

**Technical Paper presented by Steve Manville of AIG  
to the London Business Interruption Association**

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**Theme: Outsourcing - The Risks**

**The Insurers' Response:**

I think insurers can respond if the circumstances are right. I would however say I do not see the idea of the "happy client" via a VERY WIDE WORDING as being a long term solution. This would give insurers losses they did not realise they were exposed to and therefore would be short lived.

There are already accounts placed in the market which have the appropriate protection. This is probably however restricted to the larger Global accounts where the policy is matched clearly to the individual insured's requirements.

The keys issues here are good details, an understanding of the client's business &/or the outsource aspect being incidental.

Unfortunately the likelihood of this being achieved in the mid to small corporate or even SME market is much harder and therefore less likely.

I will approach this by looking at the barriers. Later on I will try and suggest some potential solutions.

In truth I feel it unlikely that this will be achieved on a widespread basis but I am sure for some clients this will become a possibility. This will however depend quite heavily on the quality of the client, broker and insurer.

**Barriers**

**1) *Appetite***

We operate in a very competitive market where price is very important. To keep premiums down it is essential to keep cost's down - this can only be achieved by having relatively standard policies.

One of the points raised by Diane early was territorial limits. Having territorial limits restricted to UK gives us a number of advantages.

- Policy wording is easy
- Underwriting is relatively easy
- We have less concerns for CATASTROPHE (CAT) exposures/Accumulation. As soon as the policy wording is expanded beyond the UK you have numerous problems. Even just extending to other parts of Europe is fraught with danger (both perils and legal).

The underwriting becomes much more difficult. We may not always appreciate it but we operate in a region where the basic infrastructure is well developed.

The underwriter also does not have to worry too much about pricing variations particularly for the basic CAT perils.

**We can rely on the general infrastructure. Although we may complain about it we rarely have lack of water or power. In many overseas areas this is not the case so the impact of a loss can be much greater.**

CAT exposure and accumulation is probably one of the biggest issues. Each insurer is able to write a massive book of exposure in the UK with limited concern for their CAT accumulation issue.

- This is not the case once you move away from the UK. **I think this is still true even after this years storm/flood losses.**

If the majority of the business is UK why would you wish to go to the expense of maintaining extensive information on overseas hazards, train underwriters in these if the additional income is minimal?

Some insurers have made the decision that they will only write UK business for this reason, certainly this is true for many insurers on risks other than those with large premiums.

However I think it is safe to say that many insurers will offer suppliers extensions to overseas locations as long as these are specified. This enables them to deal with the CAT exposure either by restricting perils covered or giving wider perils where there are no CAT exposures. Some insurers (mainly those who write Global Business) will offer wider cover. This is usually sub-limited particularly where there are serious CAT issue (e.g California Earthquake).

I would emphasise that outsource companies can be covered in the normal way by a Suppliers/Customers extension.

## **2) Contract Certainty/Ability to Handle Claims**

As Diane has rightly pointed out the current wording may not necessarily be that appropriate for many of today's businesses.

I suppose the first thing we should think about is why have these wordings, that may not be fully appropriate, survived.

Surely in a competitive market somebody would come up with a new wording that is more appropriate.

- *I do hope in this respect that LBIA has lodged for copyright and will be making a fortune out of this over the next few years.*

I think the simple answer is that the current wording does at least give us a formula for handling losses. It does from an insurer's viewpoint give us a basis on which we can fairly adjust the claim.

In this respect I think it is probably fair to say that insurers have generally handled cases sympathetically when applying the Blundell Spence rule.

I know from my discussions with our senior claims staff that handling any claim that is not on an economic basis or some pre defined formula is very difficult.

*With all that has occurred with the FSA (Contract Certainty, Treating Customers Fairly) it will be entirely inappropriate and dangerous for any insurer to agree cover without some clearly agreed and documented formula for claims settlement.*

## **3) Inability to Understand the Risk**

To underwrite a risk you need to have some basic knowledge and understanding of the risk.

The PD approach is influenced primarily by the trade, management, exposures protections etc. and quite importantly how much do we think we can lose.

Although the BI risk is influenced by the quality of the risk the overriding consideration is very much to assume a loss (however unlikely) has occurred. The key focus should be on what will be the impact, what has the insured in place to mitigate his loss (Business Continuity Plan) (BCP) and what will the likely cost be.

I think the market's ability to deal with the PD is substantially better than the BI

I would say that BCPs are a critical issue here. In my experience it is only those insured's that have gone through the process of producing a BCP that have any chance of understanding what their exposure is.

#### **4) Capacity**

I think it would be very dangerous to ignore this critical issue.

Specifically when we are looking at outsourcing this becomes a key issue. Many outsourcing companies operate from specially designed and constructed buildings. These buildings are very nice PD risks usually with very good protections.

These outsource companies often service 10's or even 100's of customers.

Unfortunately from a BI viewpoint the progress on computers has meant that 10's or even 100's of companies can be operating from one building.

It is unlikely you will have both the above applying in the 100's but you only need a small combination of these aspects and the accumulation risks become quite extreme.

Add to this that many of these building are based in CAT exposed territories and we start to see how large the challenge (or loss) could be.

#### **Solutions**

Now we know the barriers let's consider a few solutions.

##### **1) Information**

This has to be the critical starting point. We need to understand what the exposure is to be able to underwrite it appropriately.

Starting with:

- Single or multiple outsourcing
- These will need to be identified with basic underwriting information
- Where are these?
  - Be careful as the contract and direct contact may not be the only exposure. The supplier may rely on other offices (even in other territories) to do the majority of the work.
- What procedure does the insured have in the event of a loss? BCP etc.
- What will the impact be a) cost (limit) b) time (IP).

If the client/broker cannot supply the above then it is going to be difficult to underwrite.

How difficult this will be for underwriters will largely depend on its significance.

Let's have a quick look at a couple of examples.

<b>PD/BI TSI</b>	<b>£12m</b>	
	<u>Risk A</u>	<u>Risk B</u>
PD	£10m	£2m
BI	£2m	£10m
<i>BI EML £2m</i>		<i>£2m</i> (Lots of small stand alone locations)
Outsource	£250k	£10m (All locations dependent on outsourcer)

Risk A has an Outsource exposure that is incidental to the main risk and insurers are likely to be able to do this quite easily and probably with limited information, subject to applying a limit of £250k.

Risk B is an entirely different challenge. In fact with this risk the outsourcer is the main exposure. Insurers are almost certainly going to need good information to write the risk.

## 2) **Wording**

If the exposure is insignificant I suspect that insurers are likely to agree on the basis of AICOW i.e. ICOW without the economic restriction.

If however it is significant then we need a pre agreed basis on which we can handle any claim.

What the insured feels is appropriate to protect his reputation and revenue may be way beyond what can be considered reasonable.

In particular the issue of the IP becomes of great relevance.

Policies only cover the insured to the extent the revenue being protected is within the IP.

Excuse me for going off at a slight tangent here. Many clients have inadequate IPs. This is true even on straightforward risks with ICOW only cover, say a simple office.

The IP is invariably adequate for the insured's immediate requirements and will allow them to relocate to alternative premises and get back to full operation.

However what many people forget is that they will probably wish or need to return to the original premises once it is fully repaired. This return can be just as expensive as the original move away immediately after the loss. If this return occurs outside the IP then there is no cover under the policy.

Let's now get back on track.

We cannot allow ourselves to agree cover that is not "contract certain". Unless we have a claim adjustment mechanism this is exactly where we will be.

### **3) Appetite**

This could well be the biggest challenge.

Brokers are going to have to educate their client to establish the need for this coverage. This may not be easy as some clients may be surprised that they do not have full cover or that this has not been previously pointed out.

They are also going to have to work with the client (I would suggest quite hard) to obtain adequate information so that underwriters are going to be able to write the risk.

Many clients underestimate this exposure. Unless the broker can convince the client how exposed they are, the client's expectation on paying for it will become a major stumbling block.

### **Market Response**

I believe the market can respond. At present it may only be a few Global insurers on the larger risks.

If brokers establish the need for this cover it will become "added value". At this stage insurers will be able to differentiate themselves from their competitors, for once on something other than just price.

As soon as this occurs more insurers will find solutions, increased competition will then automatically occur.

I would point out that the top countries to outsource to at the moment are India and Philippines. Both of these are CAT territories.

### **Summary**

Can insurers respond, I think I can with confidence say YES.

A quick reminder of what will be required:

- Adequate Information, appropriate to the risk.
- Location specific
- Appropriate wording
- Premium

And it will need to be placed in the market appropriate to the risk. (e.g. if overseas terrorism in the specialist terrorism market).

There will be some risks that are impossible (unable to access local Pools etc.) however we should be able to deliver for the majority.

Will the client wish to buy this cover, and by this I mean pay adequately for it, I think this is probably a bigger challenge.

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