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Global Reinsurance Solutions

GIC ReNEWS

Newsletter of GIC Re

आपत्काले रक्षिष्यामि
GIC Re
Your Partner in Risk

JANUARY 2017

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HIGHLIGHTS

Mrs. Alice G Vaidyan, CMD, GIC Re, presented the dividend cheque for ₹ 860.00 crores for the fiscal 2015-16 to Hon'Union Finance Minister Shri Arun Jaitley in New Delhi in the presence of Shri Anil Kumar Khachi, Addl. Secy., Department of Financial Services, Shri G C Gaylong, Director & GM, GIC Re and Shri D R Waghela, GM, GIC Re.

Mrs. Alice G Vaidyan at the BT Most Powerful Women awards, with Chief Guest - Textiles Minister Ms. Smriti Irani and Prosenjit Datta, Editor, Business Today

CMD, GIC Re Mrs Alice G Vaidyan lighting the lamp on our 45th Foundation Day. Alongside are MD, LIC of India, Mrs Usha Sangwan, Director & GM Mr G C Gaylong and Director & GM Mr Segar Sampathkumar

CMD, GIC Re Mrs Alice G Vaidyan, Mr Randeep Chikara, Mr Hemant Shah and Mr Haresh Shah of RMS (a Leading Catastrophe Risk Modeling Company) at an RMS Insite India event held on 9th November 2016 in Mumbai

Editor's Thoughts...

The year 2016 that went by was possibly a defining year from econo-political perspective. One however needs some distance and detachment to be able to assess the events. Ramachandra Guha, an Indian historian and writer, says that history can be written only after at least 30 years have gone by since the event. Such a gap is required to digest the impact of events and put events into perspective with the required objectivity of a historian.

Heartburn from stagnant middle class income in developed economies is turning into social discontent. 2015 was the best year from economic perspective in decades for middle-class Americans with income rising by 5.2%. But probably it was not enough to compensate for the deterioration caused during global financial crisis and to assuage the underlying discontent. As globalisation promotes equality in incomes across countries, inequalities of income within countries continue to increase causing social unrest. This apparently set the stage for political upsets that were witnessed in 2016 with the potential to set the clock back on liberalisation.

While a consensus on globalisation in so far as trade is concerned eludes us, the issue of globalisation in terms of free immigration stares us in the face. While there are differences between free trade and free immigration, it would be absurd for advocates of free trade to balk at free immigration. ILO study conducted in cooperation with the European Commission showed that increasing inequalities in recent years have led to a shrinkage of the middle class in Europe. Together with high unemployment rate among the youth, it presents a worrisome scenario. This has the potential to create structural economic weaknesses and political instability.

Against this challenging backdrop, Indian policymakers continue on their path of calibrated embrace of the globalisation. Protectionism, so far an ugly word with implied condemnation, seems to shed some of its ugliness. Advocates of free trade are not equally enthusiastic about free immigration though the underlying rationale for both is quite similar. Conservative and cautious approach to liberalisation such as obligatory and order of preference attract criticism from all quarters but recent historical events put into question the unalloyed pursuit of liberalisation. Even developed economies are not entirely without trade barriers. While emerging economies have economic and non-economic rationale for gradually for-saking barriers, developed economies resorting to creating barriers would appear to be in denial of logic and is essentially retracting on liberal economic philosophy.

Insured catastrophe losses for 2016 are estimated at above USD 50 billion, level higher the 10 year average. For reinsurers, the year essentially was benign. Outlook for 2017 for Reinsurance sector is negative and for rating stable which is essentially the same as last year. This shows that owing to strong capitalisation, while solvency remains satisfactory, the pressure on the profitability will continue for some more time.

Inside this edition is an interesting article highlighting the consequences of different level of insurance coverage for an economy in terms of trajectory for GDP (de)growth and recovery. The study indicates that about 60% insurance coverage helps economy recover fully in the medium term and about 90% coverage almost neutralises the impact of the catastrophe thanks to recovery efforts contributing to GDP spurt. Most countries are likely to suffer some dent to the sovereign ratings owing to an event of 1 in 250 year frequency. It can be reasonably surmised that India does not carry significant risk in this regard owing to the advantage of geographical diversification that India enjoys and thus inherent resilience of the Indian economy.

Another article "Would reinsurers follow the fortunes of an insurers?" discusses the nuances of follow the fortunes / settlement clause - the most litigated clause between insurer and reinsurer and highlights the need for sound contractual risk management for the risk carriers!

Wish you all a very Happy New Year and Happy Reading.

Hitesh Joshi

From CMD's Desk

Alice G. Vaidyan

Warm New Year greetings to all. The year 2017 promises to be a watershed year for the Indian reinsurance industry. For the first time since the nationalization of the non-life industry in 1973, foreign reinsurers have been permitted to write business from Indian soil. As I write this, five of them have already been accorded final approval to commence branch operations. Doomsayers would have you believe that this development poses immense danger to the leadership of GIC Re in the Indian reinsurance sector, but nothing could be farther from the truth. GIC Re is the undisputed leader in the Indian reinsurance space. We are leading the reinsurance programmes of 17 out of 22 general insurance companies operating in the Indian insurance industry. The relationships we have built up over the course of more than a decade with our partners, have withstood the test of time. Cedants and other participants in the Indian market alike, seek GIC Re competence since we offer them the requisite protection, customized solutions and an exemplary record of honouring our commitments. We may see fierce competition from our peers and some upheavals in the market in the coming months, but I am certain that the USPs of GIC Re, viz. our stability based on robust capitalisation, familiarity with domestic market conditions and firm pledge towards the progress of the nation, will hold sway over all else.

> "The future will belong to those who keep pace with rapid advances in technology"

The world is witnessing an uncertain political and economic climate. The zeitgeist of these times seems to be populism and ultra-nationalism. We have witnessed this in the UK, as part of the election plank of the president-elect of the USA and are seeing it increasingly across continental Europe. This ideological shift away from globalisation is a very worrying trend and requires careful analysis. Globalization is the engine that has propelled world economic growth over the last few decades and pulled more than a billion people out of poverty since 1990. It has promoted diversity, enhanced creativity, encouraged innovation and fostered healthy competition. However, the fruits of this phenomenon have not been shared across all segments of the populace, which has led to the swelling tide of discontent. World leaders must deliberate upon this and evolve effective strategies to ensure equitable distribution of wealth across all quarters. The economist Milton Friedman once said, *"Underlying most arguments against the free market is a lack of belief in freedom itself."* Popular leaders must be proactive in shaping public opinion, responsive to the needs of the people and present them with a clear vision for the future.

On the bright side, emerging economies are expected to lead global growth in 2017. Much of the global growth is emanating from Asia, in particular India and China, and the two economic powerhouses are expected to replicate the trend this year as well. Much of what happens in the global economy in 2017, will depend on which direction the political movements across the advanced economies of the world take. The USA and EU, which are seeing significant protectionist tendencies, are amongst the largest manufacturers and consumers of the world, and have the potential to affect global economic growth significantly, based on the policies their leaders implement. With cautious optimism we hope that election rhetoric remains just that, a rallying cry to consolidate the masses.

The future will belong to those who keep pace with rapid advances in technology. Businesses and governments alike will undoubtedly need to keep pace with developments in robotics, artificial intelligence, nano-technology, biotechnology, the internet-of-things, self-driving vehicles, 3D printing, to name a few. The misgivings of climate-change skeptics aside, climate-resilient infrastructure is the need of the hour, as increasing instances of drought, flooding, cyclones inter-alia are laying bare. Losses in 2016 from natural disasters worldwide were to the tune of $175bn out of which only $50bn was covered by insurance companies. 2016 was the costliest year for the global insurance industry since 2012 as far as natural disasters are concerned. It is imperative for governments and insurance companies to bridge the yawning protection gap that is particularly large in developing countries. As the old adage goes, prevention is always better than cure. If we want to minimize loss of life and property, all stakeholders must come together and search for effective solutions. The world needs to understand that we are one global community with a shared destiny. The future, however uncertain and complex it may seem, beckons with immense potential. It is left up to our collective energies to mould it the way we envision it. With this, I wish all my colleagues the very best in their pursuit of excellence. May, above all, good sense prevail in the world.

Revisiting History - GIC Re celebrated 45th Foundation Day

Foundation Day is a day of commemoration, to celebrate what has been achieved over the past years and a day to look forward to what is yet to come.

GIC Re celebrated its 45th foundation Day on the 22nd of November 2016 at Tata Theatre, NCPA under the Leadership of our CMD, Mrs. Alice G. Vaidyan. This celebration was graced by the distinguished CEO's of Public & Private Sector Insurance companies, our former Chairmen and Managing Directors, Executives and staff along with their families. An Audio Visual was presented to the audience highlighting our illustrious journey through these 44 years. To memorialize the vision of GIC Re, an in-house competition for the Corporate Song and Corporate Tagline was conducted in our office. CMD honored the winners of the respective competitions: Ms. Swarnima Agarwal and Ms. Aditi Mahajan. The corporate song was composed with a soundtrack which was melodiously sung live by Mrs. Payal Mallik and Mr. Mehul Jaiswal.

Corporate Social Responsibility represents the policies, practices and initiatives an organization commits to in order to govern themselves with honesty, transparency and have a positive impact on social and environmental well-being, Through our Corporate Social Responsibility team, we at GIC Re have been putting in place our capabilities in terms of funds and skills to improve social problems and have a positive impact. This Foundation Day, GIC Re felicitated three of the NGOs with whom GIC Re has collaborated with for CSR Projects.

- Ms. Neelima Mishra Founder President, Bhagini Nivedita Gramin Vigyan Niketan (BNGVN) and Bhagini Nivedita Foundation
- Dr. Saanil Bhaskaran, Director Enterprises Services and Donor Care, The AkshayPatra Foundation (Mid-Day Meal Scheme)
- Mr. Mammon Akhtar, Founder, Samaritan Help mission (SHM).

The felicitations were followed by an enthralling performance by the celebrity singer, Shalmali Kholgade who had the audience rapt, for a good one and a half hour.

Deepti Atri & Venessa/Janet

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Cyber Liability Insurance

Cyber security in India has come a long way in the past few years and has gained huge importance in recent times with the thrust on Digital India, e-commerce and mobile payments. Cyber security has been identified as one of the key areas of development by Prime Minister Narendra Modi. The Government of India recently launched the Digital India Programme and the Smart Cities Mission to digitally empower society.

While the nation focuses on growth, our work as risk managers is clearly cut out. We need to focus on the basics that will help keep the growth story on course, by mitigating the risks involved in securing the financial downside to cyber attacks or cyber breaches.

A recent survey by PwC reveals that acts of transgression in the Indian cyberspace have increased twofold over the past year. Indian organisations detected 117% more incidents over the previous year, shooting up from an average of 2,895 incidents to 6,284 incidents a year. This is a sharp deviation from the global trend, which saw a 39% increase in security incidents over the previous year.

Financial losses as a result of cyber incidents increased by 135% over the previous year, which is a steep rise compared to the trend of 20-30% over the years before. The average information security budget has increased with a CAGR of 25% for Indian organisations over the last five years.

The ecosystem of Internet-connected devices or Internet of Things (IoT) is poised to soar in the coming years. Research firm IDC predicts that the number of devices connected to the Internet will reach 30 billion in 2020, up from an estimated 10.3 billion last year. IoT has indeed come a long way from being a futuristic concept just a few years ago to transforming into real products, services, and applications. Smart watches, fitness bands and trackers, smart glasses, self-driving cars and drones are just the beginning of the endless possibilities. In this type of data-centric environment, the security and privacy risks have taken even greater significance.

Hackers can hijack connected cars and control them remotely; digital snoopers can infiltrate home surveillance systems and monitor the behaviour of residents; and threat actors can compromise connected medical equipment and potentially impact the health and safety of patients. Vulnerabilities left unattended can result in grave repercussions from business losses to catastrophic establishment attacks.

CRO (Chief Risk Officers) Forum Cyber Resilience Paper (December 2014) explained that "cyber risk covers the risks of doing business, including managing and controlling data, in a digital or 'cyber' environment." More specifically, "cyber risk" refers to "any risks that emanate from the use of electronic data and its transmission, including technology tools such as the internet and telecommunications networks. It also encompasses physical damage that can be caused by cyber attacks, fraud committed by misuse of data, any liability arising from data storage and the availability, integrity and confidentiality of electronic information - be it related to individuals, companies or governments."

It is in this context that Cyber insurance holds great promise in limiting the effects of these attacks in financial terms. Technically adept adversaries will always find new ways to circumvent security safeguards, that's why many businesses today are purchasing cyber security insurance to help mitigate the financial impact of cybercrimes.

Cyber security insurance is one of the fastest-growing sectors in the insurance market. In fact, a recent report by PwC forecasts that the global cyber insurance market will notch up 7.5 billion USD in annual sales by 2020, up from 2.5 billion USD this year.

The insurance industry has responded to this challenge by offering add on covers as endorsements or standalone covers to address these risks. In the past technology companies bought errors and omissions (E&O) insurance, which over time, was extended to include things like a software product bringing down another company's network, unauthorized access to a client system, destruction of data, or a virus impacting a customer and so on.

Insurers today offer both first- and third-party insurance for cyber losses. First-party coverage insures for losses to the policyholder's own data or lost income or for other harm to the policy holder's business resulting from a data breach or cyber attack. Third-party coverage insures for the liability of the policy holder to third parties including clients and governmental entities arising from a data breach or cyber attack.

A brief description of the various covers available under First and Third party coverage is given below :

First-Party Coverage

Crisis Management & Identity Theft Response:

Expenses for communications to notify affected customers, provide credit monitoring services, conduct forensic investigations, and for expenses incurred in retaining a crisis management or public relations firm for the purpose of protecting/restoring the organization's reputation.

Cyber Extortion:

Expenses to pay ransom or investigate a threat to release, divulge, disseminate, destroy, steal or use confidential information; introduce malicious code into a computer system; corrupt, damage or destroy a computer system; or restrict or hinder access to a computer system.

Data Asset Protection:

Recovery of your costs and expenses incurred to restore, recreate or regain access to any software or electronic data from back-ups or from originals or to gather, assemble and recreate such software or electronic data from other sources to the level or condition in which it existed immediately prior to its alteration, corruption, destruction, deletion or damage.

Network Business Interruption:

Reimbursement for loss of income and/or extra expenses resulting from an interruption or suspension of systems.

Third-Party Coverage

Network Security Liability:

Covers claims from third parties arising from a breach in network security or transmission of malware/viruses to third-party computers and systems. Network security coverage can also apply if you're holding trade secrets or patent applications for a client, and that information is accessed due to a failure of your security.

Privacy Liability:

Covers claims from third parties as a result of a failure to properly handle, manage, store or otherwise protect personally identifiable information, confidential corporate information and unintentional violation of privacy regulations. It can be a breach of physical records, such as files tossed in a dumpster, or human errors such as a lost laptop, or sending a file full of customer account information to the wrong email address. Companies have also faced liability from returning a photocopier with a hard drive that contained unwiped customer tax records. A privacy breach can also include an action like wrongful collection of information.

Media Liability:

These are advertising injury claims such as infringement of intellectual property, copyright/trademark infringement and libel and slander. Due to the Internet presence of businesses today, technology companies have seen this coverage migrate from their general liability policy to being bundled into a media component in a cyber policy (or a separate media liability policy). Coverage here can extend to offline content as well.

Some common first-party costs when a security failure or data breach occurs include:

- Forensic investigation of the breach.
- Legal advice to determine your notification and regulatory obligations.
- Notification costs of communicating the breach.
- Offering credit monitoring to customers as a result.
- Public relations expenses.
- Loss of profits and extra expense during the time that your network is down (business interruption).

Common third-party costs include:

- Legal defense.
- Settlements, damages and judgments related to the breach.
- Liability to banks for re-issuing credit cards.
- Cost of responding to regulatory inquiries.
- Regulatory fines and penalties (including Payment Card Industry fines).

Key Exclusions/Sublimits

- Reputational harm.
- Loss of future revenue (for example, in the case of Target if sales were down due to customers staying away after data breach).
- Costs to improve internal technology systems.
- Lost value of your own intellectual property

Pricing

The price of coverage will vary, although prices are coming down as more insurers enter a market. The increased competition is making cyber insurance more affordable for many smaller organizations that can buy policies tailored to their risk profile. However, not having some level of cyber insurance could prove costly for organizations.

The majority of insurance payouts go toward costs within the phase of breach recovery associated with determining how the breach was caused. Legal guidance during the crisis management phase and forensics investigations are where the majority of funding is spent. These cost categories are followed by breach notification and credit monitoring.

Challenges in pricing

Providing cyber coverage for a relatively new product line has been challenging as there is very little actuarial data on which to determine appropriate coverage costs, coupled with the issue that cyber is a very dynamically changing landscape. Lack of sufficient metrics with respect to frequency and severity of loss makes pricing this product a bigger challenge.

Costs associated with Cyber extortion payout and ransomware is epidemic and disruption of critical services through compromise or denial of service may be estimated, however the range is broad and again, not enough actuarial data exists to make credible assumptions about the degree of liability. In the case of public services, disruption of critical services such as radio systems for police and fire, water purification, power distribution, waste treatment, and even traffic management may result in loss of life.

In addition, aggregation of risk is a very important issue for insurance companies. Aggregation refers to the consequences of concentrated and cascading cyber risks where key aggregation attributes such as internet failure, compromised services providers, or a number of organizations in the same or different sectors using the same IT system where something happens to that system and affects all of the organizations in that industry. This is particularly notable as cloud computing becomes more ubiquitous, one successful attack or failure of a cloud host could cause losses to hundreds of thousands of parties who hold their data within the cloud.

Fundamentally, insurers should look for a strong security culture within the company as a first step in risk triage. Additional factors such as industry, revenue size, geography, and actual assets at risk could contribute to how a risk is priced.

Conclusion

The threat landscape is dynamic and there are a growing number of adversaries. Organizations are outmatched in their ability to combat cyberattacks from nation states, global criminals and malicious insiders. Governments and organisations are looking to cybersecurity insurance as a financial instrument for transferring risk as part of their enterprise-wide risk management strategy.

Regulators enforcing compliance and Underwriters incentivizing better security awareness and preparedness along with data relating to events over time will certainly drive the Insurance industry to standardise and develop a better product.

References:

PwC, Turnaround and Transformation in cybersecurity: Key Findings from The Global State of Information Security Survey 2016

2016 Cyber Insurance Buying Guide - Financial Services Sector Coordinating Council

Whitepaper: Cyber Liability Insurance Overview Sponsored by the State, Local, Tribal, and Territorial Government Coordinating Council (SLTTGCC)

Shaji Thomas

Macro-Economic Cost of Natural Disasters

The question of Protection Gap led me to two very interesting research papers on the economic consequences of natural catastrophes. A growing literature studies whether disasters are harmful or conducive to economic activity. Interestingly, there is as yet no agreement on whether disasters are important from a macro-economic perspective. While the immediate destruction they cause triggers a range of adverse socio-economic consequences, natural disasters may also have growth-enhancing effects since investment for reconstruction is part of measured GDP (a flow), whereas the destruction of physical capital (a stock) is not. Weighing against this optimistic view are the disarray and loss of productive capacity depressing output in the immediate aftermath of a major catastrophe. Before I try to get into the debate, a quick case study from Peter et al paper contrasting Haiti & New Zealand - two island states that were struck by physically similar earthquakes in 2010, yet faced radically different economic consequences.

Two Islands, Worlds apart: Haiti vs. New Zealand

Physical Similarities: In 2010, both Haiti and New Zealand were struck by powerful earthquakes. The two events were physically similar in many respects. Both earthquakes released energy equivalent to a moment magnitude of 7.0. In both cases, the epicenter was located near a major economic hub {Port-au-Prince, Haiti's capital, and Christchurch, New Zealand's second largest city}.

Devastation & the Real Economy: Haiti's earthquake was one of the largest natural catastrophes affecting a developing country in history. The immediate destruction resulted in widespread disruption and 220,000 fatalities (2.25% of the population), and dislocated or affected another 40% of the population. Economic losses directly attributable to the catastrophe amounted to 8 billion US dollars, or 126% of 2010 GDP. The indirect macroeconomic effects resulting from the 2010 earthquake include a drop in real growth from 3.5% to -5.1% in 2010 alone, accompanied by a sharp decline in exports.

In the case of New Zealand, the direct losses were of a similar order of magnitude in absolute terms. Losses directly attributable to New Zealand's 2010 earthquake amounted to $6.5 billion (5.3% of GDP). The event produced no fatalities, in a population of 4.3 million. Even so, infrastructure disruptions included a major airport, different ports and essential roads. Hampered transportation facilities and damage to office buildings caused numerous businesses to close, including facilities for food processing, paper production, textiles, machinery, transportation equipment and service providers. At the same time, reconstruction, inventory adjustment and a large increase in local government spending on repairing public infrastructure induced positive growth effects. Local experts estimated that the immediate growth-enhancing effects of reconstruction add 0.4% to real growth.

An Important Distinction: In view of the striking physical similarities between the earthquakes, what explains the different economic consequences in Haiti and New Zealand? The difference here was that of financial preparedness for dealing with natural disasters, particularly the extent of risk transfer arranged for ex ante. When the 2010 earthquakes struck, 81% of the resulting direct losses in New Zealand were covered and subsequently reimbursed based on existing insurance contracts (coverage for the 2011 earthquake was likewise at 80%). By contrast, Haiti's insurance coverage was below 1%. The case of New Zealand suggests that insurance coverage facilitates rebuilding even with a slow pace of reimbursement. In spite of extensive insurance coverage in New Zealand, only a small share of claims were reimbursed shortly after the event.

Peter et al constructed a data-set that spanned 52 years (1960-2011), 203 countries & 2476 major events. The data were obtained from the NatCat Service of Munich Re. Their findings have been summarized below:

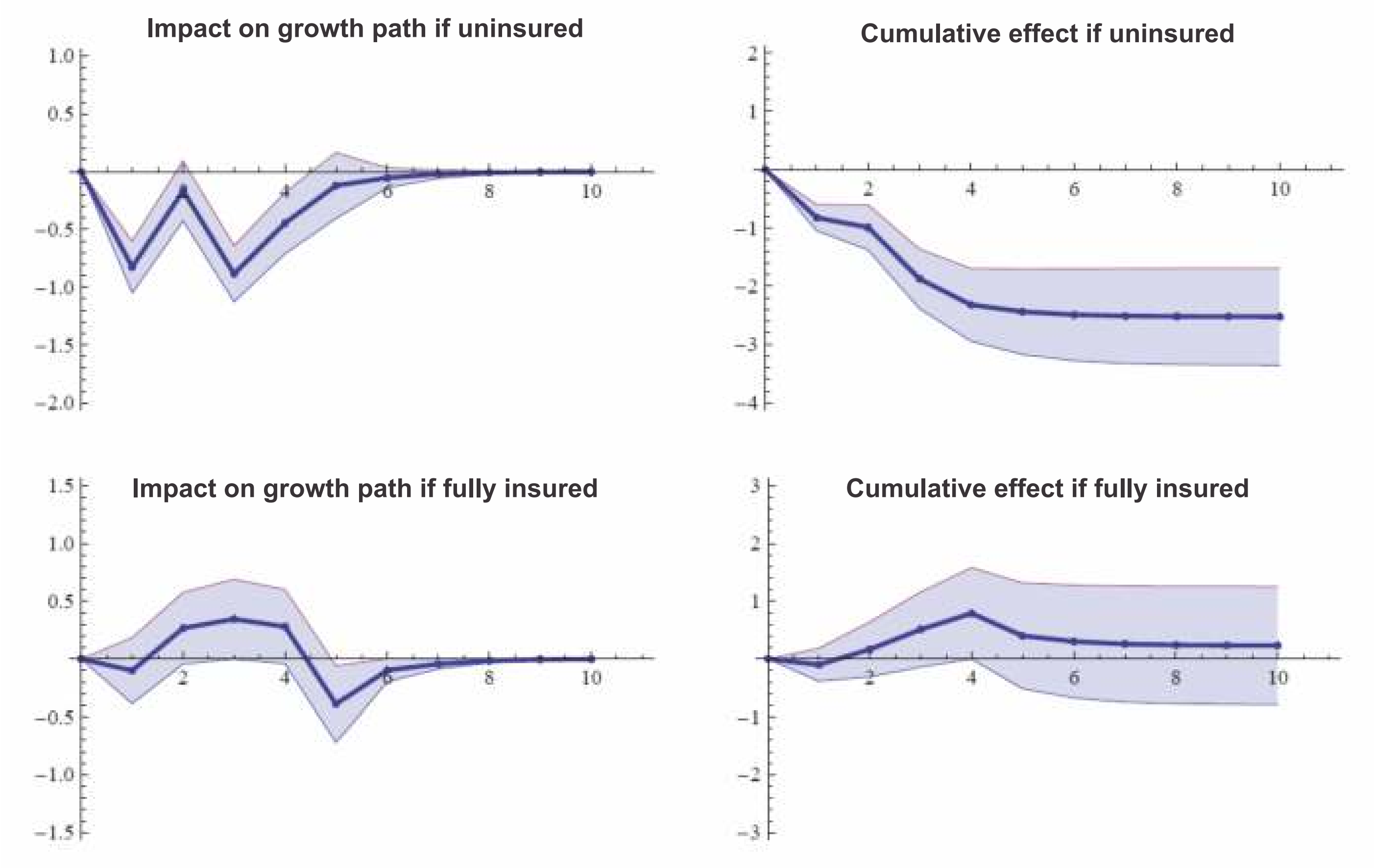
Impulse Response - Simulating the response of economic growth shows that the adverse effects of natural catastrophes are significant, both in the statistical and in the economic sense. Following a natural catastrophe, **real growth declines by 0.64% on impact,** briefly recovers and slumps again before converging back to the long-run growth rate (left panel). Does this growth pattern represent a recovery? The answer depends on the way one defines the term. Countries affected by a catastrophe may not see the level of GDP fall, since growth, albeit subdued, remains positive on average. Over time, the economy regains its long-run growth rate as the perturbed path approaches zero. **However, countries generally do not recover their previous growth path.** In this sense, countries never fully recover the output lost in the wake of a natural catastrophe. This pattern of incomplete recovery is also observed for man-made disasters (Cerra and Saxena 2008). **Consequently, natural catastrophes leave behind a permanent macroeconomic cost, over and above the direct loss from the destruction of property and infrastructure.** The right panel sums the growth deviations over a ten-year period to show that the cumulative effect converges to -1.65%.

Role of Risk Transfer - Small countries suffer more when uninsured but also recover faster when insured. Following an uninsured event, the impact estimate rises to 0.93%, and sluggish growth in each subsequent year brings the cumulative output loss to nearly 4% of GDP. The converse holds for insured

> **Unmitigated Disaster? New Evidence on the Macro Economic Cost of Natural Disasters**
> *- Peter, Dahlen, Saxena (2012)*

> **Assessing the Macroeconomic Impacts of Natural Disasters: Are there any?**
> *- Stefan Hochrainer(2009)*

The role of risk transfer



	T+1	T+2	T+3	T+4	T+5
Mean	-1.27	-1.43	-1.68	-1.75	-2.02
Median	-0.53	-1.03	-1.86	-2.27	-3.98
Std.Dev	7.19	11.01	14.99	18.37	22.53
Skewness	-1.54	-0.76	-0.13	0.42	0.98

losses: they can be growth-enhancing, especially in the year following the catastrophe and the cumulative output gain comes to 2.4%. The comparison between insured and uninsured disasters suggests that insurance plays a mitigating role: **while it cannot guarantee positive growth, sufficient coverage helps avert the adverse growth response that typically follows a major natural catastrophe.** These extreme differences in coverage yield starkly different growth paths in the wake of a major catastrophe. An uninsured catastrophe leads to the negative growth response observed earlier, but the opposite holds for the fully insured case. However, this finding does not imply that any insurance coverage delivers growth-enhancing effects in due course.

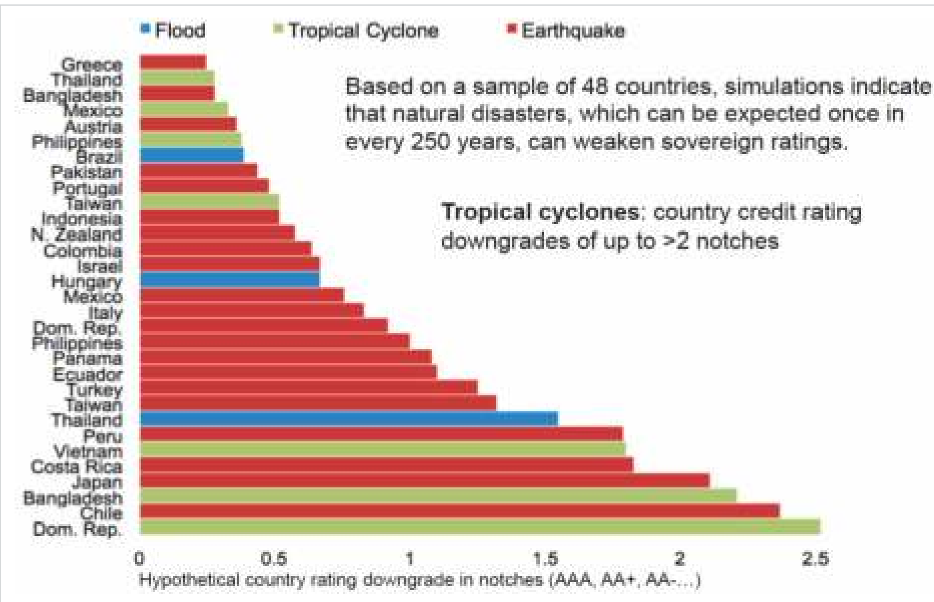
What constitutes adequate insurance coverage? If the desire is for zero output loss, it would take 91% insurance coverage for the central path to settle on zero. Allowing for estimation error, the cumulative loss turns statistically insignificant (the confidence band includes zero) once insurance coverage exceeds 60%. This basically means that a risk universe coverage of 60% implies there is minimal cumulative loss on the GDP owing to the risk transfer element. Whether it is efficient for countries to contract high coverage depends, of course, on the frequency of disasters as well as on the pricing of insurance contracts.

Hochrainer (2009) used a sample of 225 large natural disasters (Loss exceeding 1% of GDP) during the 1960-2005. The data were obtained from Munich Re NatCat Service & EMDAT disaster database. His findings were as follows-

He projected differences (in percent) between observed and projected GDP up to five years after a disaster event. Due to the heterogeneity of the data, it is not very surprising that the results are heavily skewed and as an average value the median should be looked at.

The results clearly indicate a trend. All post-disaster years show negative values with an increasing "gap," indicating that **"on average" one can expect negative economic follow-on consequences in the short-medium term, leading to a median reduction of GDP of about 4% points** (of baseline GDP in to) in year 5 after the event.

Another related area of research is to see **how much of an effect natural disasters can have on sovereign ratings.** Rare but extreme natural disasters and catastrophes can cause sovereign ratings downgrades, with the biggest impacts seen from earthquake and tropical storm simulations, making sovereign risk transfer and catastrophe insurance key. The ratings of low-income developing sovereigns are particularly vulnerable to severe natural catastrophes, followed by emerging and the less threatened advanced economies. In a study, Standard & Poor used data on catastrophe event damages provided by Swiss Re to construct a simplified sovereign rating tool. S&P simulated the impact over a five-year period of a one-in-250-year occurrence of four perils (earthquakes, tropical storms, winter storms, and floods) on key macroeconomic variables: GDP growth, the balance of payments, as well as on general government debt and deficits. The rating agency said that it sees particularly large potential direct economic damage and related pressure on creditworthiness for sovereigns on or close to the edges of Earth geological plates, for example, around the Pacific Rim (for example Chile, Costa Rica, Ecuador, Japan, Panama, Peru, Philippines, Taiwan), in the Caribbean (Costa Rica, Dominican Republic, Panama), and on the North Anatolian fault (Turkey). The threat to sovereigns is expected to increase though, as climatic trends looks set to result in more severe storms and more frequent impacts. While these trends are unproven, with the increasing urbanization of coastal areas, and populations moving to regions exposed to severe storms, surges and other perils, the chance of greater economic impact and a sovereign rating effect is rising all the time.



The above lead to very interesting policy implications which I will cover in a later article, for now, it will suffice to conclude that major natural catastrophes have large and significant negative effects on economic activity, both on impact and over the longer run. However, it is mainly the uninsured losses that drive the subsequent macroeconomic cost, whereas sufficiently insured events are inconsequential in terms of foregone output. However, implementing disaster insurance in developing countries faces three types of obstacles: paucity of markets, political resistance and inadequate institutional framework. For a number of reasons, markets have traditionally been insufficiently developed or simply nonexistent. It is for the (re)insurance industry to seize this opportunity & build more climate resilient & inclusive societies.

Anant Srivastava

Industry News

The reinsurance market continued to witness high availability of capacity in 2016. Reinsurance capital increased by about 5% in calendar year 2016 surpassing the growth in reinsurance demand. Even though there was plentiful supply, January 2017 renewals witnessed moderation in pricing. The general trend in pricing was downward, however the rate of decline has slowed somewhat. This was primarily due to localised loss activity witnessed in several sectors. Global insured catastrophic losses in 2016, at $53 bn were slightly higher than the 10 year average between 2006 and 2015. This loss trend has seen an uptick after four consecutive years of declining losses from 2011 to 2015.

It is estimated that global reinsurance capital rose to $595 bn in 2016 from $565 bn in 2015. This includes both traditional and alternative forms of capital. Alternative capital increased nearly 8% to $78 bn and constitutes about 13% of the total available capital. The proportion of alternative capital in total reinsurer capital has been steadily increasing over the years as the market encounters growing demand for innovative and customized products, and insurers seek to leverage hitherto untapped sources of capital. The surfeit in reinsurance capital continues, enabling expansion and customisation in coverage. As a direct consequence, historically complex and underinsured risks such as floods and nascent risks such as climate change and cyberspace are seeing increased focus.

Soft market conditions and slim underwriting margins have made insurers' profits very sensitive to claims losses. After a very high reserve releases in 2015 which was a 30 year record, moderation was observed in 2016. Going forward, potential for reserves release to sustain profitability looks weak. 2016 saw significant global insured catastrophic losses at $53 bn. This was the highest level seen since 2012 and is an increase of about 65% over the $32 bn losses recorded in 2015. It is the sixth most expensive year on record since 1980. The effect of convective storms was felt most distinctly in the United States, which was hit by several billion dollar losses. Hurricane Matthew was the most significant insured loss to affect the US. It is expected to cost the domestic industry more than $4 bn.

Other multi-billion dollar loss events that occurred were storms across Central and Western Europe ($3.4 bn – mainly France and Germany), wildfire in Alberta, Canada ($2.8 bn), earthquake on New Zealand's South Island ($2 bn) and earthquakes in Kumamoto, Japan ($5.5 bn). The latter was the most expensive event recorded in 2016 while the highest concentration of losses was recorded in the US. Even though on aggregate, insured catastrophic losses were high in 2016, the majority of the regions across the world witnessed below average annual insured losses. The exceptions to this trend were the Americas.

The Indian insurance industry continues to move along at a brisk pace. According to data available till the end of December 2016, the Indian general insurance industry had cumulatively registered a gross direct premium income of ₹ 91,517 crore. This is a rise of about 31% over the premium collections in 2015-16 up to December 2015. Motor and health insurance continue to be the largest segments, largely driving growth, along with crop insurance which has seen an extraordinary off-take in 2016. The non-life industry looks poised to cross the ₹ 1 lakh crore mark in January 2017 if it maintains the current momentum over the remainder of the fiscal year. The life insurance industry had registered total first year premium income of ₹ 1,16,417 crore up to December 2016, a growth rate of about 36% over a year-ago for like period. LIC continues to maintain its dominant position, having approximately 72% of the market share. The IRDAI reports that 19 out of 24 life insurers posted profit in 2015-16 and the sector's overall profit dropped by 2.57%. All four public sector general insurers posted a net profit in 2015-16.

Foreign investors continue to be upbeat about the Indian insurance industry, especially since the enhancement of FDI limits up to 49% in the insurance and pension sectors. More than ₹ 10,000 crore has flowed into India consequent to the above. Fairfax Holdings of Canada has submitted an application to form a new joint venture insurance company in India. Fairfax already holds 35% share in ICICI Lombard General Insurance. The global outlook for mergers and acquisitions remains strong for 2017. Consolidation and revenue enhancement are the key drivers behind them. We may not see deal values matching the aggregate over $150 bn through 2015 and 2016 but smaller deals are expected to continue.

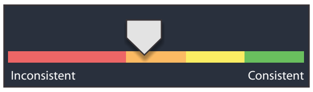
Five foreign reinsurers, viz. Munich Re, Swiss Re, Hannover Re, life reinsurer RGA and Scor, have been granted final R3 approval by IRDAI to commence branch operations in India. Others including XL Catlin, Lloyd's and Gen Re have made applications to IRDAI as well and are at various stages of approval. In November 2016, IRDAI announced the formation of a committee with representation of all stakeholders, to make recommendations for guidelines on the order of preference for reinsurance cessions. Its report is expected shortly. India will also witness its first ever domestic private reinsurance company in ITI Reinsurance Limited in the coming months.

ICICI Prudential Life Insurance Company conducted an Initial Public Offering (IPO) of its shares in September 2016. This was the first ever IPO by an Indian insurer and was met with a robust response. The IPO mopped up ₹ 6,056 crore from the primary market and represented a 12.63% stake sale in the company by ICICI Bank. SBI Life Insurance Company has announced that it may float a similar IPO in 2017. This is subsequent to the 3.9% stake sale it conducted in 2016. In addition, as announced by the Government of India, listing of the shares of public-sector general insurers is also expected shortly.

International ratings agencies are maintaining stable rating outlook for the sector in 2017, based on pricing pressures and thin underwriting profitability. The expectation is that majority of reinsurers will maintain their creditworthiness in line with their current rating over the next 12-18 months.

Rahul Dayal

THE LEGAL LITMUS



Would reinsurers follow the fortunes of insurers?

This question on the pages of the newsletter of GIC Re will take the reader's mind directly to one of the most basic and widely talked about clauses of proportional Reinsurance Contracts – 'Follow-the-settlements' or its close cousin 'Follow-the-fortunes' - and rightly so. This incidentally is also the most litigated clause between insurers and reinsurers. Broadening the ambit of discussion, however, I seek to identify certain other clauses which have a bearing on our topic. I will also examine whether effect of 'follow-the-settlements' can be magnified or mitigated by suitable construction of these other clauses.

A reinsurer called upon to pay loss, begins with checking whether the loss is from a peril insured against and is not excluded under the insurance. Next it checks whether the same falls under the reinsurance. Here it deals with concepts of reinsurance law and practice in the context of the contract wordings. Much depends on the clauses.

First is the bedrock clause, 'Follow-the-Settlements/Fortunes' (the difference between the two being saved for another day) itself. A burden-shifting doctrine, it allows the reinsured to make good-faith underwriting and claims decisions without the fear of re-litigation with the reinsurer.

The tradition of viewing reinsurance contracts within the general rules of contract interpretation has given way to a tendency to apply this doctrine whether expressly contained in the contract or not. Only two limitations to its all-encompassing quality have been laid down. Where the -

(a) reinsured has not taken proper or businesslike steps in making the settlement;

(b) claim is not covered by the reinsurance as a matter of law.

(This test was set out in ***Insurance Company of Africa v. SCOR).***

Effectively, the reinsurer agrees not to second guess cedent's underlying claims settlements if there is no evidence of fraud, collusion or bad faith. The obligation extends to the cedent's good-faith decisions to waive defenses to which it may have been entitled.

Thus, the doctrine creates an exception to the general rule of contract interpretation allowing *de novo* review by a court/arbitrator. The standard for "bad faith" is usually high requiring evidence of gross negligence or recklessness by the cedent, or evidence that the settlement is not within the scope of reinsurance coverage. (***American Ins. Co. v. North Am. Co. for Prop. & Cas. Ins.***) Holding otherwise would render the clause redundant, its purpose being to ensure timely and uninterrupted reimbursement to the reinsured.

The construction of a balanced clause, therefore, assumes utmost importance enabling one to monitor the scope and effect of the indemnity.

Next I consider additional wordings like *'follow without question', 'liable or not liable', 'pay as may be paid thereon'*, often added to follow-the-settlement clause by the reinsured, in an attempt to dodge the limitations seen above. In the absence of such wordings, despite the 'follow-the-settlements clause, the court may still conduct an extensive enquiry into how the loss was treated by the reinsured.

While it would not be impossible to draft a clause excluding the limitations, clear words would be required to do so.

Prime challenge to the blanket quality of follow-the-settlements, comes from the 'Claims Co-operation' or 'Claims Control' clauses, usually containing language in them making the follow-the-settlements clause subject to the 'claims co-operation/control' clause. It is therefore, important to consider the inconsistencies between one clause which requires reinsurers to trust the honest settlements of the reinsured and another that precludes the reinsured from making settlements without their approval.

The Law in this regard was also settled in ***ICA v Scor***. A majority held that the combined effect of these clauses was to bind reinsurers to follow only such settlements as had been approved by them. As such if a reinsurance contract contains both 'follow-the-settlements' and 'claims co-operation' clauses the former is qualified by the later. The following rules emerge -

In case the clause is stated to be a condition precedent to the liability of the reinsurer, its breach will prevent recovery, regardless of reinsured's liability under the insurance policy. If not, any non - compliance will not relieve the reinsurer. The remedy for breach of the clause would lie in general contract law.

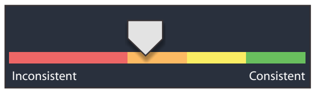
Where, it is unclear whether the clause is intended to be a condition precedent or not, the ambiguity will usually be construed against the reinsurer. Therefore, for the reinsurer, this right to control should be drafted in the broadest possible terms.

Next in line are Coverage Litigation or *Declaratory Judgment Expenses*. Reinsureds and reinsurers take sharply divergent positions on whether expenses incurred in denying coverage are covered.

Reinsureds contend that custom, practice as well as follow-the-settlements clause binds reinsurers to follow their decision to contest coverage. Reinsurers contend that these general business expenses, taken care off by the ceding commission are incurred to defend the original policy contract language and are not an obligation under reinsurance.

In ***ICA v Scor*** also, it was held that reinsurers were not liable to contribute to the punitive damages in the absence of a term to that effect. The court found no justification for implying such a term when none existed.

Coverage litigation is on the rise. To prevent disputes, contracts should explicitly state whether and to what extent such costs are covered, without which 'follow-the-



settlements' cannot be allowed to override the unambiguous wordings based solely on evidence of custom and practice as it is not meant to increase contract limits.

Of major concern to us here is disconnect caused by *narrower scope of reinsurance* combined with addition of "as far as applicable" to the end of follow-the-settlements clauses. Most reinsurance contracts provide "back to back" coverage, equal in scope and terms with the insurance coverage. What if it is not so?

The argument of the Reinsured that 'follow-the-settlements' equate to 'back to back coverage' meets stiff resistance. Courts hold that allowing the follow-the-fortunes clause to override the limitation on liability would strip the limitation clause of all meaning. The reinsurer is not precluded from arguing that the contract contains terms making its scope narrower than the original policy (chronological or geographical scope, the types of casualty reinsured, exclusions, etc.)

***Aegis Electrical and Gas International Services Company Limited v Continental Casualty Company* (2007),** affirmed this view holding that, the 'follow-the-settlements' clause in this case was *'as far as applicable'* meaning that the settlements shall be followed only insofar as the risk was covered by the reinsurance.

Thus, automatic cover cannot be assumed relying only on the follow-the-settlements provisions. *Reinsurance indemnifies against claims which the original underwriter has suffered and reinsured himself against.* Both parties benefit when the contract is clear and unambiguous, allowing the reinsurance mechanism to fulfill its purpose. Any failure could have the reinsured open to risks that were initially intended to be covered.

Next I shift focus to the 'Leading Underwriter' or 'Follow the Leader' clause. There is always some uncertainty and dispute in Subscription/ multi-layer market placement. Multiple reinsurers protecting different proportions of the same risk are bound to differ on at least few counts.

A lead reinsurer has a reputation and standing such that other reinsurers respect its ability, skills and judgment and follow the terms set by it without further negotiation. At the time of dispute, such a clause, may come to the rescue of the reinsured. This customary practice, when reduced to black and white, can save energies and enhance settlement speeds.

Another case in point is that of 'Extra Contractual Obligations'. Reinsurance contracts as a matter of policy construction cover only the reinsured's contractual obligations. Sometimes payments are without obligation for commercial reasons. Unless the clause refers to *'ex gratia'* payments, the reinsurer is not obliged by the 'follow-the-settlements' clause alone to indemnify in respect of bad faith, tortuous infliction of emotional distress, punitive damages, however reasonable and businesslike they may have been. *Reinsurance does not indemnify against gifts or voluntary payments that the reinsured might make.*

In **ICA v. SCOR,** the majority held that, in order for reinsurers to be liable to contribute towards punitive damages, a term to that effect in the contract would be required.

In ***American Insurance Company v. North American Company for Property and Casualty Insurance* (1982)**, the court, distinguished two classes of *ex gratia* payments. One is where the insurer knows that it has no legal liability, but settles the claim for extraneous or commercial reasons. The other is where there is some ambiguity or doubt as to the insurer's legal liability and hence a settlement is agreed upon. The court held that it is only in the latter case that the reinsurer is obliged to indemnify the insurer.

A well-crafted clause stating explicitly how these costs are to be handled can save the day.

Last in this sequence are 'allocation methodologies', i.e., allocation of underlying settlements to reinsurers. The reinsureds consider reinsurers bound by their allocation decisions, as distinguishing between settlement and allocation would undermine the follow-the-fortunes doctrine. Courts take this view, as long as the allocation meets the typical follow-the-settlements requirements, i.e., good faith, reasonable, and within applicable policies. The allocation decision 'must be one that the parties to the settlement of the underlying insurance claims might reasonably have arrived at in arm's length negotiations if the reinsurance did not exist.' ***U.S. Fid. & Guar. Co. v. American Re-Ins. Co* (2013).**

Thus, while the follow-the-fortunes clause does require a level of deference to a cedent's allocation decision, they are not immune from scrutiny. Whether the court will bind reinsurers to reinsured's allocation decisions will depend on the language of the reinsurance contract.

The scope and efficacy of 'follow-the-settlements' can be managed by having express, thorough and nuanced contract provisions. Agreed, that the intent of any particular wording will still be open to challenge. Agreed, that these provisions may create their own problems. It is still better to err on the side of caution.

Recently in New Hampshire Ins. Co. v. Clearwater Ins. Co. (**2015),** a New York court interpreted a clause providing that the reinsurer's 'liability shall follow the ceding company's liability in accordance with the terms and conditions of the policy reinsured hereunder except with respect to those terms and/or conditions as may be inconsistent with the terms of this Certificate.'

The Court noted that, 'The provision contains no reference to the cedent's voluntary handling of claims - absent are the words "settlement," "compromise," "payment," "allowance," and "adjustment," as well as any permutations of the foregoing and any words to similar effect. This contrasts with "follow-the-settlements" clauses, which, refer in some way to the cedent's claims-handling decisions.'

Rather than 'follow-the-settlements', the provision was constituted to be a 'following form' clause, meant to achieve concurrency between the insurance and the reinsurance, thereby assuring, that the ceding company has covered the same risks that it has undertaken.

As courts become more sophisticated about reinsurance, they recognize even the minutest nuances of drafting. Clear and precise articulation with appropriate nuance can make all the difference at a time when the venerable concept of 'follow-the-settlements' is leading to increased arbitration and litigation.

Swarnima Agrawal

Aviation Insurance - Protecting the interests of Lessors and Financiers

The capital intensive and thin margin airline industry operating in a rather uncertain regulatory environment would lease aircraft for various purposes, the main purposes being to be able to operate aircraft without actually buying them or to provide increased capacity in a shorter term. The purpose of this write-up is to highlight the solutions provided by aviation insurance to the lessors. Let us look at the types of aircraft leases.

Wet Lease (ACMI): When the aircraft is leased to an airline / operator along with crew, maintenance and insurance, it is supposed to be a Wet Lease or an ACMI contract (A=Aircraft; C=Crew; M=Maintenance and I=Insurance). These are shorter term contracts where usually both lessor and lessee are airline entities. The fuel, airport fees, duties & taxes are borne by the lessee. The Aircraft would operate under the Air Operator's Certificate (AOC) of the Lessor. Peak seasons, shortage of capacity due to maintenance / repairs, operating in a jurisdiction where lessee otherwise is unable to operate, operating on new routes are some of the main reasons for wet leasing. Code share / seat share agreements are variations of Wet Lease. Damp / Moist Leases are similar to wet leases where cabin crew (not the flight crew) is of Lessee.

Dry Lease: When only the aircraft is provided on lease to the airline / operator without insurance, crew, maintenance, such lease is termed as Dry Lease. The Lessee utilizes own crew, maintenance, supporting equipment, ground staff and arranges for insurances. The aircraft is operated under the AOC of the Lessee and under the registration obtained by the Lessee. The Lessee would also paint the aircraft and put own logo thereon. In short, the entire operational interest is with the Lessee. Most of the fleets in the airline industry are procured on Dry Lease either fully or partially. Separate lease contract may also exist for aircraft engines. In dry leases, the Lessor is usually a leasing and financing entity, eg. GE Capital Aviation Services (GECAS), ILFC. Aircraft manufacturing companies are also providing such leases to their customers by way of through their own financing / leasing entities.

Modern age aircraft are more and more fuel efficient and technologically superior. The cost of a new generation aircraft runs in hundreds of millions of dollars. Buying a new aircraft is likely to make the transaction unviable for an airline. Many major / non-major airlines therefore, take Dry Lease route to acquire aircraft. Over the years, the operating leases have become more popular over finance leases as they enable the airline to modernize fleets, reduce average fleet age, contain capital expenditure and above all make the business sustainable by reducing pressure on the revenue stream. On the other hand, leasing enables the lessors to efficiently amortize these high valued assets utilizing the benefit derived from the lease, subsequent resale and/or future residual value.

Aviation Insurance Solutions

Aviation insurance recognizes and acknowledges the role of the lessors / financiers and provides suitable protection for their interests. In a dry lease there is a clear separation between financial interests and operational interests in the aircraft. The Lessors invariably include 'insurance article' in the lease agreements that would stipulate the conditions relating to insurance that would protect Lessor's interest. (For the sake of convenience reference is being made to Lessors only instead of both to Lessors and Financiers).

In the earlier years, the aviation insurers were required to agree to the insurance conditions laid down in the Lease Agreement so as to protect the Lessors' interests. However, going through the lease agreements was getting increasingly cumbersome for the aviation underwriters due to variations in wordings of the agreements as also the complexities involved. With ever increasing dominance of leasing activity in the airline industry, a need was felt to develop a standard clause that would respond to the requirements of the Lessors. The result was the 'Aviation Lease / Finance Contract Endorsement'. When attached to the airline policy, the policy would adequately protect Lessors' interests. The Clause has evolved over the years in consultations with Lessors. This clause in its present form is referred to as AVN 67B/C and its robust wordings have made it acceptable to airlines as well as to the Lessors all over the world.

Following are the broad features of this Clause:

- The Clause provides for the Contract Parties (Lessors / Financers) to be included as Additional Insureds.
- The Clause operates as a separate contract with the Contract Parties.
- There is a Loss Payable Clause within the wordings which provides for settlement of a Total Loss to the Contracting Parties. Insurers are entitled to the benefit of salvage. (The partial losses will understandably settled by the insurers to the repairers).
- The Clause makes the liability coverage available to each Contract Party as if there is a separate policy available to each. Insurer's liability will nevertheless, not exceed policy limits.
- The Clause makes the insurance policy of the airline primary which cannot seek contribution from any other insurance (available with the Contract Parties).
- The Clause provides for 'Breach of Warranty' condition whereby the policy will not be invalidated by any act or omission of the airline (or any other party).
- The contract Parties do not have any responsibility for premium payment. In other words, even if the airline fails to pay the premium the policy will be valid to the extent of Contract Parties' interests.

All the above take care of Lessors' interests to their satisfaction. There is a separate Aircraft Financial Interest Endorsement (AVN 28B), though similar, its scope is not as broad as AVN 67B/C and is more suited to non-airline operators.

The Lessors / Financiers also tend to purchase a separate Contingent Hull and Liability Policy that would respond in case the primary policy purchased by the airline is not adequate or does not respond.

There are other features within the airline policy that cater to the needs of the Lessors:

- Agreed Values and Total Loss Only Cover: The aircraft policies are agreed value policies whereby the agreed value of the aircraft may be at a level that would take care of the amount outstanding as per the lease agreement. In the event that the agreed value does not match up with stipulated loss value under the lease agreement, a Total Loss Only cover may be provided for the difference. In a TLO Cover the agreed amount will be paid only in the event of total loss of the aircraft. The Agreed Value under Total Loss Only cover provided under Hull All Risks covers may be up to 10% - 15% of the Aircraft Agreed Value. It is a market practice to charge 80% of the Hull All Risks Rate on TLO Value as premium on TLO covers.
- Liability Limit: The Lease Agreements also stipulate the limit for the Liability Cover that the airline is supposed to purchase in

respect of the leased aircraft. More than the jurisdictions in which the airline operates, it is the lease agreements that determine the extent to which the liability cover would be purchased by the airline. Although Lessors can defend themselves against a liability claim stating that they have no operational interest in the leased aircraft, there is always a risk that they may be made co-defendant in the liability claims, the insurance purchased by the lessee may not be adequate or the insurance may not respond.

The role of lessors and financiers in airline industry is vital and above is an attempt to discuss some of the significant solutions provided by aviation insurers to protect their inerests.

Sanjay Mokashi

Aviation Hazards – Gnawing at the margins

At the fag end of November 2016, aviation industry witnessed an accident which made headlines world over. A charter plane, operated by Bolivian airline Lamia, carrying 81 people, including a rising Brazilian soccer team players heading for a championship match, crashed into a mountainside in Colombia. Of 81, only six passengers survived including three players. The reason is believed to be aircraft running out of fuel. 2016 did see some major aviation accidents but it would still rank as one of the safest years in aviation history. Aviation Safety Network which monitors aviation safety put out statistics which showed that 2016 was the second safest year on record. The safest year was 2013 with 265 fatalities. The year saw 19 fatal airliner accidents (for 2015, it was 16) involving 325 fatalities (for 2015, it was 560 fatalities), involving civil aircraft carrying at least 14 passengers. Accident rates have shown steady improvement over the last few decades. For 2016, it is one fatal passenger flight per 3.2 million flights.

The decadal rate of fatalities are tabulated below:

- 1970s:16,766
- 1960s:13,692
- 1990s:12,241
- 1980s:11,558
- 1950s:8,702
- 2000s:8,318

Source: Aviation Safety Network

However, the table does not tell the entire story of aviation safety improvement. It is noteworthy that these improvements happened in the context of growing traffic. To put this in perspective, we need to note that in 1970, about 310 million passengers travelled by air globally. Large scale jet travel took off from then on. For 2016, the number exceeded 3.5 billion.

Based on segmental analysis, there were seven major accidents involving large western-built commercial airline jets, which resulted in a total of 207 fatalities. This represented a loss rate of one major accident for every four million flights. As is known to aviation safety professionals, safety rate further improves with larger aircraft vis-à-vis rest of the industry. For western-built turboprop airliners, there were five major accidents with a total of 80 fatalities. This represented a loss rate of one major accident per million flights. Again, turboprops have a greater accident propensity as compared to jet aircraft.

According to AirlineRatings.com, which releases its annual listing of safest airlines, Qantas "remains the standout in safety enhancements and operational excellence" with no recorded fatalities since the advent of jet travel. Air transport remains the safest form of travel. This remarkable level of aviation safety is attributed to technological advances in navigation and communication, safety analysis and rigorous safety enforcement together with global co-operation of regulators, airlines and other stakeholders in co-ordinating safety analysis and safety programmes. Aviation industry has over time focussed on the most vulnerable regions and leading causative factors for accidents and have focussed their resources and remedial measures on those regions and factors leading to significant improvements.

Despite all the advances, the weakest link in the aviation safety continues to be human factor and human frailty. It is said that no industry has studied human factors more closely than aerospace. It is a tribute to human innovation that already low accident rates are getting further improved upon.

H.J.

Half Yearly Results September 30, 2016

GIC Re declared a record dividend of ₹ 860 crore for the year 2015-16 which is the highest in the history of the Corporation.

The financial results of the Corporation declared for the half year ended 30th September 2016 showed a healthy growth with premium increase of 91.51 per cent year on year with a gross premium of ₹ 16,118.08 as against ₹ 8,415.89 declared in September 2015. The premium split between the domestic and the overseas business was ₹ 11,122.71 crore and ₹ 4,995.37 crore respectively.

Corporation's profit before tax for the half year ended on 30th September, 2016 was ₹ 1163.06 crore and Profit after tax was ₹ 955.81 crore. The Corporation's assets as on 30.09.2016 was ₹ 85,615 crore. The net worth of the Corporation stood at ₹ 44,770 crore.

Agriculture segment on the back of Pradhan Mantri Fasal Bima Yojana has been the main driver of growth for the market and thus for the Corporation. The Corporation's Agriculture Business performed well in the half yearly results too. This has positioned GIC Re as one of the largest player globally for agricultural reinsurance.

Janet Nair

₹ in crore

30.09.2016	30.09.2015
Gross Premium ₹ 16,118	Gross Premium ₹ 8,415
Total Assets ₹ 85,615	Total Assets ₹ 77,998
Net Worth (With Fair Value Change Account) ₹ 43,979	Net Worth (With Fair Value Change Account) ₹ 39,578
Profit After Tax ₹ 955.81	Profit After Tax ₹ 1089.39

Ind AS - A New Milestone

Accounting is a language of business. International Financial Reporting Standards (IFRS) is a globally accepted way of presenting accounts. As per IFRS Foundation Report, 150 countries follow either IFRS itself or IFRS converged accounting standards for business. Most of the business world follows this accounting method.

In Indian scenario, our cross border trade and commerce has increased multi fold in the last few decades. This not only includes import and export but establishment of businesses by Indian companies in foreign countries, tapping the foreign capital markets and more. Hence it is essential for us to adopt globally recognized method of financial reporting. Ministry of Corporate Affairs along with Institute of Chartered Accountants has decided to implement Indian Accounting Standards (Ind AS) which are convergence of IFRS to suit our country specific requirements.

Ministry of Corporate Affairs (MCA) has notified the implementation of Ind AS from financial year 2016-17 for companies with Net Worth more than ₹ 500 crores and from 2017-18 for all other companies. MCA has announced the roadmap for adoption of IFRS converged Indian Accounting Standards (Ind AS) for Banks, NBFCs and Insurance Companies with effect from 1st April, 2018. Insurance Regulatory and Development Authority of India (IRDAI) has formed a committee of Insurance company Executives and members of ICAI to facilitate its implementation. IRDAI has also issued guidelines and formats for Insurance companies for submission of final accounts compliant with Ind AS.

40 standards have been announced so far. Out of these, two standards are important for Insurance Industry which are, Ind AS 104 that refers to Insurance Contracts and Ind As 109 relating to Financial Instruments.

- Ind As are accounting standards to align with IFRS.
- Insurance Sector to implement Ind As effective from 1st April, 2018
- Ind As 109 (Similar to IFRS 9) – Relating to Financial Instruments.
- Financial instruments categorized as assets at amortized cost, FVTOCI, FVTPL.
- IRDAI released formats for insurance companies complying Ind AS
- Implementation of Ind As 104 (Similar to IFRS 4) – Relating to Insurance Contracts is deferred till 1st April, 2020

Ind As 104 (based on IFRS 4) - Insurance contracts.

This standard requires an insurer to distinguish between an Insurance contract and a financial contract based on certain requirements.

Phase 1 of IFRS 4 was an interim standard that identifies different components of Insurance contracts but does not prescribe any method for recognition of revenue or criteria for measurement of claims and acquisition cost. Hence it permitted continuation of diverse accounting practices and provided a temporary exemption from the general requirements of IFRS that accounting policies should be relevant and reliable leading to almost negligent comparability between insurance companies around the world. It is challenging to enhance this comparability due to difference in jurisdictions and capital markets. Phase 2 of this standard will provide stipulations for presentation and disclosure to enhance comparability between entities across jurisdictions. Expected commencement of implementation of Phase 2 of IFRS 4 is January 2020. In view of the same implementation of Ind AS 104 is deferred.

Ind AS 109 - Accounting of Financial Instruments.

In the current scenario, Insurance companies are recording debt instruments at cost and investments in equity shares and mutual funds at fair value. Thus the difference between cost and fair value of the equity investments is shown in the Balance Sheet as 'Fair Value Change Account'. This account depicts the unrealized gain on the equity investments and based on the addition and deletion in the investments during the year as well as market value of the equity investments at the year end, the amount of Fair Value Change Account varies at each year end.

According to new Ind As 109, each financial asset or liability to be recognized when the entity becomes party to the contractual provisions of the instruments. Further, financial Assets to be classified in the following three categories:

1. Assets at amortised cost
2. Assets at fair value through Profit and Loss Account
3. Assets at fair value through other comprehensive income This classification is based on

(a) the entity's business model for managing the financial assets and

(b) the contractual cash flow characteristics of the financial asset.

Thus as per company's business model, it is holding a financial assets solely for the purpose of receiving contractual cash flows and this financial asset has set time for the cash flows, then such assets can be valued at amortised cost in the books of accounts. The example of this is investment in sovereign bond.

If the company acquires the financial assets for the purpose of receiving contractual cash flows as well as selling such asset then these assets to be catagorised as assets at fair value through Other Comprehensive Income (FVTOCI).These assets are carried in the books at fair value and realized and unrealized profit or loss on such investment is recorded as Other Comprehensive Income.

All the other financial assets which are held for the purpose of selling or trading purposes are catagorised as Assets at Fair value through Profit and Loss Account (FVTPL). In this case the assets are recorded at fair value and the realized and unrealized gain/loss on these investments is routed through Profit and Loss Account.

The standard states that this classification can be done once at the beginning and is irrevocable unless business model changes. Once an asset is classified under FVTOCI, all realized and unrealized gains/losses will be part of Other Comprehensive Income and this income cannot be technically considered as the profit of the entity. Similarly if an investment is catagorised as FVTPL even unrealized gain/loss will form part of the Profit of the entity. The objective of new Ind AS 109 is to provide information based on the Company's strategy to hold financial assets.

Change in the Presentation of Balance Sheet and Profit and Loss Account:

The outlook of the Balance sheet and Profit and Loss Account is modified. As per IRDA's proposed formats, Balance sheet's Asset side lists the assets based on the liquidity including Current Assets, Investments and Intangible Assets. On the same lines Liabilities side include Current Liabilities, Other Liabilities and Shareholders' Equity.

In the new format Profit and Loss Account will have an important component of Other Comprehensive Income. Comprehensive income will be that part of the income which is arising out of the investments assets held by the company on long term basis and will include realized and unrealized gains. Profit and Loss Account will be in a column format for Shareholders and Policyholders with a provision for transfer of profit from Shareholders' P & L A/c incase total comprehensive income of policyholders' income is negative. There is an Introduction of Statement of Changes in Equity gives detailed information regarding Other comprehensive Income, appropriation of profits like dividends and movement in reserves.

Few advantages of new accounting standards are as follows :

1. **Global Acceptance** : Implementation of Ind As will help to increase international recognition for Indian Companies particularly those who are involved in cross border business. Many Stock Exchanges accept the IFRS accounting which will help Indian multinationals to list their stocks. Raising capital will be easier if the accounts are reported in the international method of accounting. The Ind AS compliance will increase appeal to investors in foreign countries.

2. **Transparency and comparability**: Since opening of our economy, foreign companies are competing with our own industries in homeland as also in foreign land. When business results are read under the same methods the degree of comparability is more. A company working in the similar circumstances in foreign country can be compared with domestic companies. Performance of the industries will be more comparable and setting benchmarks will be meaningful. It is worldwide known fact that disclosures under IFRS are more transparent and therefore Ind AS is also more reliable for transparency.

At the same time there are few challenges as listed below :

1. **Implementation Challenges**: Accounts complying with new standards has specific time lines, for insurance industry from 1st April, 2018. The implementation need to involve entire organization as each function is reflected in financial results. The necessary expertise should be developed internally or obtained from the outside source. Impact study to be done carefully and identify the gaps. Investment strategies like segregation of investments in to FVTPL and FVTOCI along with other business strategies to be redesigned and changes may be carried out to the processes and procedures. Modification of the computerized system will be an important task. Training and awareness to be created for entire organization. Considering the process and all inclusive change, co-ordinated efforts are required at all levels in the organization.

2. **Clarity about the taxation laws** : Although various aspects of new standards are being discussed openly, so far taxation aspect is not very much decided upon. Presently our tax laws are a bit complicated and therefore tax impact need to be carefully assessed. For example, as per new standard unrealized gain on few investments will form part of the Profit and Loss for the year and may therefore be considered for tax. However, actually unrealized gains are not taxed until realized and even after realization, there is a benefit of long term gains for such profits. Thus such possibilities/gaps need to be addressed with appropriate amendments to the tax laws.

3. **Fluctuations in Financial Results** : Under the new way of presentation of accounts, Statement of Comprehensive Income includes unrealized gains on the investments, which are calculated on the basis of mark to market prices. So it is apparent that as economy fluctuates and stock market moves the total comprehensive income will fluctuate. When there is volatility in the market, the results will be more affected even on quarterly basis. Therefore it is difficult to estimate these figures for the purpose of budget and or any other strategy.

4. **Compliance of regulatory norms** : Insurance companies are guided by regulatory rules. These regulations advise the norms for investments, solvency margin calculations, insurance products etc. With the revised accounting formats, necessary changes in the regulations regarding investment limits, method of calculation of solvency margin need to be formulated. The issues like exclusion of fair value change account from solvency calculation should be suitably modified with new concepts introduced.

Way forward for our company to complete this project will be to put our efforts together and perform as a team for speedy implementation. The goal can be attained step by step. There may be instances where we may require to take help of external expertise, it could be for technical knowledge, IT systems modifications, training or tax consultancy services. We should still be striving to achieve the target by adhering to time lines, co-operation, and great team spirit. During the discussion on the implementation of Indian Accounting Standards, CMD Mrs. Alice G Vaidyan stated "GIC Re is financially strong and new Ind AS is an excellent opportunity to display it to our global friends. So let us start working for it and achieve this milestone"

Jayashree Ranade

Celebrating Success

Mr. Segar Sampathkumar
Director & GM

Mr. V. C. Jain
General Manager

Mr. Sushil Kumar
General Manager

Mr. N. Ramaswamy
Deputy General Manager

Mrs Jayashree Ranade
Deputy General Manager

Ms. Blessy Sequeira
Deputy General Manager