

## Product recall insurance – the indispensable protection



Food product recalls have reached unprecedented levels and are clearly affecting the bottom lines of many companies. The risks to the business, and worse still, to human life, are just too huge to be ignored.

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As of writing this article, the e-coli outbreak in Germany has caused 50 deaths, and well over 3,200 infections. Of the infected, more than 800 have been diagnosed with a severe form of intestinal illness, with possible long-term health effects. This is the second major food scare for German consumers this year. In January, the highly toxic cancer-causing chemical dioxin was found in egg, poultry, and pork products. The latest food scare has increased the focus on food industries to be accountable to stricter regulation and risk management standards.

E-coli outbreaks are not new. In 1996, 12 people died and more than 9,000 fell ill after consuming e-coli-tainted radish sprouts in Japan. In the most recent virulent outbreak, bean sprouts originating from the Lower Saxony region in Germany were determined to be the source. Sprouts, a staple diet in parts of Asia, have been linked to 30 food poisoning outbreaks in the last 15 years and they are not the only source of food contamination or infections.

At the same time that Germany was struggling to contain the e-coli threat, a tea dealer located at the heart of Japan's green tea industry started recalling his products, after measuring them to be above the legal limit for radiation. Confronted by the threat of radiation spread, Japan is currently exercising strict monitoring and

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regulation of its products, from milk to spinach. In Taiwan, as many as 522 different drinks are on the watchlist, as they are under suspicion for mixing an industrial chemical into their ingredients.

Food manufacturers and distributors have legal and civic responsibilities to make every effort to recall products that they know to be tainted. Failure to do so would have catastrophic effects for human life as well as the business. These are risks that no business should be willing to treat lightly. Organisations should be prepared to work around the clock to recall products, before they receive adverse headline treatment in the media.

**Changing safety landscape**

Regulators are responding appropriately to the threats and the food safety landscape is undergoing a seismic change. Following the footsteps of the US and EU food and product safety laws, many countries have enacted or are enacting tougher product safety laws, as well as product recall regulations and procedures. Every year, thousands of safety recalls are announced and instigated by companies and regulatory agencies around the globe. Recall costs for the food industry are estimated to be well over US\$1 billion per annum. Food product recalls have reached unprecedented levels and are having a major impact on the profitability of many companies.

Besides compelling manufacturers to have a robust product recall plan, insurance will also prompt them to have the will to recognise and act on the need for a recall when it emerges.

However, executing a product recall is wrought with many complexities and few proceed smoothly. It is often the case that companies have limited visibility over their entire supply chain, making the recall process more complicated. These problems are compounded by the lack of a universal labeling

system for food products.

Preparation for a product recall should be proactive and be part of every food supplier's/manufacturer's business continuity plan (BCP). Companies should invest to customise their BCP and include in the process a cross-functional team with representatives from product procurement, distribution management, legal department, risk management, human resources, accounting and corporate communications. The recall and crisis management plan should give due diligence to the following:

- Contracts, enforceability by jurisdiction, records retention and documentation
- Recall process (a formal written plan that is widely disseminated)
- Incident investigation
- Crisis response and process management
- Media communication
- Employee communication
- Regulatory notification



**DID YOU KNOW?**

- ➔ One third of the total world cereals is consumed in Asia.
- ➔ Two thirds of the world meat are consumed in Asia.
- ➔ Asia accounts for 80% of the world's small and marginal farmers.
- ➔ Asia accounts for 74% of the world's agricultural population.
- ➔ 90% of the world's rice comes from and is consumed in Asia.
- ➔ Asia accounts for 70% of the global food and vegetables market.
- ➔ 40% of the world's cereal comes from Asia.
- ➔ Asia accounts for 80% of the aquaculture market.
- ➔ Asia accounts for 90% of the world's fisherfolk.

**Product recall insurance - the indispensable protection** *(From page 2)*



Once a product contamination has been identified, action needs to be taken immediately, and a very thorough communications process needs to be in place to alert all relevant parties and recall the product.

**Cost complexities**

The direct costs of a product recall include costs incurred in removing the product from the market and then destroying it, contacting distributors, retailers, and customers who may have purchased it, legal proceedings, liability for testing and inspections, and product replacements. Indirect costs can include damage to reputation and brand, long-term losses to a product category, marketing and advertising costs to recover market share, and increased product liability insurance costs, among others.

**Solutions**

One key aspect of proactive risk management is planning for a crisis before it happens and protecting the company by purchasing the appropriate levels of insurance coverage and capacity. Besides compelling manufacturers to have a robust product recall plan, insurance will also prompt them to have the will to recognise and act on the need for a recall when it emerges.


In addition to covering against the expenses incurred in recalling and replacing products, as well as the legal liabilities, insurance can be purchased to cover short-term costs such as crisis management, media relations, plant cleanup costs, and loss of gross income such as the loss of a contract, arising from a recall.

Product recall insurance coverage protects entities for costs incurred on a first party and third party basis. The insurance should provide the ability to recover costs for recalling products, as well as all third party costs involving compensation of retailers and wholesalers.

A 2008 study conducted by AMR Research found that, on average, it takes 18 days for large food manufacturers to sense

Product recalls are a liability for organisations, with a potentially negative impact on their reputation, stock price and future sales.

the need for a recall and issue one. Unfortunately, until a global standard for product recall is created, the onus is on individual companies to adopt the best measures to protect their consumers and brand. Quicker “alert” triggers and response times in dealing with product contaminations are crucial. Planning to respond to a worse case scenario can be the difference between a company’s survival and its collapse. To the end consumer, it can be the difference between life and death.

JLT’s Food and Agribusiness practice offers a wide range of risk consulting and insurance services to assist food companies plan, manage, and mitigate exposures relating to products manufactured and distributed across the globe. Our specialist risk consulting services include the design and rollout of recall and crisis management plans, business continuity plans, and product security risk mapping. We also advise and assist large food companies in creating and structuring comprehensive product recall insurance covers. 

**JLT can work with you to help you understand and meet insurers’ underwriting requirements for insurance coverage in this area.**

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## Building brand loyalty through ancillary revenues

A high degree of customisation and selection of the right partners are keys to the success of any insurance ancillary revenue spin-off.

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The airline industry is a forerunner in reaping ancillary revenue opportunities. According to the Centre for Asia Pacific Aviation, ancillary revenues are expected to continue to rise as a proportion of total earnings, “as airlines become increasingly sophisticated about these new revenue streams, with network carriers also embracing the opportunities, meaning ancillary revenues are no longer the domain of the low cost carriers.”

AirAsia founder Tony Fernandes earlier this year revealed that ancillary revenue was a significant growth contributor to the airline’s business. What was interesting about the numbers he presented was the rate of growth in ancillary revenue across Asia in 2010 – growing 99% in Malaysia (to RM49 per passenger), 109% in Thailand (to THB369 per passenger) and 108% in Indonesia (to IDR155,089 per passenger).

### “Buy it all from us”

Mr Fernandes was quoted in The Melbourne Age newspaper as saying: “Remember, we’re adding things like insurance. So we’re saying, if you travel, here are all the things that you might spend on – duty-free, hotels, food, insurance, etcetera, and we’re saying rather than go and buy it from someone else, buy it all from us.”

The paper went on to add that about two-thirds of AirAsia’s profit were ancillary revenue.

The role of an experienced intermediary/broker is pivotal in helping airlines or other consumer facing businesses maximise their ancillary earnings through insurance. The broker’s role is multi-fold:

### ROLE OF A BROKER

1. Ensuring that costs are optimised, without compromising on the extent of cover – an experienced broker will be able to find the most appropriate balance between costs and coverage – such that the customers are adequately protected, at a reasonable a cost. An experienced broker will be in an ideal position to evaluate the propositions from various suppliers and identify and recommend the most attractive option.
2. Maximising the commission earnings – a broker who has structured deals for other clients will be able to bring the benefit of his experience, as well as his leverage with the insurer, to structure a profitable programme for the client. An experienced broker will be able to seek out and exploit all of the various avenues for earnings.
3. A flexible, sophisticated IT system that is proven for the purpose – service providers and brokers who have specialised in providing IT systems to support the requirements of ancillary programmes will be able to custom design a reliable platform. Their experience with other installations will help them anticipate and avoid potential loopholes and system issues. Experience at other installed bases will be valuable in helping to institute a customer-friendly user interface.

**Building brand loyalty through ancillary revenues** *(From page 4)*

Almost any type of B2C business with a large consumer base is in a position to grow its profits through Affinity deals.

**Keys to success**

A high degree of customisation and selection of the right insurance partners are keys to the success of any insurance ancillary revenue spin-off. While traditionally this has been a domain of insurance companies, the value that a broker provides in facilitating programmes is increasingly being recognised.

Ancillary revenue also provides diversity to a company’s income stream. The banking industry is a case-in-point. Bancassurance is today a highly profitable revenue stream. Banks are able to up-sell and cross-sell insurance-based products via their branches, call centres, and online banking facilities, to their massive customer bases.


In fact, almost any type of B2C business with a large consumer base is in a position to grow its profits through Affinity deals. Telecommunication companies could bundle insurance into contracts; retailers could enhance traditional warranties they provide their customers with what is popularly known as ‘gadget insurance’; manufacturers could wrap an extended insurance to cover repair work that is typically not covered as part of product warranties; and automotive industries and associations with bundled products covering gap insurance could expand their insurance product propositions to customers. There are numerous other possibilities – for the hospitality industry, unions, foreign workers and others, to expand the covers they provide to customers beyond the traditional ones.

**Inclination to be innovative**

Maximising the opportunities in ancillary revenue really comes down to businesses’ inclination to be innovative and to have a proper appreciation of the synergies with customer needs that will allow them to develop new revenue streams. It is also a question of staying true to the brand of the company while delivering a holistic, value-added service proposition to customers. Brand dilution, confused positioning, and shortcomings in service delivery are some of the dangers of venturing into this business model.

While many direct insurers will offer the plain vanilla type of product extensions, a responsible and experienced broker will be committed to maximising the client’s revenue streams, while ensuring that the customer experience is an enhanced one. The broker will design a product to suit the specific target segment and not be restricted by a single insurer’s preferred appetite or capability.



JLT’s experience in conceptualising Affinity deals can help prevent the pitfalls, while at the same time maximising the opportunities of these revenue streams. JLT has a track record of projects around the world. Our experience and expertise can benefit clients that are looking to add value to their customer experience, and build brand loyalty among them. We place primary emphasis on ensuring that the deal we put in place is unique and backed up by quality service that supports the overall reputation of the client. 

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# Wide area damage – protecting yourself from your customers’ exposures

In the aftermath of a disaster, many businesses often lose substantial revenue, simply because the customer base is badly affected, to the point of changing their consumption behaviour.

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**A** major natural disaster strikes, levelling parts of your city, and causing disruptions in others. Fortunately your own premises – business and home – are not damaged. Does it mean that you have been completely shielded from the disaster? In this day and age, when interdependency is a fact of life, no one is completely protected from the effects of a major natural disaster.

In the aftermath of a disaster, many businesses often lose substantial revenue, simply because the customer base is badly affected, to the point of changing their consumption behaviour. Restaurants, retail outlets, tourism-related ventures and many other types of enterprises that rely on consumers fall into this category.

## Are you truly protected?

Is your company protected against such an event? Based on our experience dealing with claims issues, it is more than likely that you are not. This is because most of the time, Business Interruption (BI) policies respond to loss of Gross Profit or Additional Expenses arising from damage to clients’ own company premises. Most BI policies do not respond to situations where there is a loss of business due to customers changing their buying behaviour, as a result of being affected by a major event.

While it is possible to purchase extensions to cover for losses arising from damage to your customers’ premises, such cover will often not include major disasters such as earthquakes and tsunamis. This is because insurers typically try and limit their exposure to what they know they can assess.

Such cover would be applicable to manufacturing businesses that have a few industrial clients. The insurers would be able to accurately assess the risks by reviewing the customers’ exposures.

## Domino effect


When businesses have a heavy reliance on individual repeat customers, the effect of a major disaster can be devastating, even if their own premises are not damaged. Your policy is likely to cease coverage once repairs are completed, when in effect the health of your business is dependent not only on the quality of your premises but those of your customers as well.

Some organisations have recognised this exposure and have extended their Business Interruption policies to include what in the insurance industry is referred to as “Wide Area Damage” coverage. This extension is intended to cover the downturn in revenues a business experiences due to the area adjacent to it being damaged, to the extent that customers are lost.

**Wide area damage – protecting yourself from your customers’ exposures** (From page 6)

Wide Area Damage coverage is intended to cover the downturn in revenues a business experiences due to the area adjacent to it being damaged, to the extent that customers are lost.

This cover is very rare and normally restricted to companies with significant exposures that are often prepared to pay significant additional premiums. Telecommunication companies are a case in point.

Insurance legislation, available coverage and wordings (i.e. American versus UK Business Interruption wordings) pertaining to Wide Area Damage vary from country to country. If your company has a significant exposure in the above respects and there is a case for being adequately insured, please contact your local JLT insurance service provider/broker who will advise you about the type of coverage that may be suitable to your business. It may not be possible in some countries to buy Wide Area Damage cover, however, the starting point for any such discussion is to understand what protection your policy does or does not currently provide. 




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**In-country intelligence on risk exposures and regulatory frameworks**

As your insurance and risk management services provider, JLT is committed to helping you make informed decisions, based on each country’s economic, legal, taxation and regulatory environments, insurance and reinsurance requirements, as well as historical precedents specific to that country. Our intelligence and information pertain to a wide range of industries and sectors:



We will be able to provide you with statistics and critical information on a range of risks, based on the prevailing environment, and historical data – i.e. the level of fraud, exposure to natural disasters, political and economic instabilities. In addition, if you need information on trends in premiums and interest rates, that can also be presented to you.

**Please do get in touch with us for a consultation. Email: [Compass@jltasia.com](mailto:Compass@jltasia.com)** 

# Clearing the air on Cloud Computing

More than just a buzzword, cloud computing could be a competitive differentiator.

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The last decade has seen a resurgence of interest in cloud computing as Internet speed has become faster and more stable. "Cloud Computing", a concept dating back to the 1960s, is used by various industry players to refer to software that is not deployed on one's desktop or corporate network. Instead, software is hosted on the service provider's network, with computation and storage handled by a range of remote computers.

Given the rapid commoditisation of insurance products, the pace of technology adoption has become a differentiating factor in the industry. The cloud's promise of low-entry costs, subscription-based pricing, lower energy expenses and a self-service model is an appealing proposition.

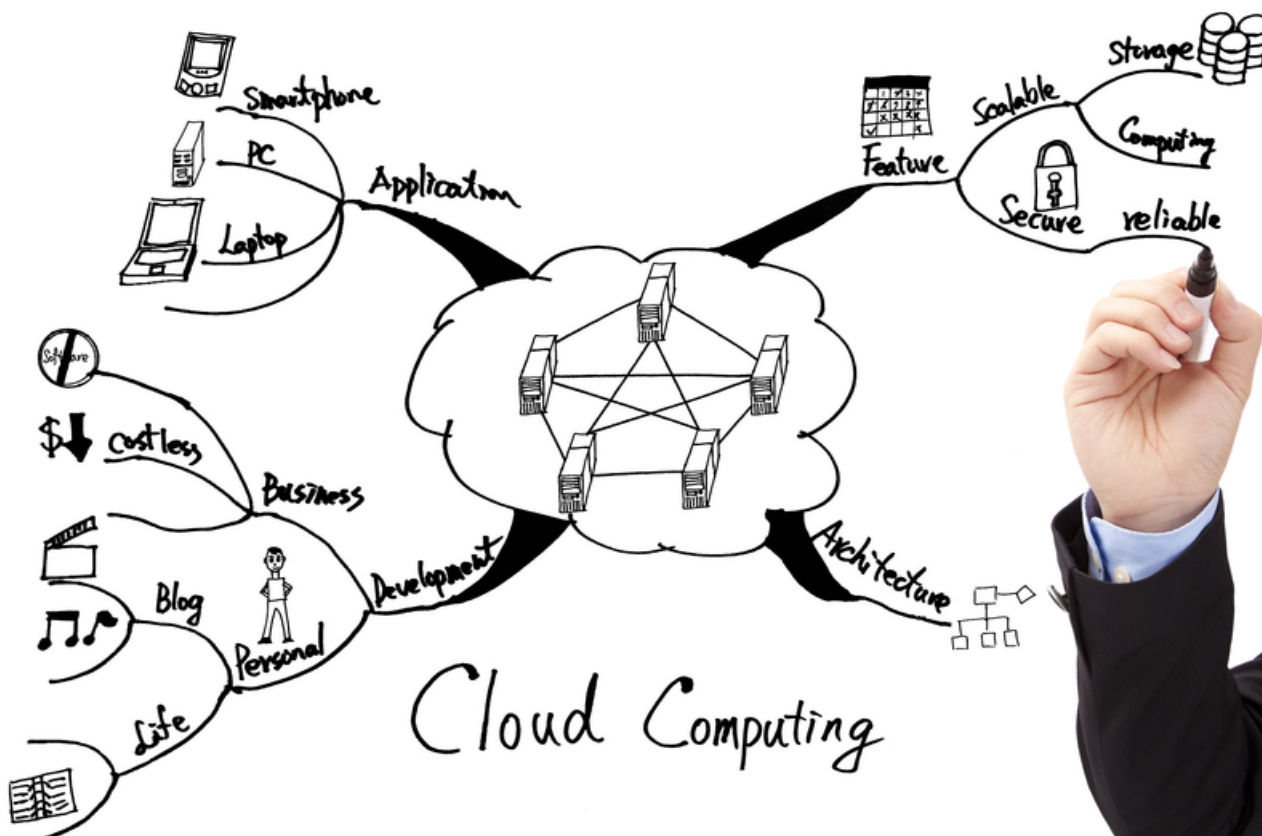
Within cloud computing there is a spectrum of services, from renting a basic machine with, say, Microsoft Windows fully installed for a dollar-an-hour (infrastructure as a service model), to full-blown, feature-rich enterprise applications such as JLT's claims management system, iClaims (software as a service model). Somewhere in the middle of the spectrum there is the platform as a service model, such as Google App Engine or Salesforce.com which refers to the provision of basic programming and hosting facilities to make deploying web-enabled software

faster and easier.

## What makes financial sense?

For most businesses, Software as a Service (SaaS) is the only form of cloud computing that makes financial sense. Traditionally, most software programmes available to users are installed on the desktop or a local server. Traditional examples of this category would be Microsoft Excel and Outlook. Others are shared across the enterprise and provisioned on the corporate network. The problem with this traditional approach is that rolling out software upgrades to even just a few hundred desktops is costly. Enterprise software systems, such as enterprise resource planning (ERP) or customer relationship management (CRM), also require dedicated resources to install, monitor, optimise, backup and upgrade to provide the functionality and performance required to

In cloud computing, there is no large upfront capital expenditure in data centre investments and costs can be amortised in an operational expenditure model.



**Clearing the air on Cloud Computing** (From page 8)

support critical business processes.

JLT's range of insurance and risk management software solutions - the interactive suite - is a good example of the SaaS model. This integrated suite of web-based solutions provides enterprises with access and control of the information they need to make timely and effective risk and insurance related decisions. The tools allow the users to access the software using a web browser such as Internet Explorer. There are no desktop installations and the end user does not need to do software upgrades personally as these are managed by JLT centrally. Backup and capacity planning are done by JLT's technology team. There is no large upfront capital expenditure for the client in terms of infrastructure and data centre investments as the costs can be amortised in an operational expenditure model rather than as an upfront capital expenditure. Because the data is now "in the cloud", it becomes globally accessible and supports a mobile workforce. All system upgrades and bespoke modifications are applied centrally, ensuring instant access to the latest tools and information for all users.

A common concern of the SaaS model is security. Many executives and decision makers are uncomfortable with putting corporate information in the cloud. However, with strong and good data centre practices, cloud computing can be every bit as secure as traditional hosting services. In fact, since a cloud vendor's main aim is to provide software on a public network, it often has better access to security expertise and technology than in-house software teams trying to build and deploy bespoke software on the Internet.

**The Private Cloud**

One approach to tackling cloud computing security is using a private cloud. In private clouds, you still have to purchase and run a data centre, but the resources and costs may be shared between different business units. Capacity can be scaled up and down based on needs. But given that there are still upfront investments and running costs, its upside benefits may be limited. Vendors have responded to this dilemma with the Virtual Private Cloud (VPC) – a combination of security technologies used in virtual private networks (VPNs) with the elastic capacity of cloud computing. This concept is now a mature technology and should be evaluated as a viable alternative or complement to traditional data centre hosting.

The insurance industry has to balance the upside benefits of cloud computing with security concerns and liability risks in the



event that data is lost, for whatever reason. Given this requirement, organisations in the insurance industry often go through an evaluation of the application portfolio and seek to qualify the applications that need to be ported to a cloud. The trend has been to move noncore applications into the cloud and this may revolve around moving applications like customer relationship management, agency management and marketing communications to the public cloud whilst retaining critical data sensitive applications related to investments and reserves management entirely internal or into a private cloud.

As the cloud computing industry matures and technology becomes commonplace, the SaaS model is fast becoming the norm for software provisioning. Whether it is risk management, customer management, agency management or claims control, cloud computing is a powerful yet easy way to bring new capabilities into the enterprise at reasonable costs.

The key to success in cloud computing for the insurance industry is in understanding your business needs, your unique challenges and the cloud computing vendor's capabilities. Evaluate those capabilities against other options and always be wary of the vendor's hype of a "silver-bullet" solution! The construction of the contract with your vendor is critical and involvement of your risk manager and legal counsel might be central to your engagement process.

When venturing into technologies such as cloud computing, recognise the significant upside benefits as well as remember the

The key to success in cloud computing for the insurance industry is in understanding your business needs, your unique challenges and the cloud computing vendor's capabilities.

**interactive** JLT Interactive is a specialised provider of 'on demand' Insurance and Risk Management software solutions. Large enterprises around the world leverage the company's flagship solution, the interactive suite, to improve the efficiency of their insurance operations and to enhance their management of enterprise risk.

JLT Interactive's hosted risk management applications support clients in a wide range of industries, from construction and energy to consumer goods and food services.

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## Living with the aftershocks

What lessons can businesses take away from the Tohoku earthquake?

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Months after a mega earthquake hit the northeastern areas of Tohoku, Japan, you can still feel the aftershocks (or earthquakes) once in a while, even in Tokyo. Some of them are as large as measuring 4 on the richter scale, while others, though relatively insignificant, are strong enough to be felt. The Japan Meteorological Agency maintains a website of all the tremors ([http://www.jma.go.jp/en/quake/quake\\_sindo\\_index.html](http://www.jma.go.jp/en/quake/quake_sindo_index.html)) including those that are too slight to be noticed. You would be amazed by the frequency of the earthquakes.

For residents and businesses in Japan, living with the aftershocks and inconveniences caused by the earthquakes are a part of normal life. According to Tokyo University Earthquake Research Institute, the Tohoku earthquake caused sizable changes to the pressure level on the ground of the Tokyo Metropolitan area, making another magnitude 7.0 earthquake at South Kanto area 70% probable within the next 30 years.

However, the Japanese people remain unfazed. If you happened to be on one of the public trains and subways in Tokyo, you might encounter a situation when most mobile phones and smart phones suddenly started beeping simultaneously. This is because not long after the Tohoku earthquake, many people installed an application on their phones that

would indicate to them yet another tremor. Passengers would then retrieve their mobile phones, check the earthquake warning notice displayed on the screen, turn it off, and put it back in their pocket as if nothing had happened. You might be misled into thinking that this behaviour is for want of concern. It would be more apt to say that they have learned to cope with the anxieties of Japanese life.

Besides the aftershocks, people are also concerned to varying degrees (depending on where they are and how they look at the publicly announced data) of the threat of radioactive contamination of food and water. The government has been doing a reasonable job in terms of keeping people informed about their findings of contaminated items, and of managing shipments from areas where products have been contaminated. Aerial radioactivity levels outside the vicinity of Fukushima Nuclear Plant #1 – including in the Tokyo Metropolitan area – are being monitored and remain low.

Still, there are some concerns as the government and Tokyo Electric & Power Company (TEPCO) continue to try to contain the ongoing spillage of radioactive substance into the air and into the ocean, due to their inability to cool down the reactors and used fuel rods at the Fukushima Plant. Initially,

One popular myth about the Japanese earthquake insurance system is that the government heavily reinsures the earthquake exposures that private insurance companies write.

Living with the aftershocks (From page 10)

Japan's second biggest convenience store chain had to close 20 stores because of physical damages and had to cease operations at another 384 stores because of disruptions to roads, trains, and manufacturing facilities.

the unstable situation at Fukushima prompted many foreigners in Japan to evacuate from Tokyo or leave Japan altogether. Since then, allayed by reports of normalising radioactivity levels, many have returned.

Reactions by businesses

Many major Japanese manufacturers have had to suspend or significantly scale down their operations and productions immediately after the earthquake. Automotive companies like Toyota, Honda, and Nissan were badly affected, since some of their key suppliers were based in the Tohoku area. Renesas Electronics Corporation, the leading global manufacturer of semiconductors for microcomputers to control various automobile functions, closed its biggest Naka Factory in Ibaragi prefecture, causing an immediate bottleneck in automobile production. Renesas is set to resume production at Naka on June 15th, but since it produces around 40% of the global automotive semiconductor market share, the significant supply chain breakdown caused by its three-month suspension put big auto manufacturers' operations in turmoil. Toyota resumed operations at its key domestic factories on April 17, but production was at 50% capacity. The production downturn reportedly affected its group March 2011 quarter ending result by JPY70 billion (US\$860 million). Toyota has been making every possible effort to back up domestic production, including reopening some of its US manufacturing facilities and searching for alternative suppliers of key components, both in and outside Japan.

Some businesses have been more resilient, not only in terms of returning to operations earlier and at full capacity, but also in contributing to the nationwide efforts to restore Japan from the disaster. Lawson Inc., Japan's second biggest convenience store chain with more than 9,000 franchise stores in Japan, had to

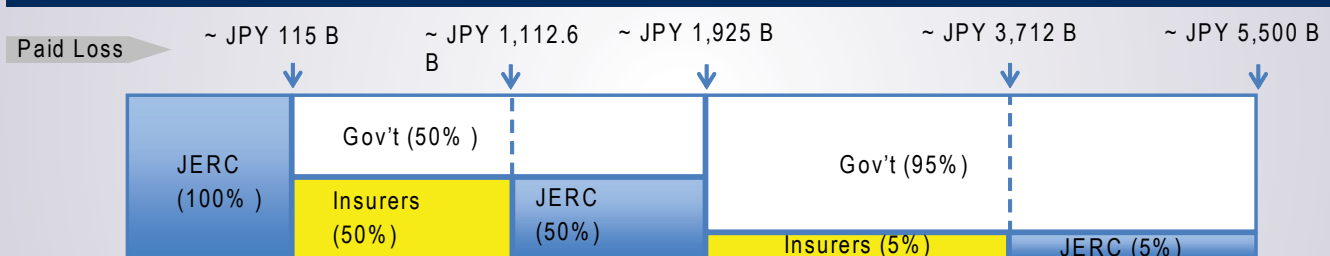
close 20 stores because of physical damages and had to cease operations at another 384 stores because of disruptions to roads, trains, and manufacturing facilities in the Tohoku and Ibaragi areas. Takeshi Niinami, Lawson's CEO, established their Disaster Recovery Headquarters minutes after the earthquake, and tried to restore communications and distributions to affected areas. His actions were exemplary of the highest standards of corporate citizenship – besides restoring suspended operations – he also made available food and living necessities to people in the affected areas. Exhausting all possible efforts such as deploying products and fuels for manufacturing facilities from other areas, Lawson managed to put 100 rice balls in each of the Sendai area stores a mere one week after the earthquake. By then, the number of closed stores had been reduced to 116 – amazingly quick operational recovery – considering that much of the affected areas was still in rubble. The number further decreased to 35 by one month after the earthquake. Lawson's quick recovery was lauded by local media for its effective crisis management and corporate citizenship.

The Japanese earthquake insurance system – myths and facts

One popular myth about the Japanese earthquake insurance system is that the government heavily reinsures the earthquake exposures that private insurance companies write. The truth however is not as simple.

For household owners, earthquake insurance is relatively easy to purchase as it is offered as an option in standard homeowners' policies. Although premiums are slightly more expensive than the standard fire coverage, and the maximum insured value available per household is JPY50 million for buildings and JPY10 million for home contents, 23% of total standard homeowner policy holders had earthquake coverage (as of March 2010). The earthquake coverage among households in the Miyagi prefecture, at 32.7%, was higher, as this area is considered earthquake/tsunami prone and awareness of the need for insurance protection has traditionally been high. Insured exposures are reinsured to Japan Earthquake Reinsurance Company (JERC), established after Japan's 1966 laws on earthquake insurance were instituted. JERC is owned by 10 domestic insurers, and after a certain level of risk retention by JERC, the risks are retroceded to the government and to the domestic insurers on a pooling share basis (see Figure 1).

FIGURE 1: REINSURANCE SCHEME



**Living with the aftershocks** (From page 11)

Nikkei has estimated the total household earthquake insurance losses to be around JPY 1 trillion, and if this is true, JERC will bear JPY115 billion of losses, while the remaining JPY885 billion will be borne in equal parts by the government and the domestic insurers. Since this scheme can accommodate up to JPY 5.5 trillion losses, and domestic insurers are required to maintain sufficient “extraordinary loss reserves” on their books, the payment of an estimated 500,000+ household earthquake insurance losses, based on the maximum loss sum insured, could be achieved without problems.

Things get a little more complicated for business sectors. Since earthquake coverage for commercial risks is not backed up by the government, the writing of commercial earthquake risks is primarily driven by domestic insurers’ abilities (backed up by their reinsurance treaties and their own net capacity) and appetites for such risks. As most of their reinsurance treaty conditions are limited for earthquake risks (e.g., many treaties exclude earthquake-induced Business Interruption or Contingent Business Interruption losses), and as they may have accumulated significant exposure for earthquake prone areas, the number of parties seeking cover against earthquake is rather small.

Ever since the Tohoku Earthquake, the domestic market has maintained very cautious positions, ceasing to write new earthquake coverage, regardless of the locations. Even for renewals of existing earthquake coverages, most markets limit the scope of coverage or factor in a significant rate increase, in view of the rate increases to reinsurance treaties caused by the Tohoku earthquake. Many of the policies were in the final process of renewal at the time of incident. With a series of unwavering aftershocks that have continued for months, most markets are expected to maintain the current position. However, a few markets seem to try to view this situation as an opportunity to gain grounds in the commercial market, and have shown a relatively positive attitude towards writing new earthquake coverage, especially for those located in the Western part of Japan.

Even for renewals of existing earthquake coverages, most markets limit the scope of coverage or factor in a significant rate increase, in view of the rate upticks for reinsurance treaties caused by the Tohoku earthquake.



**How the market is responding**

While normalcy gradually returns, businesses in Japan, as well as any other business around the world with significant exposures to natural calamities, will be well served to consider the following measures that they can undertake, lest another Tohoku type event occurs:

- Consider establishing a back up centre to ensure continuity of headquarter operations in an area less likely to be affected by a natural calamity, or even outside Japan;
- Minimise supply chain risks by reassessing the traditional “just-in-time” systems and possibly securing more alternative supply chains for crucial materials/components/parts for manufacturing;
- Consider establishing self-power generating facilities (as major rolling blackouts are planned by TEPCO);
- Secure earthquake-triggered Business Interruption/Contingent Business Interruption coverage, or earthquake derivatives/CAT bonds.

While no amount of precautions/backup measures can ensure complete recovery or mitigation of risks, good business practice calls for every feasible action that could minimise the conceivable business risks to be taken. ☎

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