

IMIA Short Paper

by Hervé Landrin, Munich Re - Nov. 2009

New markets for IDI insurance . Challenges and perspectives

FAQ

- **Where does IDI come from?**

The basis of builders' professional liability goes back some 3800 years and can be found in Articles 229 to 233 of the Code of Hammurabi, King of Babylonia. More recently the professional liability of architects and builders was fixed at fifteen years in Roman law. The decennial liability, as it is presently known, is based on Article 1792 of the Napoleonic Code passed in 1804, which sets down in writing the French common law that had been in force for centuries and was itself derived from Roman law. This Code is also known as the "Code Civil", and applies not just in France but in many francophone countries.

Art. 1792

If the building, built at a set price, perishes in whole or in part by defect in its construction, even by defect in the foundation, the architect and the contractor are responsible therefore for ten years.

Decennial insurance was first made available in France and Belgium in the 1930s. However, it is surprising to note that the very same legislation (until 1967, Article 1792 of the Napoleonic Code had precisely the same wording in France and Belgium) resulted in decennial liability policies for contractors in France (based on turnover) and project policies for principals (i.e. property insurance) in Belgium.

Therefore one can consider that IDI falls halfway between the two stools of liability and property cover.

- **Does IDI always derive from a legislation?**

No. IDI derives historically from the French Civil Code in France, Belgium, Luxemburg, many French speaking African countries as well as in Italy and Spain which have similar Civil Codes. In French speaking countries it is called decennial insurance.

In the late 1980s a similar cover on a pure first-party basis was developed for the UK market. In order to clearly distinguish this cover from decennial insurance it was called Inherent Defects Insurance (IDI) or Latent Defects Insurance. This kind of cover is now available in Ireland, Australia, and more recently in the Netherland and Denmark.

- **Is IDI compulsory?**

In some countries yes, in others no. IDI is still compulsory in France, Italy Spain and Denmark. In other countries it is written on a voluntary basis.

- **Who is the insured?**

Generally speaking the insured is the principal or owner of the building. If a building is sold then the new owner becomes the insured.

- **What is the scope of cover?**

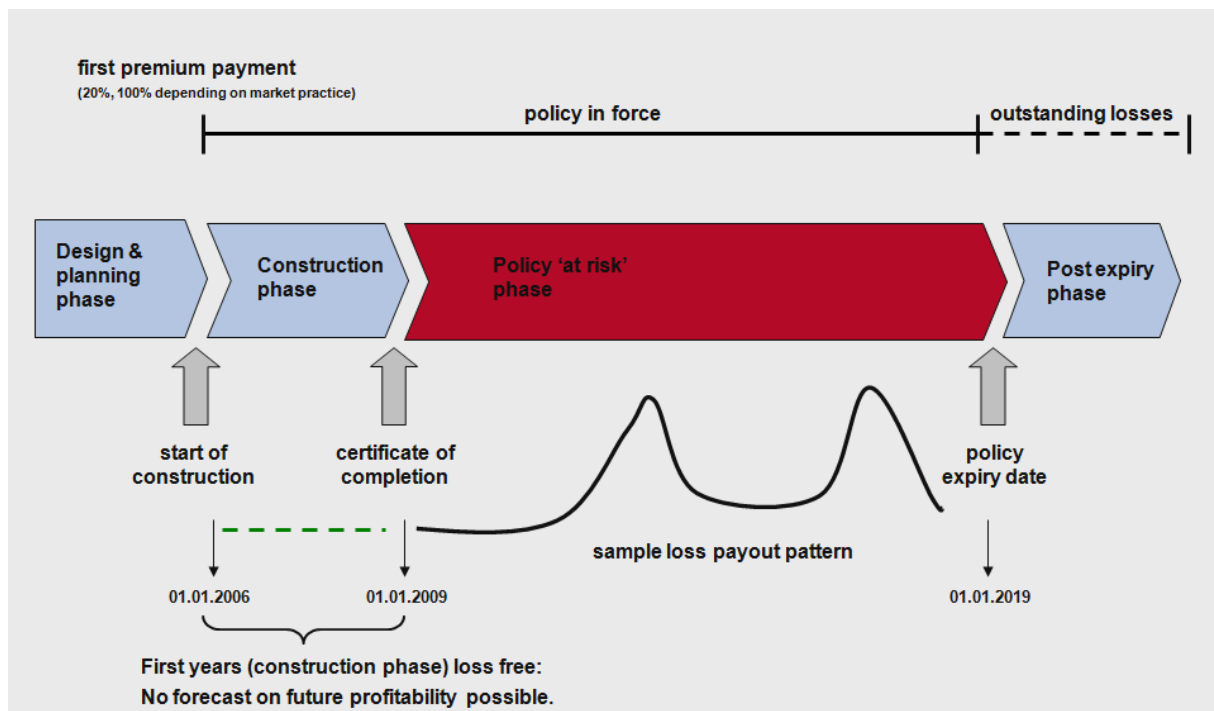
Since IDI covers damages due to inherent defects (i.e. defects due to defective planning, material or workmanship) that were not visible at the time of the completion or handing over of the building, external causes like fire or natural perils are always excluded.

Apart from countries where the scope of cover is dictated by law (France, Italy, Spain) usually the following perils are covered:

- Total or partial collapse (basic coverage)
- Solidity / stability of the structure (basic coverage)
- Waterproofing of roof and external walls (extension of coverage)
- Seepage (extension of coverage)

- **What is the true nature of IDI Business?**

Although IDI as a first party cover is considered as property business it has a long tail character which is illustrated by the picture below.



This type of business, ties up risk-based capital for several decades, and it takes many years until all claims related to a specific underwriting year are notified. The run-off period for an underwriting year is approximately 15 years. Any remedial measures needed usually come late, possibly not taking effect until a good ten years have passed.

- **What about Technical Inspection Service (TIS)?**

IDI can be seen as the transfer to the insurer of the obligation (to construct a strong and solid building) lying on the contractors. In order to make this risk transferable and therefore insurable, the construction must meet quality standards both at the level of calculation and design norms and at the level of the quality of materials and workmanship. It is the role of the TIS to confirm to the insurer that the object to be insured does indeed meet these standards, making it a "normal risk" and therefore insurable. TIS should always be appointed since the beginning of the design & planning phase. The costs of TIS have to be borne by the insured. TIS have to be bodies totally independent from insurers, contractors and engineers.

- **And what are the challenges and perspectives by introducing IDI in a new market?**

Experience has shown that the introduction of IDI does not improve the quality of construction.

If the quality of construction is acceptable as well as the moral risk (i.e. corruption at a low level) introduction of IDI can be considered and the main challenges would be:

- Build up a staff of specialized underwriters and claims handlers
- Set up conditions (tariff and wording)
- Take into account the risk of change (inflation, consumer behavior, case law)
- Define a premium earning pattern
- Establishing independent TIS with competent surveyors
- Difficult interpretation of statistics

On the other side introducing IDI can be a good opportunity for engineering insurers by:

- Diversifying their portfolio in a COB with no nat. cat. Exposure
- Generate a increase of premium
- Creating a new cross selling opportunity (CAR + IDI + property)