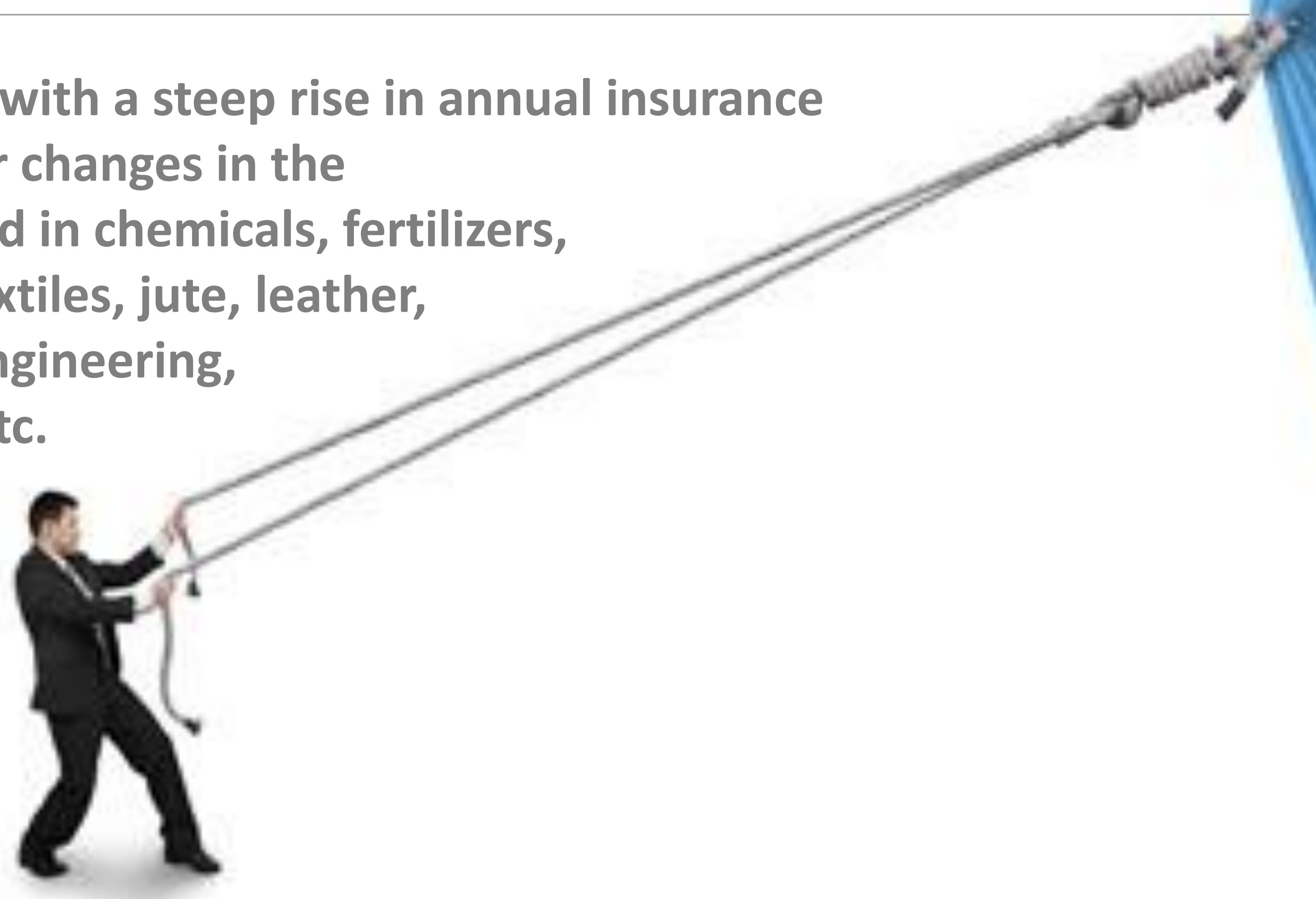
Recent changes in the Fire line of business

The industry is grappling with a steep rise in annual insurance premium following major changes in the rates for facilities involved in chemicals, fertilizers, plastic, rubber, paints, textiles, jute, leather, distillery, power, steel, engineering, warehousing & storage etc.



The insurance industry is currently witnessing some unprecedented changes which majorly impact the way the risks have been underwritten in India so far. Rates for nearly 37 Risk Codes have been revised and minimum rates have been mandated. Risk (business) acceptance capacities of insurers have been reoriented, leading to substantial down-scaling. Additionally, these changes also impact the extent of indemnity offered by Fire Insurance policies in case of a loss.

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THE PROMPT

These changes have come about as GIC Re has decided to amend the terms forming part of its reinsurance treaties with insurance companies in India, basis which the insurers accept insurance business from clients. It would be pertinent to mention that GIC Re leads the reinsurance programs of most insurers, both public and private, in India.

The trigger for these changes was indiscriminate discounting of rates (at times up to 99%) post de-tariffing of the Fire line of business in 2007. In other words, the basic coverage afforded under the Fire Policies became practically free of any charge. Whatever premium that was logged by the insurers was on account of NATCAT perils (Earthquake / STFI) and the other add-ons. The situation rendered the Fire line of business unsustainable for GIC Re at the prevalent price levels, leading to their mandating minimum rates for certain risks.

EFFECTIVE DATE

All new businesses and renewals, policy period of which starts on or after 1st March,2019, shall have to conform to these changes. Foreclosure of insurance policies has been prohibited.

IS THERE ANY EXEMPTION

Regrettably no exemption of any kind is currently available to the risks which fall in the realm of the changes mandated by GIC Re. Having said that, it is hoped that cognizance shall be taken, in near future, of some valid points put forward by the industry.

ARE ALL INSURANCE COMPANIES IMPACTED

All insurers whose treaties are either led by GIC Re or where GIC Re is a participant are required to implement these changes.

WHAT ARE THESE CHANGES

These changes have been made at three levels.

LEVEL-1 : REDUCED BUSINESS ACCEPTACE CAPACITIES

The capacity of insurers to underwrite the risks without obtaining prior approval of GIC Re has been reduced from previous levels. This has been done by way of revising the threshold limits of Probable Maximum Loss (PML).

It is to be noted that PML is a tool to determine how much of a risk (i.e., the sum insured) can be accepted by an insurer at the front-end and cede to GIC Re at the back-end.

This implies that the insurers shall now not be able to accept businesses involving the sums insured of the same levels as in the past without concurrence of GIC Re.

To exemplify the point, some insurers may not be able to automatically accept business having sums insured (Material damage + Business Interruption)
in excess of Rs. 800 crores

LEVEL-2 : INCREASED DEDUCTIBLES / EXCESS

In case of Steel plants and Power plants (excluding Wind and Solar plants) which have sums insured (Material damage + Business Interruption) in excess of Rs. 500 crores, the deductibles/ excess (i.e., the amount of loss which is borne by a client) has been increased substantially. This involves losses involving physical damage, breakdowns and loss of profits. This implies that the insured shall have to bear a far bigger share of losses than in the past.

LEVEL-3 : INCREASE IN PREMIUM RATES

GIC Re has mandated minimum rates for nearly 37 risks (i.e., Risk Codes) which are far higher than the previous (discounted) rates. No discounting of any kind is permitted on these minimum rates by GIC Re. A major fallout of the situation is that many impacted clients will now be required to pay far more premium than previously.

OTHER ISSUES

- Previously insurers allowed discounts (in certain cases up to 99%) on the premium rates. No discount can now be given for these 37 Risk Codes.
- GIC Re has mandated minimum rates at which it will accept the business from insurance companies. To the minimum rates, the insurance companies are required to add business acquisition costs and management expenses.

MISLEADING SUGGESTIONS BY SOME INSURANCE BROKERS

Some insurance brokers have been inappropriately advising clients the ways to avoid / minimize the impact of these changes. Such advices may appeal theoretically but do not offer any working solution.

MISLEADING SUGGESTION : 1

Take a client's insurance program out of the reinsurance arrangements of Indian Insurers with the GIC Re: In other words, it is being suggested that reinsurance shall be obtained by such brokers from foreign reinsurers and an Indian insurer shall be arranged to front the arrangement. Some serious questions facing such a proposition are –

- What is the guarantee that Indian insurer will agree to front this arrangement.
- Is (meagre) fronting fee be enough to prompt an Indian insurer to enter this arrangement.
- Will Indian insurer spoil their business relations with GIC Re for stray cases of fronting, knowing fully well that GIC Re supports them in many other classes of business, quantum of which is far higher than the business expected out of these fronting arrangements.
- Why will an Indian insurer take on the financial risks (e.g., non-payment of claims) by foreign reinsurers arranged by these brokers in selection of which Indian insurers have no role.
- What is the assurance given by such brokers that they will be able to obtain better terms from foreign reinsurers. There is an underlying presumption in the advice of such brokers that terms offered by Indian insurers under the post-change regime compare hugely negatively with what the foreign reinsurers may offer. It would only be appropriate to mention that the changes implemented by GIC Re are in alignment with the international practices followed by foreign reinsurers (e.g., linking premium rates to the burning cost, higher deductibles for capital-intensive risks as a tool for better risk management).

MISLEADING SUGGESTION : 2

A bizarre suggestion is being made to clients to ask the Indian insurers to charge no premium on the portion of the risk which is retained by them to their net account. This suggestion expects that Indian insurers shall agree to –

- Carry the risk but charge no price for the same. In other words, pay the proportionate claims without charging any premium.
- Bear the management expenses.
- Pay the business acquisition charges to intermediaries from their own coffers.

MISLEADING SUGGESTION : 3

Another tool that is being recommended to clients by some fellow brokers to reduce the impact of increased insurance premium is to net down the brokerage payable to a broker. This too is totally misleading. Clients need to note that the revised premium rates are net-to-GIC. In other words, all insurance companies are required to cede business to GIC Re necessarily on these rates without reduction of any kind. It is, therefore, evident that any suggestion that reduction in brokerage shall lead to reduction in the minimum premium rates mandated by GIC Re is totally incorrect.

THE MISSING PIECES

It is evident in many cases that the premium bill for certain risk categories has multiplied manifold which is a cause of serious worry among clients. Some suggestions to GIC Re to provide relief to the clients impacted by these changes are -

- GIC Re should stagger the targeted increase over a period (say over three years). This way the clients would be able to make adequate provisions in their financial budgets.

- No allowance has been made by the GIC Re for the risks which carry favourable claims experience. The clients whose insurance program has been profitable for insurers over years should either not be in the realm of these changes or their premium bill should be appropriately discounted for good claims experience.

- There is no acknowledgement of the quality of risks in these changes. The clients with facilities having good loss prevention and control tools have been bunched together with others. Such risks should be treated differentially as far as insurance premium costs are concerned.

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