



„Mind the Gap“

—

between the
financial and
insurance views



DSU - LONDON MARKET WORKING PARTY 2012

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1. **Complex values** – shifting market for large infrastructure projects
 2. **Changed DSU demands** – view on the current DSU insurance situation
 3. **Expensive gap** – different insurance understandings of the insurance offering
 4. **More transparency** – our target to overcome the present gap
 5. **What's next?** – work of the London Market Working Party
 6. **What's in it for everyone?** – benefits for the insured, the insurer and the broker

Complex values – shifting market for large infrastructure projects

Factors influencing the market for large infrastructure projects

- Tightening public spending budget versus increasing demand for infrastructure, energy supply etc.
- Alternative funding: BOT/PPP/PFI
- About 80% of the projects funded by bank loans

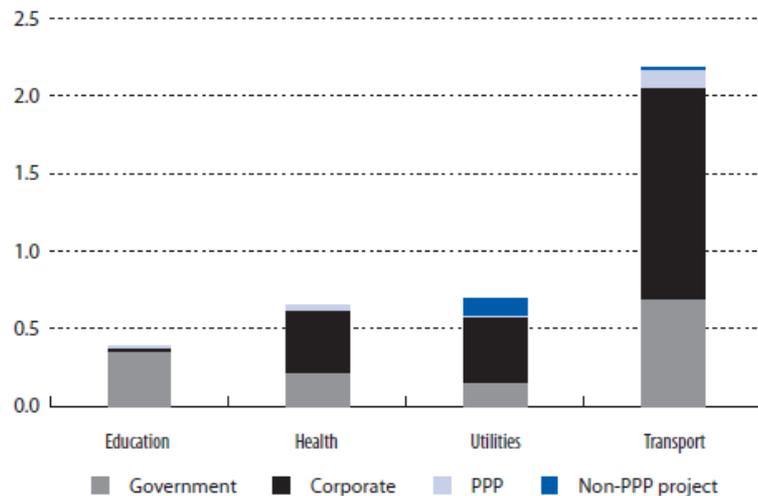


Consequences for DSU

- Increasing demand due to complex risk structure
- Steadily increasing DSU sums insured
- Unique risks, no standard solution available
- Financial figures only a prediction
- Lenders agreement different from insurance interest

Complex values – shifting market for large infrastructure projects

Composition of infrastructure finance across sources, by sector of activity (2006-2009 EU average, in percent of GDP)



Key drivers for purchasing DSU

- Shift from governmental funding to private financing schemes with different desire for securing the loans
- Collateralisation of loans often with project assets
- Loan repayment often funded solely from project earnings
- Higher turnover can also result in higher loss of profit
- Tight financial schedules with little or no buffer
- High complex project structure / leading edge technology
- Just in time supply chain no time buffer
- Lenders more insistent upon purchasing DSU

Changed DSU demands – past experiences on DSU

According to IMIA member statistics: all policies and losses up to 31st December 2008

Industry group	Number of risks	DSU sum insured	Number of claims	Loss amount 100% - ground up
Building construction	317	14,618,373,925	5	46,999,124
Industrial process plants	150	21,543,714,910	19	151,857,674
Civil engineering	119	9,633,554,742	14	53,799,694
Food industry	30	947,199,826	2	5,228,179
Wood industry	21	566,712,528	5	22,376,681
Metal industry	55	4,260,441,581	1	2,573,549
Mining	51	3,334,363,076	2	11,593,320
Other	48	2,314,149,428	2	6,010,540
Paper industry	62	2,310,888,421	2	10,250,734
Power plants	323	31,145,197,705	25	156,289,837
Totals	1,176	90,674,596,143	77	466,979,330

- The **number of DSU covers doubled** within the last 10 years (539 risks until 2000 to 1,176 risks cumulative by end 2008), also the sums insured rose significantly (average €61.8m in 2000 to an average of €77.1m in 2008).
- Generally, the **frequency of DSU claims is increasing**. About 6.5% of all DSU risks suffered a loss.
- The **average DSU claim** in 2008 was €6.1m and had almost **doubled** since 2000 (€3.4m)

Changed DSU demands – cause of loss analysis over 28 years worldwide

Nb. of risks by segment

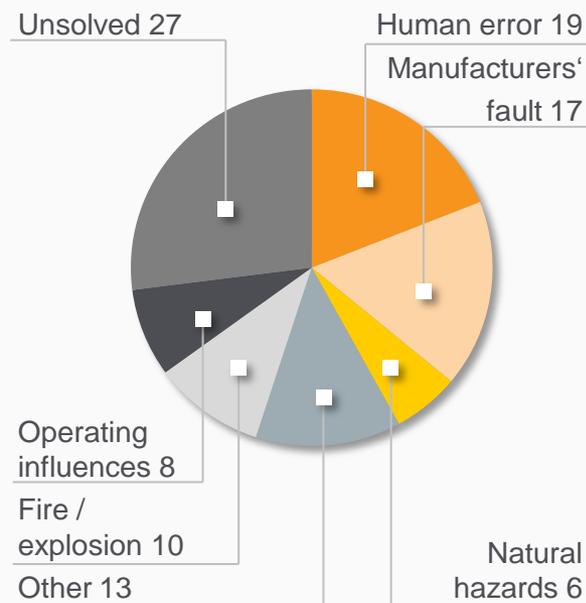
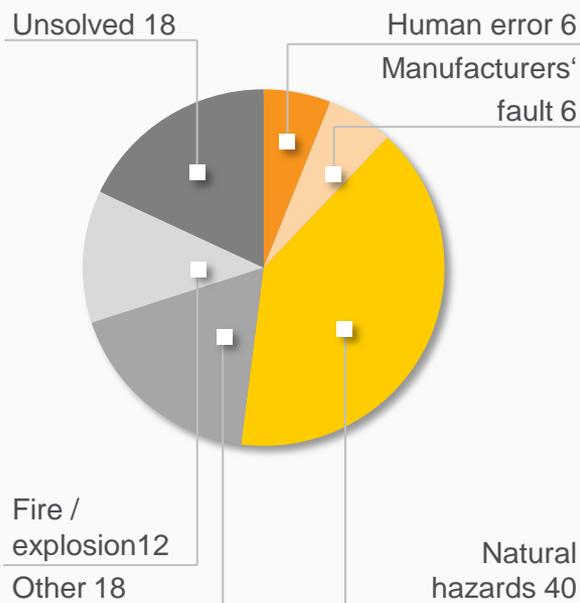
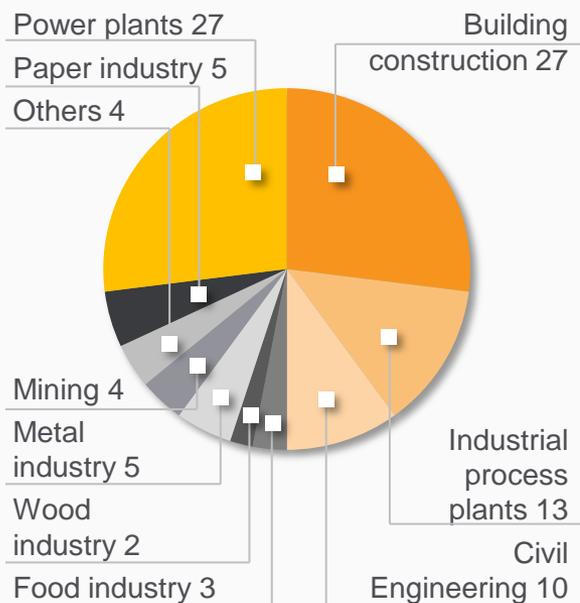
%

CAR: Cause of loss

%

EAR: Cause of loss

%



- **Power plants** and **building construction** risks with DSU cover represent more than 50% of all policies.
- While the cause of loss for CAR are often **natural hazards** (40%), the cause of loss for EAR is characterised by **human error** (19%) and **manufacturers' faults** (17%).

Expensive gap – different understandings of the insurance offering

Client perspective

Increased demand

Lender vs. Owner demand

Do clients know what they buy?

Challenges within the product

Concession contracts

How good are the insurer's models?

Complex product

Clear policy language

Do buyer and seller use the same language?

Balance PD SI and DSU SI

Bespoke vs. standardised product

Insurable interest vs. entrepreneurial risk

Insurer perspective

Do insurers know what they sell?

New business opportunity

How accurate can the DSU SI be predicted?

Mega Projects with DSU SI > USD 1.5 bn

Profitability

Expensive gap – different understanding of the insurance offering

Client perspective

The client's wish...

There is a delay – please indemnify us!

No. Then we need an extension...

We have a PD loss – please indemnify us under the DSU section

Yes – please indemnify us!

Yes – but that shouldn't matter....

Insurer perspective

and what has been purchased...?

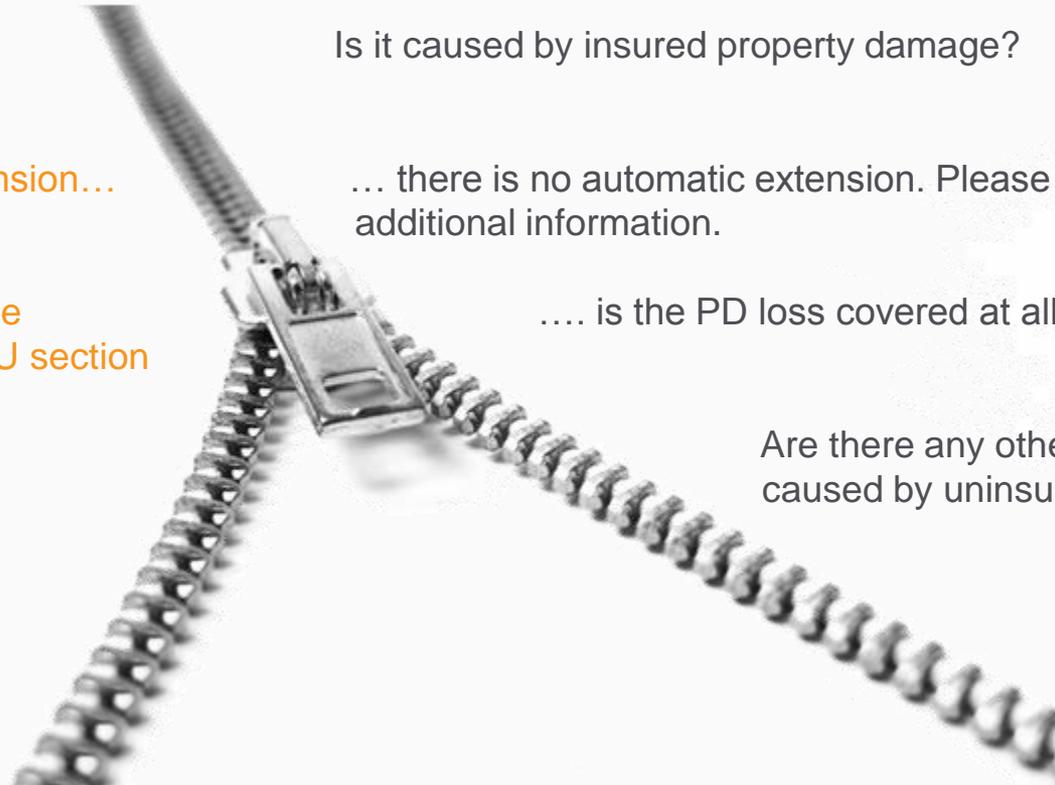
Is it caused by insured property damage?

... there is no automatic extension. Please provide additional information.

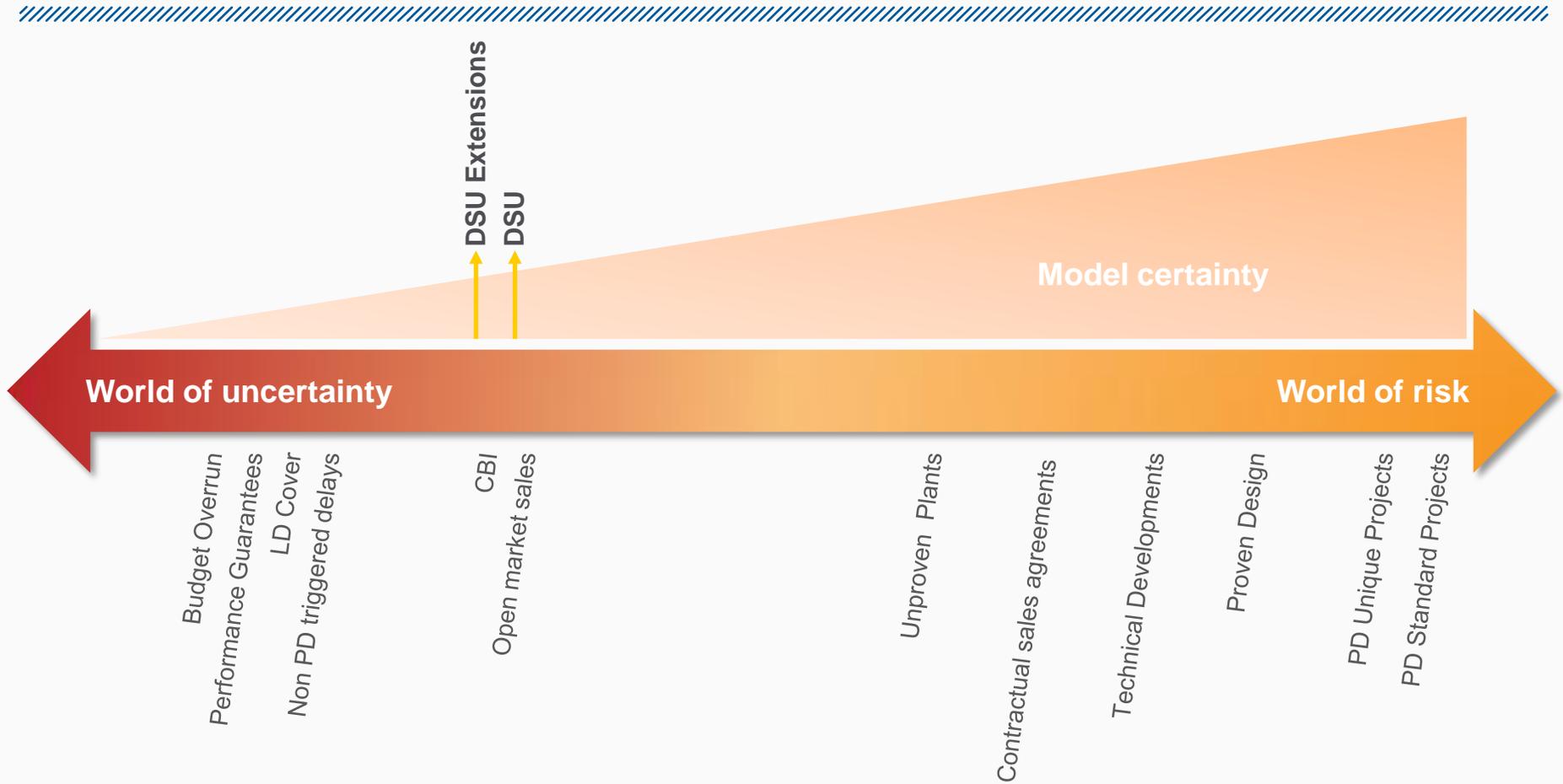
.... is the PD loss covered at all?

Are there any other delays caused by uninsured events?

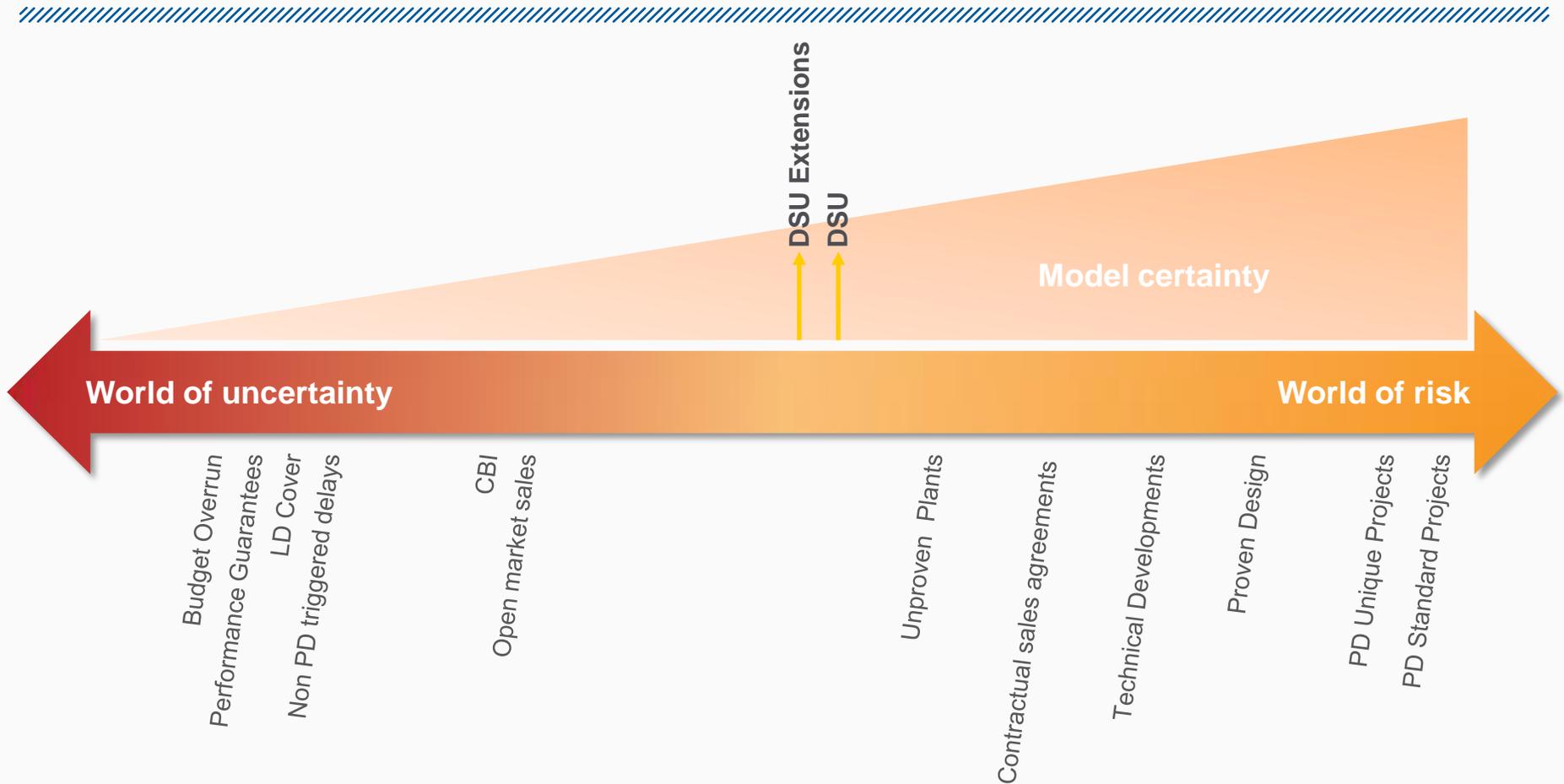
Are other delays reducing the indemnifiable period ?



More transparency – our target to overcome the present gap



More transparency – our target to overcome the present gap



By sharing information symmetrically greater transparency can be achieved resulting in improved insurability.

More transparency – our target to overcome the present gap

If more elements exist in the world of risk, this will benefit:

- ✓ a **professional approach** to deal with the exposure
- ✓ **adequacy** of terms
- ✓ **risk appetite** of risk carriers for an individual risk
- ✓ **availability for insurance** solutions even after an adverse loss development

What's next – work of the London Market Working Party



Why

- Is the intention of DSU amongst all parties understood?
- Do insurers have adequate transparency of the DSU sum insured?
- Possible and necessary steps forward



Who

- (Re)Insurers
- Brokers
- Forensic Accountant



Findings

- Mismatch of expectations along the value chain
- Lack of transparency (pre- and post-underwriting)
- Lack of expertise



Results

- DSU Principle Paper outlining the basic intention/concept of DSU
- DSU worksheet, uniform split of value template
- Post underwriting progress monitoring
- Evaluation of extensions and reinstatements

Work to be
continued by LEG

What's next – the work of the London Market Working Party

DSU Principle Paper outlining the basic intention/concept of DSU



LEG
London Engineering Group

Delay in Start Up Insurance

London Market Working Party 2012
Supported by IMIA and The London Engineering Group

An overview

Introduction

Delay in Start Up (DSU) is also referred to as Advanced Loss of Profits (ALOP). DSU insures project owners for the financial consequences (as described in the policy) of a delay to project completion arising from an insured physical damage event. The cover is best purchased with the Contractors All Risks/Erection All Risks (CAR/EAR) policy covering physical loss or damage to the project.

Key Facts

- 1. Insured Parties for DSU Insurance.**
Typically, DSU is purchased for the project owner. Any project financiers / lenders to the project are likely to require purchase of DSU cover, where finance is on a limited recourse basis. For concession contracts however contractors (as concessionaires) may also be insured.
- 2. Claimants under DSU Insurance.**
The project owner, and where applicable the project financiers / lenders and contractors under concession contracts will be entitled to claim.
- 3. Contract of indemnity.**
The indemnity granted under a DSU policy will reimburse the owner only to the extent that they have actually suffered a loss. Any claim settlement will take into account seasonal and market fluctuations in the actual business performance, and crucially the effect of any uninsured events (such as poor contractor performance, late delivery of equipment etc) which have delayed project completion.
- 4. Material damage proviso.**
The DSU cover is triggered only by a delay to project completion due to physical damage events insured under the CAR/EAR cover.
- 5. Scope of cover.**
There are generally three levels of cover:
 - Gross profit. Loss of anticipated revenue, including debt service costs, fixed operating costs as well as anticipated net profit, less variable costs.
 - Debt service and fixed costs.
 - Debt service only.
 Increased cost of working is also insured under DSU to the extent that the increased expenditure reduces the insured loss. Any indemnity will be limited to the insured's actual loss sustained within the policy parameters.
- 6. Triggering a DSU claim.**
The policy will contain a DSU trigger date. It is the agreed date the project was anticipated to be complete and the commercial operations would begin. Such date may be linked to a contractually defined term. There are 3 key criteria for payment of a DSU claim.
 - An event indemnifiable under the physical damage policy.
 - The resultant delay exceeds the DSU deductible.
 - A resultant loss of the interest insured (e.g. Gross Profit).
 Variants to address specific operating regimes such as phased handover and interim operations are also available.

7. DSU Sum Insured.

The amount payable under the policy will be expressed as both a monetary and a time limit - a sum insured and a maximum indemnity period. It may be further defined by a maximum daily indemnity amount. Insurers will pay up to the amount stated as either the sum insured or the indemnity period, whichever is exhausted first.

The maximum indemnity period purchased should ideally not be less than the maximum rebuild period envisaged. The sum insured should be sufficient to reflect the financial exposure for the level of coverage purchased, during the indemnity period.

8. Deductible.

Also referred to as a "waiting period" or "time excess", this is the period of the loss during which the delay is self insured. The deductible is usually expressed as a number of days and will be applied to the aggregated delay.

9. Aggregate delay (insured and uninsured).

The delays suffered by a project potentially from multiple physical damage events will be aggregated, leading to one overall delay period beyond the trigger date. Delays can also occur to a project from events that are not covered by the physical damage insurance, such as slow progress or late supply of materials. Indemnity under the DSU policy will discount time lost to such circumstances.

10. Reinstatement of cover.

The DSU sum insured is invariably an aggregate limit. If DSU is triggered, it may be necessary to reinstate the sum insured, indemnity period and deductible. The policy may contain provisions relating to the reinstatement of the DSU section. It should be noted that there is generally no obligation on insurers to extend the period of insurance, to advance the trigger date, or to reinstate the sum insured.

11. Key exclusions.

DSU typically does not cover:

- Fines and penalties.
- Non damage delays (non performance, late delivery of materials etc.)
- Periods of insured delay concurrent with those from uninsured events.
- Delays due to redesigning, adding or improving the insured property.
- Inadequate funding to complete the project.

12. The claims process.

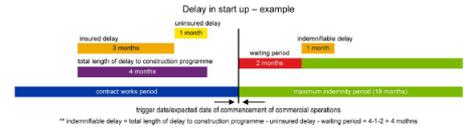
In the event of a claim under the DSU policy, insurers will usually seek to establish:

- The actual status of the project progress at the time of the physical damage occurrence. Generally, the more transparent the project progress, the simpler the claims process will be. Providing insurers with regular progress reports and schedule updates during the life of the project is strongly recommended.
- The actual revenue situation of the insured business had the loss not occurred.

Forensic accountants may be used to assess the actual loss sustained.

Claim settlements will be subject to deduction of concurrent uninsured delays and the application of the policy deductible.

Delay in start up – example



Your insurance adviser should be able to assist with the following:

- A detailed explanation of principles and the scope of cover.
- Insurance programme design, assessment of needs, selection of interest insured, sum insured, maximum indemnity period, reinstatement needs.
- Identification of potential loss scenarios with indemnity examples.
- Establishing a statement of intent from insurers on advancing the trigger date/ extending the period of insurance.
- Periodic reviews of project schedule.

By explaining the intention of the cover, close the gap between differing expectations.

What's next – work of the London Market Working Party

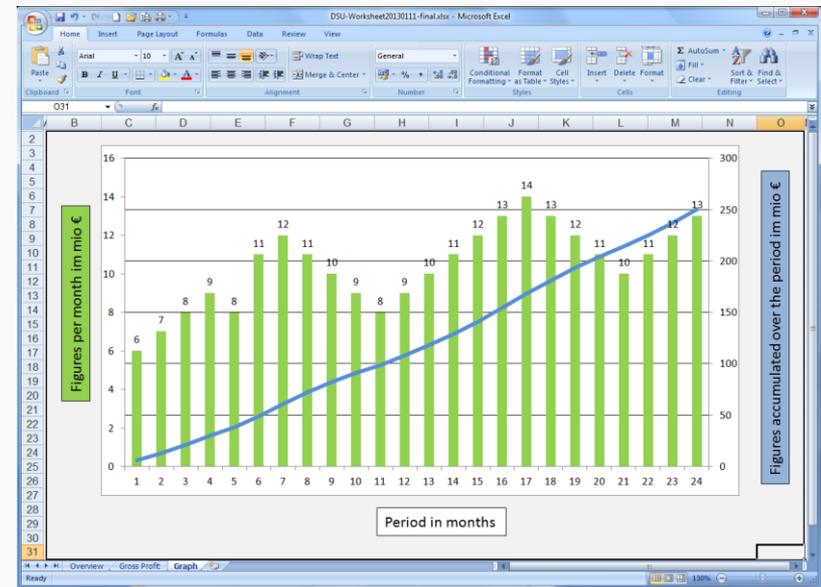
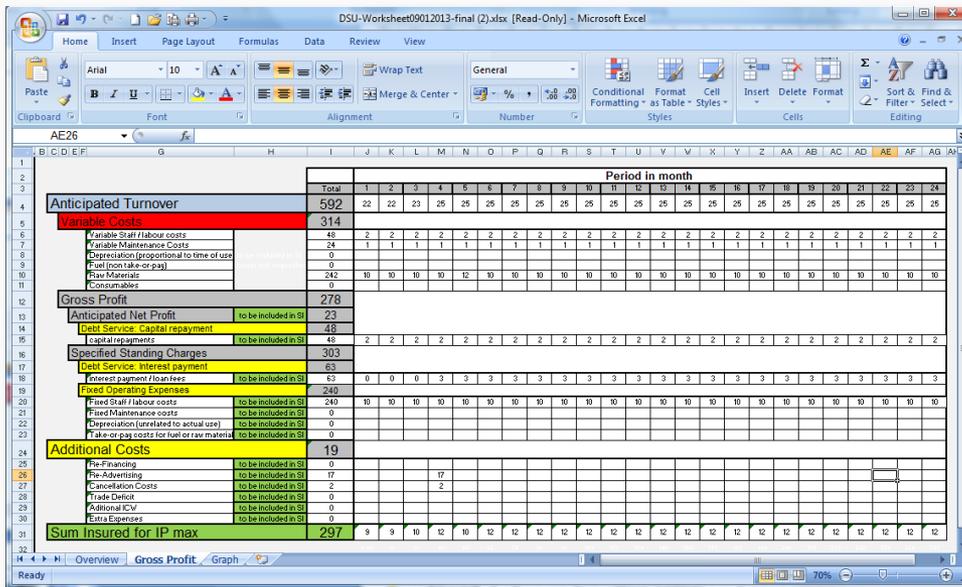
DSU worksheet, uniform split of value template

Anticipated Turnover of Insured Business		Additional Costs	
Gross Profit of Insured Business		Costs Savings from Variable Costs	
Anticipated Net Profit of Insured Business		Specific standing charges	
Debt Service		Fixed OPEX	
Capital Repayments	Interest Payments		
capital repayments	interest payment / loan fees	Fixed Staff / labour costs	Variable Staff / labour costs
	loan fees	Fixed Maintenance costs	Variable Maintenance Costs
		Depreciation (unrelated to actual use)	Depreciation (proportional to time of use)
		Take-or-pay costs for fuel or raw materials	Fuel (non take-or-pay)
			Raw Materials
			Consumables
			Re-Financing
			Re-Advertising
			Cancellation Costs
			Trade Deficit

Obtain transparency of the sum insured and thereby close the gap of “what is intended to be insured”

What's next – work of the London Market Working Party

Pre inception - DSU worksheet, uniform split of value template



Provision of information prior to inception will promote improved transparency of the DSU sum insured value split

Active progress monitoring

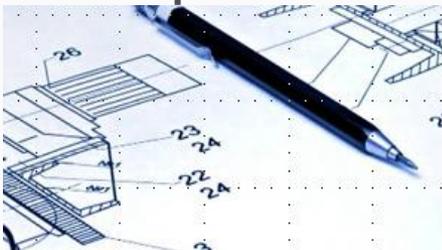
- **Independent review** of owner's and contractor's schedule on a regular basis and, thereby, a **regular update** on project progress and delays
- Timely provisional of information which is critical for claims above and below deductible
- Periodic review of sum insured



DSU claims are more efficiently handled due to high transparency in respect of project progress and delays. Policy extensions or reinstatements are easier to deal with for the same reason.

What's in it for everyone – benefits for the insured, the insurer and the broker

Pre-inception



Post-inception



Post-loss



Insured

- ✓ Clarity of cover
- ✓ Understand what you buy
- ✓ Adequate DSU SI

- ✓ Improved ability to agree changes in the DSU cover

- ✓ Policy delivers as expected
- ✓ Faster and fairer adjustment

Insurer

- ✓ Increased model certainty
- ✓ Transparency
- ✓ Understand what you sell

- ✓ Improved ability to respond to changes mid term, e.g. extend policy period, SI

- ✓ Reduce potential for dispute
- ✓ Transparency simplifies discussion over reinstatements

Broker

- ✓ Alignment of expectations
- ✓ Adequacy of product
- ✓ Promotion of coverage availability

- ✓ Closer client relationship
- ✓ Can respond to client needs

- ✓ Happier clients

For further information please see:

- The International Engineering Insurance Association at www.imia.com under “**Key topics**”
- London Engineering Group at www.londonengineeringgroup.com under “**DSU toolbox**”

THANK YOU VERY MUCH FOR YOUR ATTENTION

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