MARINE

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The headline item of the year for the Marine segment is piracy. However, piracy is only one of the threats organizations face in the transportation of assets. Several complexities increasingly put profitability at risk for companies dependent on outsourcing and global trade. These complexities can be political, physical, geographical or all of these together. Whether your organization is involved in commodities, manufacturing, industry, communications or entertainment, the risks faced in transportation are numerous. As with piracy, the threats to profit margins are not necessarily related to physical loss or damage.

We cover the topic of piracy and the related topics of kidnap and extortion in our *Marketplace Realities* piece on Special Contingency Risks, the Willis specialist group that is a world leader in Kidnap & Ransom risks. For our Marine insurance sector discussion, we refer readers to our recently published *Marine Market Review – Riding the Waves.* Below, we look at a product area that we believe should be a top consideration for any organization involved in transporting their assets by any means of transportation via any route – Trade Disruption Insurance.

As economic instability circles the world, the potential for geopolitical upheaval soars – through global terrorism, political tensions in developing nations, labor disputes and the acts of capricious governments. Political uncertainty and civil unrest frequently cause direct physical damage and consequential loss to global assets and personnel. Less readily apparent but no less serious is the impact that such events can have on the highly integrated global supply chain – the delicately balanced network of manufacturers, suppliers, shippers and retailers.

As supply chains become more streamlined, emphasizing minimum stockpiling and just-in-time delivery, the links become more fragile. If a key source of supply goes down, there can be serious ripple effects throughout the entire chain. Failure to expeditiously move product can result in loss of customers, reputational damage, reduced share price, higher cost of capital, delays in projects and failure of strategic growth plans.

This fragility has led companies to recognize that effective supply chain management is critical to profitability. In turn, this has compelled risk management to examine the internal and external forces that could lead to failure – some of which can be strategically managed and some of which are beyond anyone's control.

Traditionally, internal supply chain management addresses operational issues, such as streamlining the production process, reducing interdependencies, developing alternative supply sources and increasing or reducing stockpiling. Little attention has historically been placed upon those external factors which are outside of risk management's control. As the supply chains fan out and become more reliant on domestic and foreign infrastructures, the whims of domestic and foreign governments and volatile forces of nature have greater consequence.

Companies are spending more resources to assess and map these risks. As for transferring them, the traditional insurance market has offered limited options. Property, Political Risk and Marine products have traditionally focused on insuring separately those risks which are quantifiable. Traditional Property and Marine Cargo insurance responds only to direct physical loss or damage to goods in transit. Business Interruption (BI) coverage is triggered when the physical loss occurs to insured property. Contingent BI provides coverage against loss of net earnings as a result of direct physical loss or damage to suppliers. What if there is no direct physical loss to goods being shipped, but the company is unable to source or deliver them to customers on a timely basis? This critical exposure – the risks of late or non-delivery of product at any point in the chain – needs to be hedged to guarantee a smoothly functioning trade flow and maintenance of a satisfied customer base.

Trade Disruption Insurance (TDI) fills this gap.

WHAT IS TRADE DISRUPTION INSURANCE?

TDI covers:

- Loss of profits
- Extra expenses
- Contractual penalties
- Delayed debt repayment
- Increased operating expenses

Insureds are covered for delay or non-delivery of product due to the occurrence of:

- Terrorism, rioting, civil commotion and war
- Political risks, including confiscation, seizure, import/export license cancellation, embargoes and trade sanctions
- Damage to or closure of key infrastructure: roads, bridges, railheads and conveyances
- Fire, flood, storms, earthquake
- Port blockage, breakdown of vessels
- Insolvency of a named supplier or customer

Unusual supply chain perils can be brought to TDI underwriters for discussion and negotiation. The TDI product is generally fluid and can be molded to the needs of the insured.

DISRUPTION WITHOUT DIRECT DAMAGE

Recent natural disasters in the U.S., China and Thailand, and political unrest and terrorism events in Central America, Africa and the Middle East have cost companies billions of dollars because of trade disruption not related to "actual physical loss or damage" but to failure to deliver products on time or the extra expense incurred to secure an alternative source of supply or delivery. Here are some scenarios.

- A clothing manufacturer sources clothing from a factory in a Southeast Asian country where diplomatic and trade ties with the U.S. have been strained. The export license is revoked, and the clothier must find alternative sourcing to satisfy outstanding Christmas orders. Orders cannot be filled, earnings are impacted. TDI would cover the loss of earnings.

- Thousands of industries in Central America have been devastated by the effects of hurricanes over the past several years. While in many cases factories were left untouched by the storms, the infrastructure of urban areas was devastated – bridges, roads, ports, telephone lines wiped out – making export of products and crops nearly impossible. Losses have been in the hundreds of millions and many companies were forced out of business. In cases where actual production facilities were undamaged, traditional insurance would not cover their losses. TDI would have covered their extra expenses and/or loss of revenue.

- A producer of fruit juice drinks charters a vessel for the transportation of fruit concentrates. The vessel suffers an accident that damages the hull and puts the ship in dry dock. The producer must hire a replacement vessel for a short period. This cost would not be covered by either the Marine Cargo or the Marine Hull policy – but could be by TDI.

One of the features of TDI is that losses are, in effect, adjusted prior to occurrence of the event. Policies are issued on an agreed-value basis, which means that there is a predetermined daily indemnity or agreed amount to be paid in the event of a loss. Trade disruption can also provide coverage on the basis of a percentage of revenues or loss of a sales contract.

TDI can help protect major infrastructure projects, serving as a credit enhancement when a lending institution is concerned about the timely completion of a project. Contractual penalties can be included in the policy.

To make informed decisions regarding supply chain risk, companies need to undertake a careful supply chain assessment. This requires:

- Mapping end to end every step in the manufacturing and delivery process

- Identifying potential logjams, bottlenecks and other vulnerable points

- Creating a contingency plan to determine potential response tactics and costs should a problem occur

- Evaluating which problems are preventable and which can only be mitigated through a properly tailored Trade Disruption program

TDI has limitations. It does *not* cover perils traditionally covered by Property, Marine or Political Risk insurance. The coverage is designed to work in tandem with existing risk management programs. This combination protects physical assets while hedging against the risk of late delivery or non-delivery of goods and protecting the company's balance sheet and reputation – protection that is needed in today's global commercial world.

CONTACTS

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