Impact of GIC Re Treaty Circular on The Fire Insurance Market

*Pratibha Sinha**
*Channabasava R. Jyoti**

Recent years have seen manifold changes in India's financial landscape. Developments in insurance also have kept pace with the new reforms and regulations. This article focuses on the GIC Re Treaty circular and its impact on the fire insurance market.

This circular comes at a time when the fire insurance market is marred with high discounts and huge claim outflows. It discusses the GICs stipulations making it compulsory for the general insurers to adhere to the IIB identified loss-cost-rates for 8 industrial occupancies in fire portfolio, if the insurers want to keep pace with the treaty with GIC.

Keywords: Insurance Information Bureau of India (IIB), Loss, Cost, Regulations, Treaty, Insurance

Introduction

Business assets play a key role in generating revenue for the organization. Safeguarding the assets therefore becomes a necessity and hence insurance comes into play. Fire insurance, because it provides protection for capital assets against fire and allied perils, it is one of the most sought-after insurance policies by an organization.

In the year 2000, the insurance industry, both life and general were opened to the entry of private domestic and foreign companies. The fire insurance business was governed by the All India Fire Tariff (AIFT), which fixed the rates for various industrial occupancies. Post 2007, after extensive discussions, it was decided to de-tariff the fire insurance market with the idea to promote a free market and a realistic risk-based pricing. But this led to a price war.

Insurers started to provide discounts up to 99 percent on the erstwhile tariff rates for FLEXA covers (fire, lightning, explosion, aircraft) and charging a meager premium for covering Nat Cats. This was done in order to increase their market share. However, it led to an increase in competition. At times, fire policies were handed out free with premiums charged only for add-on covers.

Reinsurance is an arrangement whereby the direct insurer who has insured a risk, insures a part of

*PGDM Students, NIA. Email : pratibha199601@gmail.com, channajyoti@gmail.com

that risk again with another insurer in order to reduce his own liability. The difference between the retention and the total amount of acceptance is reinsured. There are two main methods of reinsurance: Facultative and Treaty. In the facultative method, each risk is reinsured individually whereas in treaty reinsurance, the reinsurer agrees to cover all risks within the scope of the treaty. The advantage of the treaty method is the obligatory nature of reinsurance acceptances.

GIC Re Treaty Circular

On February12, 2019, GIC Re issued a circular stating that for 8 industrial categories, the general insurers must adhere to the published IIB[1] loss cost[2] rates if they want to have a treaty reinsurance with GIC.

The circular explicitly states that if the IIB loss cost rates are not followed, GIC would not have a treaty with the general insurers and they are free to approach the other 11 reinsurers operating in India. Total of 35 occupancies under the 8 industrial categories are as follows:

Table 1: Various Occupancies in the Affected Industries

Sr. No.	Category	Number of Occupancies	Some of the Occupancies
1	Chemicals (<32 C flash points)	8	Bulk Drugs, Distilleries, Detergent manufacturing with sulphonation plant, Paint Factories (water based), Paints - nitrocellulose-based
2	Textiles	14	Jute mills, Leather-cloth factories, Weaving Mills
3	Manufacturing rubber goods	4	Rubber goods manufacturing with spreading
4	Plastics	3	Plastic goods manufacturing (excluding foam plastics)
5	Transporter's warehouses	1	Transporters' godowns, Warehouses of clearing and forwarding agents
6	Category 3 storage	1	Storage of hazardous goods listed in Category 3, subject to warranty that coir waste, coir fibre and, caddies are not stored therein
7	Steel factories	2	Aluminium, Zinc, Copper factories
8	Thermal power plants	2	Electric generation stations Hydro Power Stations

[1] *IIB: Insurance Information Bureau of India*
[2] *Loss cost: The amount of money an insurer must pay to cover claims, including the costs to administer and investigate such claims.*

The IIB has worked out the rates using the burning-cost ratio analysis method which calculates the estimated cost of future claims based on the previous year's figures. It was stated that for the above-mentioned 8 industrial categories, the claim ratio was above 200 percent, indicating steep losses.

The premiums for the above occupancies would then be determined as follows:

- IIB loss cost rate + NAT CAT rates + Other relevant costs (like the management expenses)

  The other notable points in the circulararare:

A. Deductibles[3] for power and steel plants (excluding wind, solar and power plants)

Table 2 : Change in Deductibles

Type of Loss	Previously	Currently
Material Damage	5% of the claim amount, subject to minimum of Rs. 10 lakh	5% of the claim amount subject to minimum of Rs. 1.25 cr.
Machinery Breakdown	5% of the claim amount, subject to minimum of Rs. 10 lakh	5% of the claim amount subject to a minimum of Rs. 1.25 cr
Fire Loss of Profit	7 days of gross profit	30 days of gross profit
Machinery Loss of Profit	14 days of gross profit	45 days of gross profit

B. In Table 1, Occupancies from Sr Nos. 1 to 6 must be ceded on 100% of the sum assured and not on Probable Maximum Loss (PML). This was changed since PML is a subjective estimation. The risk of the error in PML originates from the direct insurer as the reinsurer has access to the direct insurance portfolio and not the individual risks.

Outcome of the GIC Re Circular

The circular had a huge and sudden impact on the general insurance companies. The various outcomes are as follows:

a) No more discounts applicable

As mentioned in the circular, the general insurers cannot offer any discounts as stipulated. This would result in huge financial outflows for the corporate clients apart from the business and administrative expenses which they have already incurred.

[3] *Deductible: The amount of moneya policy holder pays in an insurance claim before the insurance coverage kicks in and the company starts paying the policyholder.*

b) Huge increase in premiums

For the affected industrial categories, the premium has increased three to eight times due to the new rates introduced. For example, the previous overall premium rate for a chemical manufacturer was 27- 28 paisa for a sum assured for Rs. 1,000. Now, due to the GIC circular the overall premium rate is 268 paisa for a sum assured for Rs. 1,000. Pharmaceutical companies like Wockhardt Ltd... the renewal premium for FY19 increased to Rs. 5.83cr from Rs1.32 cr.

The overall pie of premium from the non-life to the reinsurance is going to increase in the coming years although it has been estimated that portion of premium retained by the insurance companies is also going to increase in the subsequent years.

c) Entire industry re-rated

Companies with no previous claim history would need to pay higher premiums since the entire industry is re-rated. While this could be manageable for large companies and firms, it could be a financial constraint for small and medium sized firms. This will cause a huge burden for them since they might not be ready for such an increase in premium.

d) Risk awareness

Risk awareness is one of the important factors to be considered in this market. Since no more discounts would be offered to the companies, the insurers in return can make their clients more aware and keep them abreast of the risks hovering around their respective businesses. This could lead to a better and efficient management with a robust infrastructure for a long-term run. The client would become more aware of the risks as they would be shelling out more money as premium.

e) Foreign reinsurers

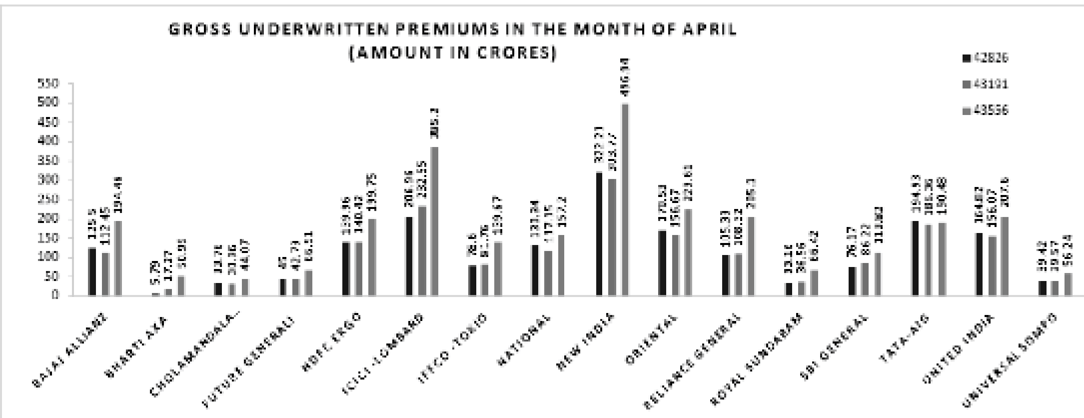
This gives an opportunity for other reinsurers to capture the market share from GIC, but not up to a great extent. The reasons being: (i) there is a mandatory cession of premium for insurers towards GIC Re, and (ii) the regulation set by IRDAI stipulates that insurers require to offer business to GIC Re first. Since various Indian insurers have different domestic treaties with GIC Re (fire, marine, motor, etc.), switching their businesses to other reinsurers becomes difficult. The regulations however allow insurers to simultaneously seek terms from at least four foreign reinsurers and incase the domestic reinsurers do not match up to the rates quoted by their foreign counterparts, they lose the business. But GIC Re due to its consistent growth has managed to gain advantage in this competitive arena. Placing business with other reinsurers may lead to hampering of relationship between GIC Re and insurers. Also, the terms of treaty with foreign reinsurers would be stringent - such as higher deductibles, revising and formulating another risk engineering report - if the existing one does not match up to their desired parameters.

f) Increase in the premiums collected by insurers

One of the probable reasons for increase in the fire insurance premium in the month of April (start of FY 19) for general insurers can be attributed to the circular issued by the GIC.

	April (FY17)	April (Fy18)	April (Fy19)
Gross fire insurance premiums underwritten (of all companies)	1884.27 Cr	1860.76 Cr	2817.37Cr

Figure 1: Gross Underwritten Premium for Various Insurers in April for Last 3 years



Why Did GIC Re Do This?

As mentioned earlier, the corporate entities in the country were blissfully enjoying the 99% discount. When this is compared to individual and retail policyholders who were paying higher premiums continuously, the corporate bodies enjoyed low premiums due to their higher bargaining power. The result of providing such discounts led to disproportionate collection of premiums because it was not matching the risks insured. In the event of a loss due to fire, the incurred losses had the potential to wipe out the entire premium collected, thus leading to the underwriting of losses. For example, in FY12 the fire losses accounted for over 50% of the claims lodged with general insurers. The domestic fire treaties for GIC Re (since GIC is the market leader, all insurers have treaty arrangements with it) have been running at a combined ratio of 100% loss consistently for the last few years, and, hence this anomaly led to the identification of those sectors which have huge claims outgo.

The reinsurer also reported a loss in the FY18 and 9M FY19 despite strong premium inflow. An insurance company's profitability was measured through combined ratio[4], which stood at

[4] *Combined ratio: It is a measure of insurer profitability, calculated by taking the sum of claim-related losses and general business costs and then dividing that sum by the earned premiums over the period.*

107.6% for 9M FY19. This was due to higher claim/loss ratio which was up to 92%; whereas the commission and expenses ratios were 15.2% on the better side. Due to consistent and favorable income returns due to prudent investment policies, the company tided over the underwriting losses and registered a profit of Rs1621 crore in 9M FY19. The solvency ratio was well above the regulatory requirements of 150and the Returnson Equity (RoE), which were in double digits, helped the company to register a profit. This helped the company to maintain its profit margin for a couple of years until it was required to raise new capital.

Legal Proceedings

Legal cases were filed against GIC Re by several companies, namely Biocon, Wockhardt, Lupin and Cadila Healthcare, but subsequently the petitions were dismissed by the High Court which stated that GIC is fully entitled to determine the rates at which it offers re-insurance in respect of risks covered by various insurance companies.

Conclusion

The GIC Re circular caused a massive turbulence in the fire insurance market but it was required in order to bring in stabilization of rates and establishan adequate and realistic risk that matches with the premium.

This circular also had the effect of creating a strong awareness by highlighting the need to put in place an objective and effective risk management system. Management of risk in an organization is a continuous process. Investing certain amount every year into risk management mechanisms and operations is much better than facing a huge accidental loss suddenly, which would leadto the potential shutting down of the organization for months.

In the coming years, there is a possibility of similar revision of rates for other occupancies across the board as well with the movement of the fire insurance market back to a regimented tariff regime.

References

- Biocon, Lupin, Wockhardt, Cadila Healthcare Lose Insurance Battle in Delhi High Court (May3,2019). Retrieved from :https://business.medicaldialogues.in/biocon-lupin-wockhardt-cadila-healthcare-lose-insurance-battle-in-delhi-high-court/
- GIC Circular(February 12, 2019). Retrieved from : Http://ibai.org/wp-content/uploads/2019/03/GIC-RATE-AND-CAPACITY-GUIDELINES-1.pdf
- GIC Re Raises Premium for 8 Industry Categories(March 26, 2019). Retrieved from : https://economictimes.indiatimes.com/markets/stocks/news/gic-re-raises-premium-for-8-industry-categories/articleshow/68571837.cms

- IIB Circular Release (March 24, 2017). Retrieved from : Http://ibai.org/wp-content/uploads/2019/03/IIB-Circular-Release-2-dated-24-Mar-2017-1.pdf
- Insurance Data. Retrieved from GIC Council:https://www.gicouncil.in/
- Industry Performance. Retrieved from :https://www.gicouncil.in/statistics/industry-statistics/segment-wise-report-on-homepage/
- Insurance Cost Goes up to 9-fold for Companies (March 25, 2019).Retrieved from:https://www.asianage.com/business/in-other-news/250319/insurance-cost-goes-up-to-9-fold-for-companies.html
- Ideas for Profit | Giant Size Makes GIC Re a Safe Bet in theRisk Business; Buy for the Long Term (April 1,2019).Retrieved from : https://www.moneycontrol.com/news/business/moneycontrol-research/ideas-for-profit-giant-size-makes-gic-re-a-safe-bet-in-the-risk-business-buy-for-the-long-term-3814531.html.
- Local Reinsurance Giant Raises Premium Rates(March20.2019). Retrieved from:https://www.asiainsurancereview.com/News/View-NewsLetter-Article?id=46058&Type=eDaily
- Treaty Endorsement Related Clarifications Raised by Cedants(February 12, 2019). Retrieved from :http://ibai.org/wp-content/uploads/2019/03/Treaty-Endorsement-related-clarifications-on-FAQs-raised-by-cedants-1.pdf
- Wockhardt Limited vs Union Of India and ORShttp://lobis.nic.in/ddir/dhc/VIB/judgement/20-04 2019/VIB12042019CW37692019.pdf