PRUDENT
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QUARTERLY NEWSLETTER

SPOTLIGHT

INDIA

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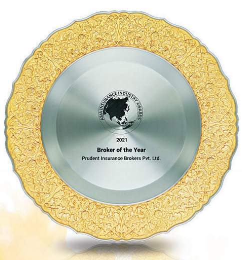
INDEX



BROKER
OF THE YEAR

25th Asia Insurance Industry Awards 2021

We thought we'd lead the July 2022 issue of Spotlight with an uplifting, positive case study from our Affinity Practice. Princy Bhatnagar shows clearly how affinity programs create opportunities for organizations to drive business objectives while simultaneously making a profound impact on the buyers and users of their products.

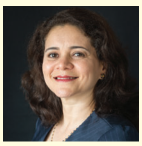
Insurance Regulatory and Development Authority of India's (IRDAI) guidelines on Surety insurance have come into effect from April 1, 2022. The current guidelines permit the use of surety bonds for specified purposes only, namely infrastructure development projects driven by the National Highway Authority of India (NHAI). Vjay Bhatt and Ashish Dhingra describe the challenges insurers face in designing and offering this product as well as the legal framework required to instil confidence in insurers to do so.

Our Marine experts, Gaurav Agarwal and Capt. Vijay Pal Singh, chat with us about the impact of sanctions on coverage for transit risks within Russia that can no longer be covered under a global program. Further, they describe the recently created GIC Re Marine Cargo Pool for Excluded Territories - Russia, Ukraine, Belarus which enables fertilizer importers, and perhaps soon other essential goods traders, to continue to trade with Russia.

We share our Cyber Liability team's important note on the Ministry of Electronics and Information Technology (MeitY) directions for reporting cyber-attacks, which became effective from 28 June 2022. All organisations including service providers, intermediaries, data centres, and corporate and government bodies along with 'specified entities' must comply with these notification requirements or face punitive action under section 70B (7) of the IT Act, 2000 and other laws.

Our ever-popular Liability Claims Takeaways, published by our Liability Claims Head Jyoti Krishnan and her team, dissects some Liability claims to provide insight on coverage design. We provide links to the June and July editions here in case you missed them.

We wish you a happy, healthy summer and hope for peace.



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AFFINITY SOLUTIONS: THE INVISIBLE BRAND ASSURANCE

With a CAGR of over 35%, affinity solutions has seen robust growth in the last three years in India. Consumer-centric companies have led the acceptance. Industries like telecom, consumer electronics, travel, fintech, and retail have been at the forefront of this adoption.

This adoption has now spread to business-to-business organisations as well. The wide-ranging evaluation of affinity solutions in contract manufacturing, ancillaries, Engineering, Procurement, and Construction (EPC), and agribusinesses very clearly sets up the footprint for growth over the next three to five years.

One of our business-to-business customers had a peculiar problem:

- A large part of their services revenue came from the rental income of equipment usage.
- Their equipment damage and repair costs could destroy their margins in the business.
- At the same time, India was witnessing a major rise in infrastructure CAPEX, so they didn't want to lose this opportunity.
- All the operators were skilled at their work but were uneducated.

We understood their challenge and, upon careful deliberation, identified gaps and opportunities that helped them achieve robust growth.

- The client launched a loyalty program for all their operators.
- The program gave operators, who used their equipment, point-based benefits for:
  - Equipment pre-check and self-maintenance.
  - Adherence to guidelines during usage.
  - Cleaning and post-project maintenance SOP.
- In return for these points, the operators got something they could not get before, i.e., comprehensive medical cover and additional benefits, if they kept their scores above a threshold.

The benefit of this program is visible to all stakeholders:

- The company has reduced the cost of repair and increased the life of the equipment.
- Multiple operators have started associating themselves with the company because of the brand assurance of 'care'.
- There is an evident rise in customer satisfaction, due to timely completion.

Affinity solutions challenge us to think out of the box and create win-win solutions for all stakeholders.

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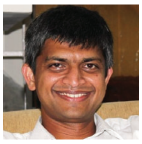

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WITH A CAGR OF OVER 35%, AFFINITY SOLUTIONS HAS SEEN ROBUST GROWTH IN THE LAST THREE YEARS IN INDIA.

SURETY

IRDAI issued surety insurance contracts guidelines to facilitate infrastructure development projects.

The much-awaited guidelines on Surety Insurance Contracts have been released by the Insurance Regulatory and Development Authority of India (IRDAI) and have come into effect from April 1, 2022. This is a big move by the regulator bringing much-needed relief to the infrastructure and construction sector.

Surety insurance, also called insurance bond or surety guarantee, does not require a collateral, unlike bank guarantees. It's a tripartite agreement between the contractor (principal debtor), the awarding authority like the government department (obligee), and the insurance company (surety) issuing the contract. A surety bond assures the obligee that the contractor will perform as per the scope of the contract. In the event of a default by the principal, the surety provider honours its contractual obligations as per the awarded contract to the obligee.

While bonds are used for a variety of transactions, the regulator has approved surety contracts like bid bonds, performance bonds, advance payment bonds, contract bonds, customs and court bonds, and retention money. The surety guarantees are required majorly in the Engineering, Procurement, and Construction (EPC) contracting segment, covering medium- to large-scale projects. The current guidelines issued by IRDAI emphasise the acceptance of sureties for these specified purposes only, focusing mainly on infrastructure development projects driven by NHAI under the Ministry of Road Transportation.

Surety bonds bring in a huge opportunity for small and medium contractors (including new contractors) to bid for projects and compete with large contractors which are financially strong. With the help of a surety bond, the contractor shall not be required to furnish a bank guarantee which, in turn, shall free up the working capital for SMEs and reduce indirect costs for suppliers and work contractors and help them efficiently complete the project.

The challenge for insurers would be to develop competence in this line of business and create robust underwriting and risk management skills and capabilities to assess the ability of the contractor to perform the contract. Insurers can work together with banks and financial institutions to share risk information, technical expertise to monitor project development and cash flows among other aspects, and with contract-awarding authorities to evaluate the risk with more information and data available. Needless to mention, reinsurance arrangement and expertise for this business needs to be developed in India so that part of the risk gets transferred.

[1]INR 5 billion = approximately USD 65 million/ Euro 59.9 billion/GBP 49.6 billion

[2]IBA stands for Indian Banks' Association

[3]NCLT stands for National Company Law Tribunal.

Key underwriting criteria:

1. IRDAI guidelines mention a 10% cap of the total gross written premium for that year subject to a limit of INR 500 crores (INR 5 billion[1]) on the quantum of surety business that an insurer can write.
2. It also speaks about the minimum solvency margin of 1.25 times the control level of solvency specified by the authority.
3. The limit of the guarantee shall not exceed 30% of the contract value. This is in line with standard market practices.

Legal re-course: Can the surety company assume the role of a secured creditor in participative surety structures with pari-passu on assets from the lending bank? What are the legal recourses available for the surety company in case of non-performance/default of the contractor? Resolutions to similar apprehensions shall encourage insurers to participate in surety programmes. The IRDAI guidelines on surety are silent on such legal recourse. We understand from our discussion with overseas participants that the legal recourses available in different regions such as the USA, Europe, South America, or the Middle East differ from one another in terms of applicability of local laws, and the surety bonds and the terms are designed in a manner that deems fit to the regulatory framework. While this is at a nascent stage in India, a joint direction of IBA[2], IRDAI, and NCLT[3] may bring about the operational guidelines to govern surety contracts issued in India.

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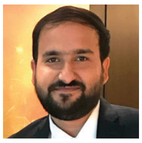

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IMPACT OF SANCTIONS ON MARINE COVERAGE IN THE RUSSIA-UKRAINE CONFLICT REGION

We spoke with our National Marine Head, Gaurav Agarwal (GA), and our National Marine Control Loss Engineering Leader, Captain Vijay Pal Singh (VPS), about how the Russia-Ukraine conflict and sanctions have impacted risk and coverage for our Indian clients who trade with Russia, Ukraine, and the affected region.

Here's an update from them on two key issues:

- How we addressed the Russian requirement for admitted coverage and
- GIC Re's June 2, 2022, circular that issued a Specified Territory Exclusion Clause (Belarus, Russia, and Ukraine)[1], and the subsequent solution introduced through a Marine Cargo Pool for Excluded Territories - Russia, Ukraine, and Belarus.

1. **How have global marine programs placed in India been affected by sanctions?**

   GA: The main impact is on the pharmaceutical sector, which has a major presence in Russia and Ukraine, both in manufacturing and distribution. Through our Russia-based affiliate broker, we were able to secure the marine risk of a leading pharmaceutical client in Russia with a major Russian insurer which is (still) not sanctioned by the US and EU. All the transactions and declarations are being manage by our affiliate broker. Having a well-known and trusted affiliate there helped us tremendously in quickly putting a solution in place.

2. **How have Indian insurers changed their coverage as a result of the sanctions?**

   GA: With sanctions imposed by some European Reinsurers, Indian GIC Re stopped providing any coverage of Russian-origin cargoes from any touchpoint w.e.f. June 2, 2022 through its Specified Territory Exclusion Clause. Their circular sanctioned cargo originating from, cargo passing through, going to and coming from Russia, Ukraine, and Belarus with immediate effect and had to be followed by all the insurers who have GIC Re-led marine treaties. The implication was that all shipments from Russian ports which left on June 2, 2022, or were under loading, were without cover.

   This impacts the Indian economy, as India has been importing fertilizers, edible oil, coal, and crude oil from Russia in a big way and the requirement is currently higher than ever.

   After the GIC Re circular was issued, an emergency meeting was held between the Ministry of Finance (MoF) and General Insurance Council (GIC). The MoF asked the GIC to create a pool to cover fertilizer imports from Russia. The pool came into existence on June 14, 2022, and offers a per vessel capacity up to INR 5 billion[2]. Various public and private sector insurers are providing capacity with GIC Re acting as the pool manager. The rates of the pool have been determined and fixed. Other essential products such as coal, edible oil, and crude oil are likely to be added to the pool.

3. **What actions do Insureds have to take to mitigate and transfer transit risk now and in the next six months?**

   GA: No one can predict the next six months. We can at best forecast cautiously and conservatively for the next month or two. Currently, import contracts are getting converted to CIF, where Russian insurers are insuring. But the weakening financial strength, every passing day, poses a challenge. No one knows how they will settle claims in India.

   Now that the GIC Re Pool is in place, insurance of imports of essential items will ease out and, claims, if any, will get settled in India by Indian insurers. For exports out of India, it is tough as there is no shipping line willing to take containers for Russia; an air charter is the best bet as of now. Besides insurance, even banking channels are getting squeezed and it will become impossible to do USD/Euro transactions with Russia or Russian-owned entities.

   VPS: As sea and some air routes are completely closed due to absolute sanctions, clients, especially in the pharma sector, who still have Russian shipments, are trying to find alternate methods of shipping cargoes. The latest is the India-Karachi-Afghanistan-Tajikistan-Uzbekistan-Russia route and by road. However, stitching an insurance program for such shipments is becoming a great challenge.

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[1]Effective June 2, 2022, as per the Specified Territory Exclusion Clause, we will not be covering any Cargo, Hull and Energy risks originating, destined, or passing through the Republics of Belarus, Ukraine and/or the Russian Federation. There will be exception to this rule. This will be applicable to existing policies, quotes released but not bound, and for all future policies to be issued by us."

[2]INR 5 billion ~ USD 63 million/EU 61.8 million/GPB 52.9 million

4. **On June 13, 2022, Russia and Iran announced that Iran's state-run shipping company had successfully completed the first transit of Russian goods to India using the 7,200 km International North-South Transportation Corridor (INSTC)[3], which does not pass through any country enforcing Western sanctions. How will this new alternate channel for shipment of goods mitigate risks for Indian businesses exporting to Russia?**

   VPS: Though the route through Iran is the safest, with Iran being a fully-sanctioned country, there may be no coverage while the cargo is in transit in Iran. The wordings followed by Indian insurers and reinsurers for Iran are, "No coverage for any shipment from, to, and through Iran." (Captain Vijay Pal Singh suggested to GIC Re to include the word *through* during his tenure with a private Indian general insurer.)

   GA: Coverage may be secured in Iran itself for this leg of the transit. However, companies with Western investors will have to examine their options carefully to avoid violating sanctions. There's no one-size-fits-all solution in these times. Companies will have to look at how they can mitigate risk by choosing alternate routes and trying to maximise the risk they can transfer. They can expect increased transit time and higher costs as well.

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[3]Please refer to https://www.russia-briefing.com/news/russia-tests-india-freight-direct-via-instc.html/ for more information on the territorial range of this trade corridor, ownership, and the details of this first test movement.

MANDATORY CYBER INCIDENT GUIDELINES BY THE MEITY

On April 28, 2022, the Ministry of Electronics and Information Technology (MeitY) issued directions to be followed at the time of any cyber-attack or event. These said guidelines have been in effect since June 28, 2022.

All organisations must abide by the directions of the MeitY including service providers, intermediaries, data centres, and corporate and government bodies along with their 'specified entities'.

We designed an advisory listing the types of incidents that qualify as a cyber-attack or event, some of which are:

- Targeted scanning of the network and critical systems
- Unauthorised access to IT systems or social media accounts
- Malicious code
- Phishing
- Identity theft
- Spoofing
- Denial-of-Service (DoS) or Distributed Denial-of-Service (DDoS) attack
- Attack on applications or data breach/leak

When a cyber event takes place, the organisation must notify the respective authorities via mandatory CERT-In* notification within six hours from the discovery.

Each of these specified organisations is designated with a CERT-In SPOC and is well-informed about the prescribed format to update all relevant information about the attack.

*Indian Computer Emergency Response Team

For security reasons, all specified entities have been instructed to enable their logs of all Information and Communications Technology (ICT) systems while also connecting to the Network Time Protocol (NTP) server of the National Informatics Centre (NIC) or National Physical Laboratory (NPL) for 180 days. Entities can also connect to the traceable NTP servers for synchronisation of all ICT system clocks. These logs are to be shared with CERT-In along with a report of any incident either upon occurrence or when ordered/directed by CERT-In.

These organisations have been provided an email ID (incident@cert-in.org.in) and telephone (1800-11-4949) and fax (1800-11-6969) numbers where they can report an incident or attack.

If the organisation or the specified entities fail to share the information or are unable to comply with the directions, then they are open to punitive action under section 70B (7) of the IT Act, 2000 along with other laws including imprisonment for up to one year or a fine of up to INR 100,000, or both.

With the implementation of these directions, the ministry aims to increase transparency on cyber incidents and better communicate information to the CERT-In.

Click here to read our advisory.

IN FOCUS

In Liability Claims Takeaways - June 2022, our monthly insights on liability claims, we focus on:

- The impact of acquisition on coverage for prior acts
- Fidelity guarantee insurance
- Professional indemnity insurance

When a company is acquired as a subsidiary, it is supposed to be added to the existing policy of the acquirer as an insured entity by paying the additional premium. The retroactive date for the acquired company in such policies will be the date of acquisition. While the acquirer's policy grants cover to the acquired company, the latter's cover for actions taken before the acquisition is terminated unless extended.

In fidelity guarantee insurance, we must adhere to the key aspects including the insurer's right to the employee's full & final settlement, forfeiture of gratuity by the employer, and bail deposit to be considered as recovery.

A professional indemnity insurance policy aims to cover any claim arising against the insured alleging an error or omission in the services being provided by the insured.

Click here to read the full article.

Click here to see the July edition which dissects claims under Commercial General Liability, Public Liability, and Directors & Officers Liability Insurance.

WE FOCUS ON:

- THE IMPACT OF ACQUISITION ON COVERAGE FOR PRIOR ACTS
- FIDELITY GUARANTEE INSURANCE
- PROFESSIONAL INDEMNITY INSURANCE

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