted corporate assets, or overlooked significant growth or investment opportunities. These can result in financial injury to stockholders, employees, investors, and any other third party. Claims reported earlier indicate that Shareholders file approximately half of all D&O claims, and employees file approximately one-third. Plaintiffs in the remaining cases include customers, competitors, the government, suppliers, and contractors.

Coverages of D&O Policy:

Three types of coverages can be given under standard D&O policy.

1. Coverage A ("Side A coverage"):

It provides coverage directly to the directors and officers for loss - including defence costs - resulting from claims made against them for their wrongful acts. Coverage A is written to apply only

where the corporation is not in a position to indemnify its directors and officers, because it is:

- Prohibited by law from doing so, or
- Permitted to do so by law but the company's bylaws do not allow it to do so, or
- Financially incapable of doing so, due to bankruptcy, liquidation, or lack of funds.

2. Coverage B ("Side B coverage"):

Coverage B, or "Side B coverage," reimburses a corporation for its loss where the corporation indemnifies its directors and officers for claims against them.

3. Coverage C ("Side C coverage" or "Entity" Cover):

This optional coverage protects the corporation against securities claims. It provides protection for the corporation for its own liability. Many policies today provide such coverage to the corporation whether or not its directors and officers are also sued; other policies, however, provide such coverage only where the corporation is a co-defendant with its directors and officers.

Most, if not all, policies are written on a "claims made" basis, which means the claim (or suit), must be made against the Director and Officer during the policy period.

Typically, Limits of Liability hover between \$ 1 million and \$ 5 million (larger companies purchase limits up to \$ 25 - 50 million). Increased limits may also be purchased as umbrella coverage.

Computation of Premium:

Computation of premium is a complex exercise. This is not an off-the-shelf product and usually the domestic insurers retain only a small portion and re-insure the rest in the International market. Premium is computed, based on an elaborate proposal form, comprising:

- Organizational structure with the financial history and its asset size

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Directors and Officers Liability Insurance (Contd....)

- Geographical spread (e.g.: USA subsidiaries)
- Shareholding pattern – recent changes – recent mergers/acquisitions, if any
- The sum insured and deductible opted
- Past claims and litigations history
- Number of Full time and part time directors and their past performance history
- Audit particulars - Internal Audit Department, External Audit firm
- Number of employees with geographical distribution
- Whether listed – domestic and/or international markets
- Whether Jurisdiction required for USA & Canada.

General Exclusions:

In all events, coverage is provided for defence costs even where dishonesty is inferred and such defence will continue until there is formal adjudication of guilt.

The policy will not pay for the losses arising from any claim relating to:

- Prior and pending litigation and claims submitted under previous policies.
- Bodily injury, sickness, disease, emotional distress, death, damage of tangible property
- Directors of the Company suing each other.
- Illegal personal profit and remuneration.

- Deliberate, dishonest or fraudulent acts.
- Fines, penalties and claims for Pollution and/ or contamination.
- Professional Indemnity.

Some Recent D&O Liability Settlements		
Company	Settlement Value	Settlement Year
MicroStrategy	\$103 million	1999
Ikon Office Solutions	\$111 million	1999
Philip Morris	\$116 million	1998
Conseco	\$120 million	2002
Mattel	\$122 million	2002
Sunbeam	\$125 million	2001
Informix	\$142 million	1999
Rexene	\$145 million	2000
American Continental	\$157 million	1999
Rite Aid Corp.	\$200 million	2000
Waste Management 1	\$220 million	1998
Computer Associates	\$230 million	2000
3com	\$259 million	2000
Oxford Health Plans	\$300 million	2003
Lucent Technologies	\$315 million	2003
Waste Management 2	\$457 million	2001
Bank of America	\$490 million	2001
Cendant	\$2.83 billion	1999

Source : Market Conditions - June, 2003

What is a "Claim" and how is it defined broadly under the D&O Policy?

Since most D&O policies are "claims-made" policies and since the "claim" must be made within the policy period, it is critical for the policyholder to understand how the policy defines the term "claim." Surprisingly, some D&O

policies fail to define the term "claim." This often leads to confusion and litigation battles between policyholders and their insurers. Most policies, at a minimum, define the term "claim" to include a "written demand for money" and a "civil proceeding." It goes without saying that the broader the definition of the term "claim," the broader the coverage that is afforded by the policy. Policyholders in their interest should seek the broadest possible definition of the term "claim."

Usually the definition of "Loss" will include Damages, Judgments, Settlements, Defence costs. It often explicitly excludes Civil or criminal fines or penalties, Punitive or exemplary damages, the multiplied portion of multiplied damages, Taxes, etc

Answers to a few Frequently Asked Questions:

1. D&O policy can be extended to cover retired directors or Directors or Officers who served on board previously.

2. If the director is on board of another company whose activities are similar to that of Insured Company, the cover of first company may be extended for service of Directors on other Company's boards. However, it is advisable to have separate D&O policy for different companies.

In Lighter Vein

Steve's shed burned down. Julie, his wife, called the insurance company and said, "We had that shed insured for fifty thousand and I want my money."

"Just a minute, Julie, it doesn't work like that. We will assess the value of the building and provide you with a new one of comparable worth." the officer replied.

Julie, after a pause, said, "I'd like to cancel the policy on my husband."

Risk Mangement tips (Floods and Inundation)

Floods lead all natural disasters in the number of people affected and in resultant economic losses. One never knows where or when a flood will strike, which is irrespective of proximity to rivers, seas, oceans, etc.

It is a fact that we cannot stop the floods and inundation. However, we should be able to minimize the loss and come to a state of normalcy soon after the floods through various Risk Management Techniques, which are listed below:

Dealing with Electricity:

- One should not dare to enter a flooded room or basement where electrical power is believed to still be active. When disconnecting the power source it is essential to be standing on a dry platform.
- In some flooded areas, water levels may reach or submerge power bearing electrical cables. When operating any vehicle in flooded areas, exercise extreme caution to avoid contacting "live" wires.
- Proper planning should be in place for extended power failures, efforts should be there to keep facilities like lighting, heating, ventilation, air conditioning, pumps, alarm systems, etc. running.

Turn off other utilities. If the factory uses LPG or natural gas, turn off the gas at the main valve. Disconnecting the utilities can prevent further damage to appliances.

Watch for dangerous debris and pests. Do not walk through flowing water. Snakes, nails, and other debris may be on the floor.

Move possessions to higher ground. Items like computers, analytical equipment, etc. may be moved to the higher elevation,



which prevents permanent damage and enable rapid service restoration as flooding recedes.

Record keeping and Disaster recovery: Steps to be taken to prevent damage to essential records, files, and other materials during a disaster by way of planning proper storage devices.

Network of Pipes and Drains:

- To re-route water pipes that pass through vulnerable areas i.e. data processing areas
- To make sure that gutters, down pipes and storm drains are designed to cope with heavy rain, and arrange regular inspection and cleaning.
 - To maintain all rainwater and plumbing equipment regularly

Insurance Angle:

There is a common mis-conception among insureds that Flood cover is a needless expense (STFI cover), especially when there is no river or sea in the vicinity or when the office is situated in the upper floors of a multi-storied complex. Consequently, many have opted out of this cover, and availed corresponding discounts.

It is important to note that STFI ("Storm, Tempest, Flood & Inundation) covers not just floods, but also "inundation" i.e water flow

through pipes, windows, balconies etc. In the torrential rains that hit Hyderabad during August 2000, hundreds of vehicle owners and occupants of multi-storied office complexes, who had opted out of STFI as there is no "river" in Hyderabad, realized, to their chagrin, that this clause would have saved them.

Thus it pays to have flood insurance for all types of risks.

Considering the above points, one should at least be able to tackle the risk of Floods and related perils with confidence and not with a flooded heart.

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Contact Us

India Insure Risk Management Services Pvt. Ltd.

BANGALORE

26, Palmgrove Road, Off. Victoria Road, Bangalore - 560 047.
Ph : 080-56610361/62/63/64 Fax : 080-56610360
Contact: Mr. Sagar Tanksali
email: sagar@indiainsure.com

HYDERABAD

405, Archana Arcade, St John's Road, Secunderabad - 500025
Ph: 040-27822990/91 Fax: 040-27822993
Contact: Mr. Vijaya Kumar Madhira
email: vijay@indiainsure.com

NEW DELHI

#307, 3rd Floor, Ansal Bhawan, Kasturba Gandhi Marg, New Delhi-110001
Ph: 011-51520666/67
Contact: Mr. Anuraag Kaul
email: anuraagkaul@indiainsure.com

CHENNAI

Sri Valli Griha, Flat GA, Ground Floor, New # 34 (Old # 26), Raman Street , T Nagar, Chennai-600 017.
Ph: 044-5202 3797/98 Fax: 044-52023799
Contact: Ms. Anjana Raj
email: anjana@indiainsure.com

PUNE

501, Aditi Commerce Center, 2406, East Street, Pune 411001 Ph: 020-4030713/6342362
TelFax : 020-6340613
Contact: Ms. Deepali.A.Rao
email: deepali@indiainsure.com

MUMBAI Branch & Corporate Office

427/428 Chintamani Plaza Chakala, Andheri-Kurla Road, Andheri (East) Mumbai - 400 093.
Ph: 022-56791417/18/19 Fax: 022-56791421
Contact: Mr. V. Ramakrishna
email: vrk@indiainsure.com