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GEARING UP FOR A DE-TARIFF REGIME

Strategies & Experiences in Managing Risk Transfers - A Brokers Perspective

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Marsh & McLennan Companies

Sanjay Kedia

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- Market Overview
- Total Cost of Risk
- Components of Insurance Programme
 - Structural Elements
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- Insurance Myths

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Market Overview

Market Overview

- De Tariff regime to remove rate restrictions
- Wordings and Coverage proposed to be liberalised later
- 'File & Use' Guidelines to see new products being introduced
- Many large falls under 'Mega Risks' and free from rate and coverage restrictions. Are already Reinsurance driven
 - Mega Risks : PML > 1054 crore with Option of Reinsurance Driven Covers

Majority of the Large Risks would get exposed to Free market / Reinsurance dynamics

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Total Cost Of Risk

- Fundamental concept of Insurance and Risk Management

Total Cost of Risk

- Total Cost of Risk, comprises expenditure in:
 - Risk Control
 - Self-insurance, and
 - Insurance
- Strategy which relies solely on insurance entirely is potentially more expensive
- Optimal mix of the three components results in minimisation of Total Cost of Risk
- Lower Layer of risks has large frequency of losses and greater predictability
 - Focus on Risk Control and NOT insurance (Dollar Swapping)
- Higher Layer of Risk has high impact and low probability of loss event
 - Potential for commercial insurance

Premium (F)

- What does your Insurance Premium constitute of ?
- Premium = E (L) + Op (Cost) + P
 - E (L) = Expected Losses
 - Op(Cost) = Operating Costs of insurance company
 - P = Expected Profits of insurers

Insurance is a commercial venture and Premium paid are expected to cover Losses in the long run

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Components of Insurance Programme

Components of Insurance Programme

STRUCTURAL ELEMENTS

- Limits
- Deductibles
- Coverage
- Bundling
- Tenure : Long Term Agreements
- Buyer : Owner Vs Contractor

PARTICIPANTS

- Insurer
- Reinsurers
 - Lead Market
 - Follow Market
- Claim Adjuster
- Valuer
- Broker
 - Direct Broker
 - Reinsurance Broker

PLACEMENT PROCESS

- Tendering Vs Exclusive
- Appointment of Broker
- Risk Presentation
- Marketing of Risk
- Placement Structures
 - Layered Vs. Proportional
 - Domestic Capacity Mix

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Structural Elements

Structural Elements

■ Limits

- International Market: Mostly Based on Loss Limits
- Estimated Maximum Loss (EML): Basis for Ascertaining Loss Limit
- Indian Tariff Market: Full Sum Insured (FSI) Basis
- ***An optimal Loss Limit structure above your EML helps to manage Premium cost.***

■ Deductible Options

- Higher Frequency low severity best retained with insured
- Discover Optimal deductible level based on
 - Retention capacity
 - Discounts offered by insurers for higher deductibles

Structural Elements

■ Coverage

- Business Interruption covers are linked to Property Damage Covers
 - Separate purchases potentially causes claim settlement disputes
- Advance Loss of Profit Cover linked to Construction Insurance
 - Separate cover have Availability issues and cost prohibitive
- Third Party Liability (TPL)
 - Usually Small limits purchased along with Package Insurance Policy in specialised business brings pricing efficiency
 - Large Limits tends to be purchased Standalone

Structural Elements

- Terrorism Insurance : Potentially Catastrophic
 - Usually bought on First Loss basis (USD 100 mn to USD 220 mn.)
 - When Property and Business Interruption Limits is insured in excess of PML - WHY NOT TERRORISM?
 - Limits purchased are driven by availability and price rather than risk exposure
 - Do your DUE DILLIGENCE, does your cover provide for
 - Non cancellation or 7 days notice of cancellation
 - Automatic Reinstatement
 - Is coverage/limit for your operations or per compound / location

Structural Elements

■ Bundling & Unbundling of Assets

- Group together and offer similar assets as Portfolio
- Separate sizeable assets which are placed in different markets

■ Long Term Agreements

- Long Term Agreements as against Annual Policy may be potentially cost effective
 - Continuity of business benefits factored in
 - LTA based on Loss ratios, Total claims and other parameters more likely to succeed
 - Underwriters likely to support and participate in risk improvements
- Share the fortune:
 - No Claim: Bonus, Profit Sharing and continuity credits

Structural Elements

■ CONSTRUCTION INSURANCE

- Principle / Owner Controlled Insurance Programme (OCIP) Vs. Contractor Controlled Insurance Programme (CCIP)
 - **Advantages of OCIP:** Purchase of Advance Loss of Insurance Policy (ALOP)
 - Multiple Contractors included in one umbrella Project policy
 - Manage Coverage Overlaps/ Gaps
 - Helps manage Transition from Construction to Operation phase
 - Lenders requirement in Project Finance
 - **Disadvantages of OCIP:** Potentially higher Administration – Purchase and Claims management

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Participants



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Participants

■ Insurer

- Choice of Insurer – Risk Carrier:
 - Balance Sheet size necessarily does not indicate Ability to Pay Claims:
 - Retention as per Financial Capabilities
 - Quality of Reinsurance for your risk
 - **Solution to Your Needs** : Understanding of your business, Administration convenience, RELATIONSHIPS
- Have a Co-insurance Strategy – rather than a share to please all

■ Reinsurer

- Lead Market(s) : Drives price, coverage and administration
Including claims : KNOW THEM
- FOLLOW markets also seeking greater understanding and involvement in Key Decisions

Participants

- Claim Adjusters

- Get pre agreed panel of Claim Adjusters with proven capabilities and resources to respond to Claim situations.

- Valuer

- Insurance Values Differ from Accounting Values
- Establish relevant Insurable values at appropriate time periods through credible valuers

Participants

- **Insurance Broker-**

- Difference between Insurance Agent and Broker

Client - Broker Relationship



Insurer - Agent Relationship



Participants

- Partnering with Right Insurance Broker – Why?
 - Who understands Your RISKS
 - Structuring Appropriate Risk Management and risk transfer need through insurance programme
 - Insurance programme design based on CLIENT's Need and Market dynamics
 - Presentation of Risk to the market
 - Your broker creates right competition to Discover the best pricing among quoting markets
 - Placement
 - Premium Collection and disbursement
 - Policy Documentation
 - Claim negotiation and Collection on your behalf

Participants

- Broker – Potential risks in Processes
 - There are ultimately ‘risks’ to YOU if there are errors and omissions in the processes carried out by the brokers in Placement (Reinsurance)
 - Errors in Risk presentation by Broker
 - Placement completion & Confirmations
 - Premium payment transfers (meeting the PPWs)
 - Incomplete Claims collection
 - Does the Broker on Your Risk has
 - **‘Adequate Professional Indemnity Insurance’**

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Placement Process

Placement Process

- Tendering Vs Exclusive appointment

- Decide at what level(s) and in what form you need competition

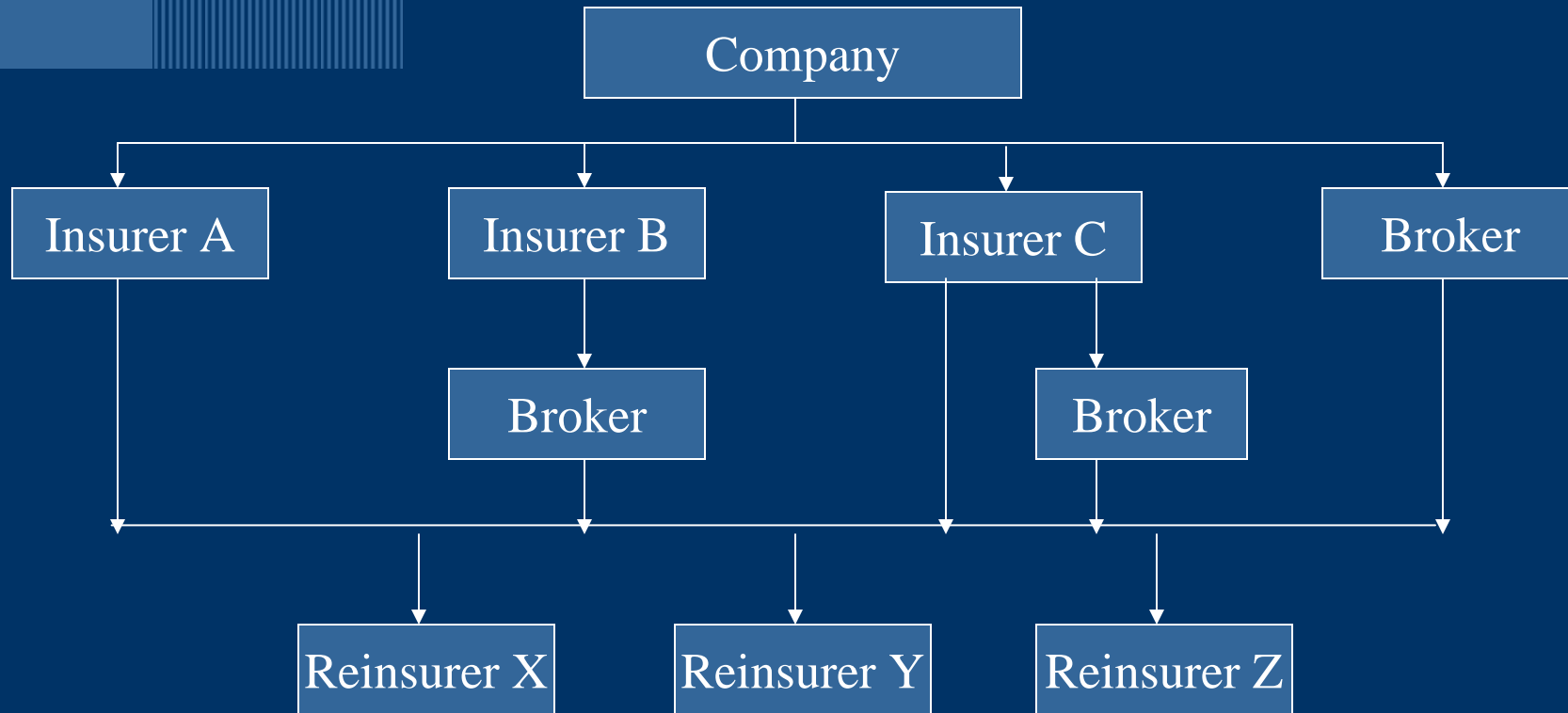
- Insurance Companies locally
 - Reinsurance Broker
 - Quoting Reinsurance markets

- TECHNICAL COMPETITION Vs PRICE COMPETITION

The drivers for decision could be

- Your nature of risk and requirements
 - Who is truly going to be retaining your risks
 - Local market retention and involvement
 - Brokers services needed
 - State of Reinsurance market and capacity required

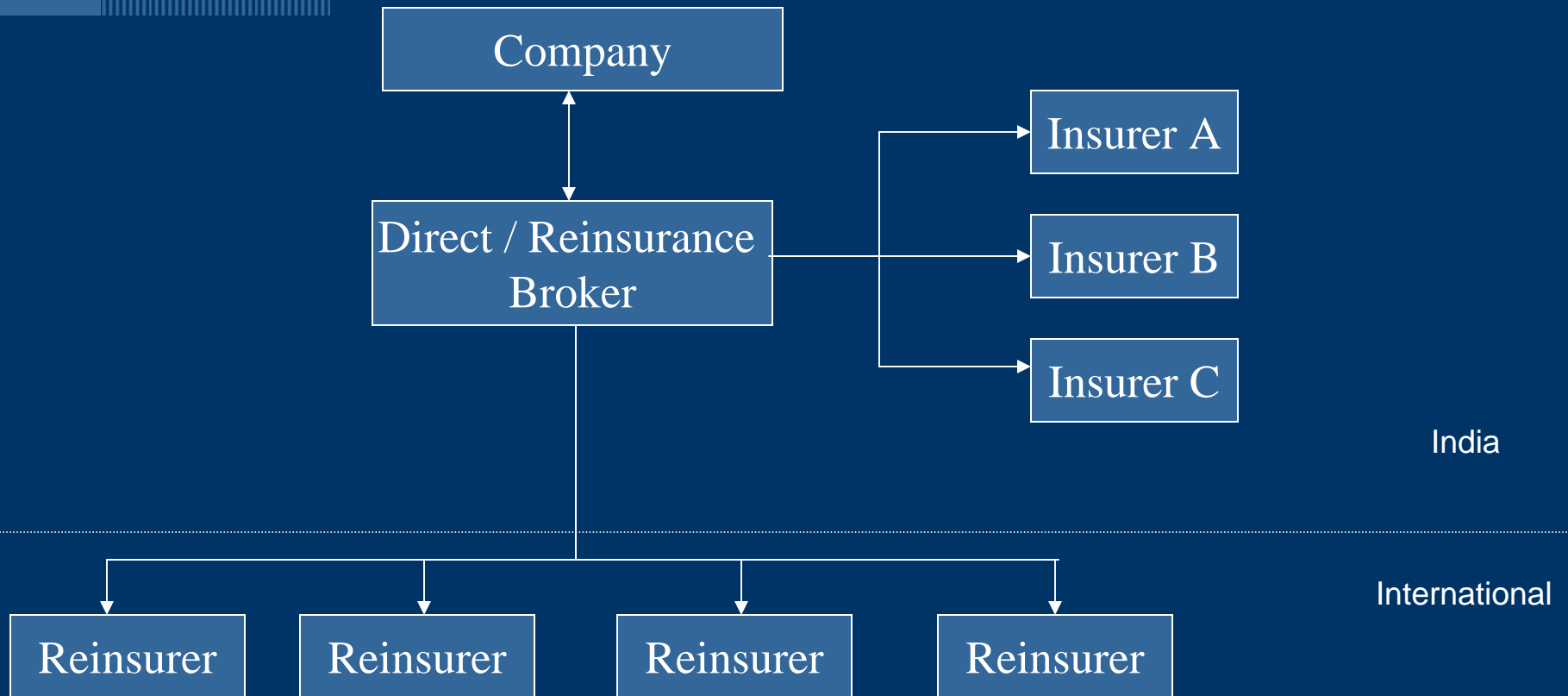
Insurance Buying Process – Traditional



The same risk being marketed by different approaches = segmentation/confusion of R/I markets

Disadvantages - Premium rates are set in world reinsurance markets
Without the process managed by insured. Insured has no direct
contacts with reinsurers until after the rates and terms are set.

Suggested Insurance Buying Strategy



Advantages – Controlled approach allow the Insured & their Broker to obtain competitive terms from Local & International market without segmenting/confusing the markets

Placement Process

■ Risk Presentation

- Work on the underwriting submission
- Presentation of risk to market - “differentiation”
- Ensure underwriting submission contains all the relevant information, so that premium pricing is correct and does not factor for the “Unknown”
- Showcase the company and growth plans not the project alone
- Ensure clear presentation of your insurance requirement so that you get the optimal solution from the market
 - Decide on options on limits/deductibles upfront
- Meet your insurers / Reinsurers - You are in the best position to market your risk

Placement Process

- Placement Structures

- Layered Placement Structures: Why?

- Pure quota share placements: May not achieve best pricing as all available market capacity is not used
 - Layered Structure works on the premise:
 - Different markets have different risk appetites
 - Knowledge of requirements/needs of various markets allows structuring and completing the placement at optimal pricing

Placement Process

- Domestic Market Burning Layer
 - The first layer of risk has seen retention by Local Insurance companies to offer competitive price
 - Needs balance and caution at times!
 - A reasonable risk retention based on ability to retain at competitive pricing might be a Win – Win for all
 - Excessive retention at virtually no premium is not sustainable
 - Checks in the System
 - IRDA guidelines

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INSURANCE MYTHS

INSURANCE MYTHS

MYTH

✘ I have at least 5 guaranteed losses every year of Rs 10 lakhs or less (and my deductibles is Rs 50 lakhs.) I need to have insurance cover for this.

a A loss which is certain, the insurance premium has to be much more than the loss amount Plus Administration costs + Profit for the capital of the insurance company + other Frictional Costs (tax etc.). Insurance is not the solution for this.

INSURANCE MYTHS

MYTH

- ✘ At the end of the insurance policy in the current year my Losses under the programme is LESS than the Premium paid therefore I have incurred a loss.

- a Insurance markets provide contingent capital and there is cost associated with the Capital. The protection available during the policy period is utilization of that capital and the cost associated with that.*

INSURANCE MYTHS

MYTH

- ✘ It does not matter whether my insurance company has purchased right reinsurance cover.
 - a** A large Risk Claim can impair the health of any insurance company if not reinsured and create complications in your claim settlement.
 - a** The failure of a Lead Reinsurance market jeopardizes agreement and settlement of claim. Quality of Reinsurance market security important.

INSURANCE MYTHS

MYTH

- ✘ I have asked Four insurance companies to procure reinsurance quotes and therefore my quote would be competitive.
- a The Real Price discovery and competition needs to happen at Reinsurance level from where the quote is obtained and not at Insurance company level which does not generate the quote.*
- a Uncoordinated approach to reinsurance market capital tends to confuse the reinsurance market and doesn't generate adequate interest in them, this tends to increase the price.*

INSURANCE MYTHS

MYTH

✘ The best insurance policy is one which has zero deductibles

a *Covering small losses under insurance increases cost of administration and profit expectation (as high frequency). The premium cost factored for such small losses would be much higher than such potential small losses. It is not economical approach for the insured to cover such losses.*

INSURANCE MYTHS

MYTH

- ✘ I will get a better deal by going direct to the market and not through the broker
- a. A professional broker places businesses of several clients and into several markets, is in a better to position to negotiate and discover the best deal.*
- a. World over the largest corporations use Broker as this is the most efficient.*
- a. Besides the best price, the quality of 'Right coverage', the administration of the programme and support in claims makes the case of using broker even stronger.*

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