19th FAIR CONFERENCE 2005

Mumbai, India

Newsline

September 19, 2005 *For Private Circulation Only*

"Big and Small Need Each Other"

Cooperation is FAIR's primary objective. This is true of the past and the future and helps members reach their true potential, says Mr. Albert J. Nduna, President of FAIR and Group Chief Executive Officer, Zimre Holdings Ltd. In the last few years there have been groupings of some strong institutions like GIC which will strengthen the weaker members, he says.

This cooperation will aggregate the capacity available among the African and Asian countries so that there is a valid alternative when we go to other markets to place business, he explains. "We can transact business from a stronger position."

Two major FAIR initiatives are to be launched in the Mumbai conference, he says, relating to brokers and to the life industry.

FAIR Brokers & Consultants Society (FBCS) will create a forum for these intermediaries and professionals who will be playing a greater role in product development, marketing and backup.

The life insurance industry is also getting a platform for voicing its concerns in the form of FAIR Life Insurance Professional Group (FLIPG), a deliberate move in response to a long felt need since FAIR had a distinct non-life orientation.

Creating distinct entities for these constituents will strengthen the FAIR membership collectively, says Mr. Nduna. And that, precisely, is the desired objective!

Mr. R. K. Joshi, Chairman-cum-Managing Director, General Insurance Corporation of India (GIC) releases "The Indian Insurance Industry (Non-Life) 2004-05," an annual statistical publication of Interlink Insurance Brokers Pvt. Ltd. at a function prior to the inaugural dinner of the 19th FAIR Conference, 2005 at Mumbai on September 18 as Mrs. K. H. Parekh, Chairperson, Interlink and Mr. D. Sengupta, retired Chairman, GIC look on.

Securitise it

– Transferring Terrorism Risks

M K Garg
Chairman cum Managing Director
UNITED INDIA INSURANCE COMPANY LTD.

September 11, 2005, marked the fourth anniversary of one of the most highly visible and expensive manmade disasters – the terrorist attacks on the World Trade Centre, which produced insured losses estimated at US$ 32.5 billion.

In its aftermath, global insurance and reinsurance capacity shrank by 15 to 25 per cent, insurers introduced terrorism exclusions, and costs of risk management went up sharply. The US Federal Government adopted the Terrorism Risk Insurance Act (TRIA) in 2002 to provide insurers with a three-year federal programme for sharing incurred losses resulting from certain acts of terrorism. This was to protect businesses by minimising market disruptions and ensure availability and affordability of insurance coverage for terrorism risk. The TRIA is due to expire on December 31, 2005. Apart from the uncertainty regarding future availability of terrorism coverage, this raises many vital issues for the global insurance and reinsurance market, such as:

- Whether terrorism risks are fully insurable
- Capacity of insurers and reinsurers to pay high-magnitude losses caused by terrorism
- The role of government in sharing economic losses arising out of terrorism

Insuring against terrorism is a complex undertaking because the risks do not comply fully with the four basic criteria for insurable risks, namely measurable frequency, measurable severity, ability to spread or diversify loss and fortuitous / random nature of loss.

Terrorism can not only produce a huge number of claims but also a large magnitude of losses across different lines of business – property, business interruption, liability, life and aviation.

Reinsurance is one of the principal determinants of capacity, but reinsurers are unwilling to commit significant capital resources for terrorism risks.

Reinsurance is one of the principal determinants of capacity, but reinsurers are unwilling to commit significant capital resources for terrorism risks. Many reinsurance companies are capital-constrained. Large underwriting losses from other operations, poor investment environment, and the 9/11 attacks combined to deplete reinsurers' capital resources, and they are yet to recover. This has resulted in reduction in the reinsurer's claims-paying ability and downgrading of ratings, aggravating the problem of insurability of terrorism, insurance risk and capacity of insurers to pay for terrorism losses.

One option that has been touted is the securitisation of terrorism risk. Although there were predictions that capital markets would provide alternative funding for terrorism risks, this has not happened. Only a small proportion of catastrophe risk, estimated by one firm at 2.5 to 3 per cent of the worldwide catastrophe reinsurance market, has been transferred to capital markets.

The limited capacity of insurers to absorb losses has led to the conclusion that governments must serve as a last-resort reinsurer for the economic losses caused by terrorism.

This is important because of the hesitation of the private sector to cover the associated risks. Also, it is mainly up to the governments to offset, if not eliminate, macroeconomic losses arising from private insurance market failures.

... Continued from Page 8

"When Catastrophes Strike"

is more likely to be property losses. Statistics do point out that of the 40 worst catastrophes in terms of the number of victims or human lives in 1970-2001, 39 occurred in developing countries.

One of the biggest disasters in recent times not attributed to natural causes was the attack on the World Trade Center in September 2001. An analysis of the economic loss of property and life is staggering. New York City Comptroller Alan G. Hevesi estimated about US$ 34 billion in property damage in New York City and other estimates skyrocketed to US$ 75 billion.

Although one cannot replace the value of human life, the attack resulted in a loss of "human capital" of $11 billion from the productive capacity of the lost lives.

Over the years since 9/11, insurance companies all over the world have been faced with an increased number of claims relating to catastrophic losses of lives and property. One of the solutions that many insurers are looking at is the establishment of a catastrophe insurance pool for severe but unlikely events. These may fare better than reserve funds, especially if insurers are worried about events that occur once in a few centuries. Multinational insurance companies with global risk portfolios could play an important role in the creation of such a pool. The advantages of a catastrophe pool would include affordability of premiums, good governance and effective risk management.

Keeping Pace

– The Insurer's Big Challenge

M Ramadoss
Chairman and Managing Director
THE ORIENTAL INSURANCE COMPANY LTD.

Certain unpleasant truths have to be dealt with as matters of fact. One such truth, which has been haunting insurers' minds around the globe, is dealing with the menace of terrorism.

To this day, there has not been unanimity among the insurers even on the definition of the word "terrorism." Recently, the world noted with grief the death of more than a thousand people in Iraq due to "perceived" terrorism. These are newer aspects of terrorism, and insurers are almost expected to keep pace with the terrorists in covering these developments.

With some regret and sadness, I would say that this provides great opportunities to insurers. But insurers are not fully equipped to handle these new breeds of terrorism. Even today, many insurers and reinsurers treat terrorism as Policy Exclusion. Primarily, the perils of terrorism make the concept of PML outdated. After all, who could imagine that a single act of terrorism could bring the WTC towers down to rubble in minutes?

However, wisdom lies not in refusing the cover but in building capacity to cover these perils. Some initiatives are already underway in several countries. For instance in India, a "terrorism pool" was created to share the risks. However, there is still much left to be done. There is immense scope for creating a global insurance pool to cover catastrophes caused by terrorism, weather and earthquakes.

Yet another peril of the current century is cyber crime. These are specific crimes using computers and networks or the facilitation of traditional crime through the use of computers, such as child pornography, hate crimes, telemarketing/Internet frauds. This apart, there is also "computer-supported crime," which covers the use of computers by criminals for communication and document or data storage. Possibly these activities may not be illegal by themselves but then they are often invaluable in the investigation of actual crimes.

To this day, there has not been unanimity among the insurers even on the definition of the word "terrorism."

Present-day technology poses many new challenges regarding issues such as privacy as related to data mining and criminal investigations. Until now the potential damage that can be caused have not been known to many underwriters. The pace of technology is so fast that its perilous facet also grows at the same speed. So the fraudulent use of computers and passwords, hacking, cyber theft and misuse of credit cards are all exposures faced by the industry.

A recent development is the cloning of credit cards and even cell phone SIM cards. Many crimes are committed by juveniles, who may not be aware of the seriousness of the offences they commit. The assessment of losses or liabilities is quite a challenge in such cases.

These issues need to be taken up for serious discussion at international forums of insurers so that we not only develop the capacity to underwrite but also the skills to do so.

... Continued from Page 8

"Crop Losses to Weather Factors"

in terms of high administrative costs and assessing the probability of the risks for which the cover was provided.

In search of an alternative for traditional multi-peril crop insurance schemes, the World Bank has been spearheading weather insurance initiatives in the backdrop of the knowledge that weather contributes to almost 80 per cent of crop losses. What is novel about these developing world programmes is that the contracts are linked to weather indices, rather than actual losses by the insured. The advantages of this latter approach are:

Transparency: Traditional multi-peril insurance schemes rely upon human assessment of yield, which is subjective. Weather insurance replaces human subjective assessment with objective weather parameters.

Speed of claim settlement: Weather data is available almost on a real-time basis and therefore claim calculation is also a concurrent process.

Technology adoption: Another advantage that weather insurance offers over traditional yield insurance is that cover is provided only for factors of production, which are uncontrollable. Providing insurance for yield basically equates to providing insurance also for a farmer's mismanagement. It takes away a farmer's incentive for entrepreneurial excellence. Weather insurance, however, still requires that the farmers have to excel managerially – a characteristic that promotes adoption of modern technology and farming practices.

19th FAIR CON

INTERLINK

Bi

Int

The Sy

IFERENCE 2005

Insurance & Economies

– Insurance Penetration in Developed vs Developing Countries

Mohammad Bin Abdullah
Chairman,
MALAYSIAN REINSURANCE BERHAD

In today's complex financial systems, insurance has a significant role to play in the economic wellbeing of any country. The industry will see the rapid development of a wide range of products, from basic risk protection to more sophisticated financial planning products for retirement and asset accumulation, as well as huge improvements in the best standards of service. We envisage that the main driver for these changes will inevitably come from the higher demands of consumers, which have over the years become increasingly sophisticated.

In this context, insurers and intermediaries need to continuously improve and upgrade their range and quality of services to consumers so as to support the broader economic and social agenda.

Insurance Industry Growth - 2004

The global economy expanded by 4 per cent in real terms in 2004. Growth accelerated both in developed countries and developing countries. Total world premiums increased by 2.3 per cent in real terms and profitability improved further in spite of high catastrophe losses.

Penetration Rate Trends

Generally, insurance penetration remained stable among the developed countries in 2004. Life insurance penetration was 5.1 per cent while non-life was 3.9 per cent.

Penetration in developing countries picked up only marginally in 2004. Overall insurance penetration was 3.9 per cent.

Insurance penetration varies dramatically amongst countries and within regions. Penetration is relatively low in developing countries.

Factors that significantly affect insurance penetration in a country are: Economic factors, legal factors, demographic factors and social and cultural factors.

i. **Economic Factors:**
Obviously, the level of income would have a significant effect on the demand for insurance of both life and non-life insurance. Price is another important economic factor. The price level, in turn, depends on the level of competition, which is determined by legal factors. Thus, these determinants are not independent but they reinforce one another.

ii. **Legal Factors:**
Laws affect the competitiveness of the industry. If, by law, an insurance company has a monopoly, it will affect the supply and demand as it will affect the price charged per unit of service. Thus, deregulation can give a boost to the demand structure.

iii. **Demographic Factors:**
An example of socio-economic and demographic factors that could have a big role is the education level. It is not easy to document that education alone, and not income, is of importance. But there seems to be some evidence that higher level of education leads to higher demand for insurance. Demographic factors play a role too as, for instance, in a country with an ageing population would have higher demand for long-term care.

iv. **Other Factors:**
Other factors affecting the insurance penetration rate include consumers' confidence, changes in pension system and longer life expectancy.

The questions that insurers and reinsurers must also address is whether the insurance industry has reached maturity, whether it will be able to continue to grow in the future and whether the infrastructure required to support the industry in terms of a pool of trained and skilled manpower to meet the expected demand is available. Insurers should place emphasis on the improvement of their underwriting skills and the introduction of more effective marketing methods to harness the potential of the market place.

Mr. D. Sengupta, Retired Chairman, GIC, Mrs. K. H. Parekh, Chairperson, Interlink, Mr R. K. Joshi, Chairman-cum-Managing Director, GIC, Mr. P. C. Ghosh, Retired Chairman, GIC and Mr. Bharat Boda, President, Insurance Brokers' Association of India at the function held to release Interlink's statistical annual, 'Indian Insurance Industry (Non-Life), 2004-05.

Opening up an Industry

- What will Fuel Growth

Yogesh Lohiya
General Manager
THE ORIENTAL INSURANCE COMPANY LTD.

Competition is not, and has never been, a zero sum game. Detractors of a more open economy forget that by providing better and more innovative products at lower prices, competition actually expands markets.

The Indian economy has undergone major reforms in the past. However, until November 1999, insurance remained untouched. It was then that the Insurance Regulatory and Development Authority (IRDA) Bill was passed in Parliament and, since then, insurance reforms have aimed at creating an efficient and competitive financial system.

In an increasingly competitive scenario, the key differentiator will be the customer experience that each insurance player can offer in terms of quality of advice, product choice, policy servicing and settlement of claims. Service will focus on enhancing the customer experience and maximising customer convenience.

Potential changes to look out for in terms of the distribution channel include the gradual evolution of independent brokers. Complex insurance products will, however, continue to be sold direct by the company or through brokers.

The growth and development of the industry in the future will be impacted by the following factors:

Regulatory Framework

The future development of the insurance industry will depend on how the regulatory regime is enforced. Unfortunately, in the race to gain market share and establish a presence, we may come across certain questionable market practices that will adversely affect the image of the insurance industry in the long run. The hope is that the regulatory body will take action against those who violate regulations.

Simplification of insurance laws

Another cause for concern is the delay in the formulation of a unified act addressing all issued related to insurance. Many restrictions enshrined in the Insurance Act, 1938 need to be removed and reframed as regulations issued by the regulator.

Risk Management

The role of regulators in monitoring the risk profile of each participant will be crucial to maintaining the good health of the sector.

Insurers will need to take appropriate risk mitigation measures to minimise risk, while regulators will need to strengthen their armoury of risk measurement tools.

The Rural Market

Insurance companies have established a presence and extended coverage in rural areas.

The challenge that faces new and old insurance companies is to recognise that the rural market is also segmented, and that they need to design products that meet their needs without sacrificing profits.

Conclusion

The keys to the success of the operation will depend on:

- The ability to understand customer needs and service them efficiently and effectively at the lowest cost
- The development of systems to manage multi-level risks faced by them and
- A practice of the highest levels of transparency and corporate governance

Corporations and institutions have an enormous responsibility to support the reinstatement of a business ethic that shuns shortcuts and questionable practices and to build a management style to reflect this ethic.

In the long run, this approach makes business sense as customers are likely to be much more discriminating in a world of information and transparency.

Mr.B. B. Sawhney of Tower Insurance releases Interlink's newsletter, "Newsline" at a function prior to the inaugural dinner of the 19th FAIR Conference, 2005. Also in the picture is Mrs. K. H. Parekh, Chairperson, Interlink.

When Catastrophes Strike

– Recouping Property Loss

D K Burman
General Manager
NATIONAL INSURANCE COMPANY LTD.

As this article was being written, Mumbai was recovering from a major loss of lives and property owing to the floods in July. New Orleans had nearly been wiped off the map by hurricane Katrina, followed by large-scale flooding of the city. A few months earlier, South East Asia had just recovered from the tsunami, which had left thousands dead and resulted in property losses of billions of dollars.

To an insurer and a human being, these scenarios brought to light the losses both in terms of life as well as property. They proved that nature does not discriminate between developing and developed countries.

It is also seen that while the massive economic losses from natural disasters occur in developed countries because of the value of exposed capital being higher in absolute terms, the impact of natural disasters in developing countries is far more severe owing to several reasons like less resilient infrastructure, lower building standards, and greater constraints on government resources available to cope with disasters. As a result, the first loss to happen in the developing world is usually of human lives, as in the recent tsunami, while that in the developed countries

Continued on Page 2...

Crop Losses to Weather Factors

– The Paradigm Shift

Sandeep Bakhshi
Managing Director & C.E.O.
ICICI LOMBARD GENERAL INSURANCE COMPANY LTD.

In developing countries, as in the industrialised world, agricultural insurance is by no means a new concept. Most of the developed countries in the past have put in place insurance schemes – typically state-run or state-backed – to protect their farmers against disasters.

India's quest for a comprehensive and effective solution to agriculture's various risk exposures has been extant since independence. This has manifested itself through massive technology upgradation initiatives on the one hand and crop insurance schemes on the other. Substantial gains have been made on account of the former, which is well epitomised by the Green Revolution.

The initiatives on the crop insurance front began with a Pilot Crop Insurance Scheme that ran between 1979-80 and 1984-85, followed by the Comprehensive Crop Insurance Scheme that was introduced in April 1985 and the National Agriculture Insurance Scheme, which was introduced in the Rabi season of 1999-00. The Task Force on Agriculture (July 2001) set up by Government of India reports that the schemes had challenges

Continued on Page 3...

INTERLINK INSURANCE BROKERS PVT. LTD.
601, Sapphire Arcade, M.G. Road
Ghatkopar (East)
Mumbai - 400 077, India
Tel.: +91-22-2509 3509 / 10 / 11
Fax : +91-22-2516 6259 / 2510 6259
E-mail : postmaster@interlinkre.com

Powered by **POWER QUILL**
The Editorial Services Company
40/1, Karpagam Apartments
Sreeman Srinivasan Road
Alwarpet, Chennai - 600 018, India
Tel.: +91-44-2499 6472 Telefax : +91-44-2499 4189
E-mail : info@powerquill.com Web : www.powerquill.com