



FIRE TARIFF

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Historical Background

- ◆ A Fire Tariff was introduced in the early 1920's based on the statistics available and physical features of the risks at that time.
- ◆ It continued in the same fashion until early 1950's where minor revisions were made with new risk classifications and changes in the physical hazard.
- ◆ This same Tariff was used when Act No.2 of 1961 nationalized General Insurance in 1964 with the establishment of Insurance Corporation of Sri Lanka.
- ◆ The Tariff depicted basic rates for each class of risk and sub-divided into 04 categories based on the type of construction. There was a 20% loading on the basic rate, if the risks were located outside Colombo and Kandy Municipal limits. This was to take into account the Fire Brigade facilities available in the Colombo and Kandy Municipal areas.
- ◆ It was felt that the basic rates were on the high side, as the tabulation was based on the risk characteristics that prevailed in the 1920's and 1950's. Further, technological changes, changes in the moral hazards and physical hazards, the Insurance Corporation decided in consultations with the Fire, Rating Committee to grant 5% and 10% discounts on the basic fire rates. The latter discount of 10% was not allowed for stocks insured on declaration basis.
- ◆ In addition to the basic rates on fire, the Tariff also detailed the minimum rates to be charged in respect of Riot & Strike, Malicious Damage, Explosion, Cyclone, Storm and Tempest, Flood Damage, Earthquake, Impact Damage, Aircraft Damage, Electrical Extra and Bursting and Overflowing of Water Tanks, Apparatus or Pipes. Other than for few additional perils, such as, Malicious Damage, Impact Damage and Electrical Extra, the Fire Tariff spelt- out differential rates on other additional perils, based on the situation of the property insured, nature of the property insured and type of cover required.
- ◆ In addition, the rating schedule also indicated the compulsory warranties that must be applied for the rate in question. There were loading on the premium if the warranties cannot be complied with by the client and in some instances, the risk was not acceptable by the insurers. There are 44 warranties.
- ◆ There was a separate rating schedule for tea factories with warranties meticulously drafted to highlight the risks, which the tea factories were exposed to.

- ◆ The same Fire Tariff was used even after establishing an independent insurer, i.e. National Insurance Corporation in March 1980. At that time, both Corporations religiously followed the Tariff. The two Corporation's officials would discuss and come into a consensus if there was any variation in the Fire Tariff, such as discounts, special rating etc. These were addendums to the existing Fire Tariff and there was no violation by either party .
- ◆ With the advent of July 1983 riots, the Riot & Strike Rating schedule of the Fire Tariff was increased to 300% of the basic rate during the period July - October 1983. As these rates were on the high side, such rates were reduced by 50% in October 1983 and currently, the same rates are supposed to be in use i.e. a 50% loading on the basic Riot & Strike rate.
- ◆ The Fire Tariff survived in the first 4 -5 years since privatisation of insurance by Act of Parliament in 1986.
- ◆ In the mid 1990's due to stagnant economic situation in the country , competition to acquire new accounts by the private sector and retention of their accounts by the two Government Corporations, market penetration, recruitment of sales force, there was severe pressure on the fire rates. The competition was very much focused on the price (premium) rather than other service factors, as the fire insurance Terms and Conditions was uniformed in the market. As the fire portfolio was considered profitable and as most companies wanted to show turnover / growth, there was wide spread discounting.
- ◆ Currently, although the Fire Tariff is still used, there is more violation of the Tariff than complying with it.
- ◆ This deterioration in the rating structure was mainly caused by the unwillingness of the Insurance Association of Sri Lanka (IASL) or the inability of the IASL due to non-unanimity among the insurers.
- ◆ When violations were detected and brought to the notice of the members of the Fire Technical Sub Committee and reported to the IASL, IASL did not take these issues seriously and no members / companies were reprimanded.
- ◆ The violation of the Tariff was more of a rule rather than an exception in the late 1990's.
- ◆ A committee was formed to look into the Fire Tariff with specific instructions to collate and streamline the rates rather than to revise/modify the Tariff. Mr. S I

Fernando chaired the committee. The committee forwarded a report depicting the same rating structure and same warranties, but consolidating the current rate i.e. + 20% -5% -10% to a two digit percentage and incorporating some of the special rates that have been decided upon by the Fire Technical Committee.

- ◆ Although, the effort of this committee is commendable, the irony is that this report never saw daylight. The proper terms of reference for this committee should have been to collate data and revise the Tariff taking into account the current processes, technological advancements, risk exposures, high sum insured, moral hazards and other physical hazards. Apart from the current rates being too high, the committee should have reviewed and re-looked at the rates and come-up with a workable Tariff which all members would have complied with.

The Current Situation

- ◆ Although, there is a comprehensive Fire Tariff, it is rarely followed.
- ◆ The Tariff does not apply for risks above Rs.300Million in anyone location. The Tariff does not apply in respect of Board Of Investment (BOI) approved projects.
- ◆ Insurers are lenient with regard to Section 17(21) in respect of BOI approved projects. Some BOI approved projects do not enjoy all the facilities offered to BOI enterprises, such as hard currency account and facility to insure with overseas insurance companies.
- ◆ Insurers grant various discounts for Fire Extinguishing Appliances (FEA) and others in order to "win" the account or to "match" a competitor's quotation / business.
- ◆ Discounts are offered for superior construction without proper evaluation of the construction details as detailed under the existing Tariff.
- ◆ Some insurers add various locations to make the sum insured more than Rs. 300 million in order to avoid applying the Tariff rates.
- ◆ Some insurers add the sum insured under the Business Interruption Policy to the Fire Material Damage Policy, so that they do not have to charge Fire Tariff rates, when the total sum insured exceeds Rs.300 million.
- ◆ When the declared sum insured is more than Rs. 200 million but less than Rs.300 million, some insurers and intermediaries advise the client to enhance the sum

insured or they themselves increase the sum insured, so that the Fire Tariff rates need not be charged.

- ◆ In order to match competitor's quotations, insurers take no heed of the basic rate given in the Fire Tariff. Unfortunately, the IASL has allowed this "matching" of premium if sufficient or reasonable proof can be given.
- ◆ Many insurers do not charge the correct SRCC rate in respect of Shops and other risks, which require higher SRCC rates.
- ◆ There are various first loss covers granted currently. Under the market agreement, first loss cover was available for buildings insured in respect of Cyclone, Storm, Tempest and Flood only. Now this has been extended to other perils, such as Electrical Extra, Impact Damage, Bursting and Overflowing of Water Tanks, Apparatus or Pipes and Earthquake Damages without a market agreement.
- ◆ Tea factory rating is now defunct. All the risks are rated at the lowest rate with no consideration to the warranties. Further, an inspection is not carried-out to determine the warranties applicable or the correct rate to be charged-
- ◆ There is no proper method of arriving at the fire rate of premium for the BOI approved enterprises. Many insurers charge a flat rate of 0.04% for all perils irrespective of occupation, location or the risks associated with the surrounding property, thereby violating a fundamental principle of equitability of premium vis-à-vis risk.
- ◆ Some insurers do not use warranties or do not apply the compulsory warranties as specified by the Tariff.
- ◆ In order to win the business or match a competitor's quotation, the underwriter do not take into consideration the occupation, the exposure from the surrounding areas, the process involved, value at risk, the fire extinguish appliances and other physical and moral hazards. In most cases, insurers reduce the existing premium to attract the account into their books.
- ◆ Although the current Law indicates the maximum commission payable to an Agent or a Broker, some insurers offer higher commission to an Individual or an Institution, who is not an Agent or a Broker .
- ◆ Even the special rates that have been established by the Fire Technical Committee are not adhered to.
- ◆ Tariff rates in respect of fire additional perils too are not followed.

- ◆ The Fire Tariff also indicates that certain additional perils could be granted with a certain minimum deductible. Some insurers do not impose an excess on some of the additional perils.
- ◆ Some insurers do not apply the outstation surcharge of 20% on outstation risks-
- ◆ Stock Declaration Policies are issued on values below the recommended/ agreed minimum sum insured.
- ◆ Without charging the correct rates for additional perils, some insurers package the rate in order to be competitive in the market.
- ◆ The minimum rate 0.0125% or V4 of the special rate whichever is higher, which is considered the Riot & Strike component under the specially rated policies as directed by the SRCC & TC Fund, is not followed.
- ◆ There is no justification to charge such a lower rate, which is lower than the rate given in the Riot & Strike rating schedule.
- ◆ The insurers have been instructed by the Fund to charge the correct SRCC premium and remit same to the Government Fund. Some insurers do not charge the correct Tariff SRCC premium.

Advantages of maintaining a Fire Tariff

- ◆ The Fire Tariff is a comprehensive document which includes, in addition to rates, special rating rules, short period rates, standard form of policy , special conditions, conditions relating to additional perils and extensions, warranties, FEA rules, rules relating to breaches, construction and classifications.
- ◆ The Tariff gives the minimum rates that should be applied and the underwriter has the discretion of charging a higher rate if physical characteristics of the risk proposed for insurance dictates.
- ◆ All fire underwriters have been trained to underwrite with a Tariff, which gave them the best exposure to proper underwriting.
- ◆ In the absence of reliable market statistics to underwrite, it is impossible to underwrite without a Fire Tariff-
- ◆ The Tariff could also be used as a Training Manual.

- ◆ The Reinsurance contracts/Treaties take into consideration that there is a Fire Tariff applicable to the market.
- ◆ Most of the underdeveloped and developing countries use a Fire Tariff, as the insurance market is not developed in such countries.
- ◆ As the Fire Insurance is an important class in general insurance business, maintaining a Tariff would ensure solvency , no room for unethical practices of discounting, healthy relationship with the Reinsurers, safeguarding the interest of the policyholder and ensuring long term survival of the insurance companies.
- ◆ With uniformed wordings, scope of cover and rating, the market as a whole can maintain useful statistics (including claim statistics) and changes either in the scope or rate could be effectively and scientifically done. The regulators and the insurers should agree on the type of statistics to be maintained.
- ◆ With proper supervision and monitoring, retaining the Tariff would be the ideal situation to Sri Lanka's insurance market.
- ◆ Due to the current competitive nature of the industry, the fire portfolio has a cushioning effect in the clients portfolio due to the unpredictable nature of other classes of businesses namely, Medical, Motor and All Risks-
- ◆ With the current hardening of the reinsurance market, withdrawing the Tariff would work against the stability of the market because of wrong rating and terms. The Reinsurers also would not favour Sri Lanka and would ultimately lead to further hardening-
- ◆ Some countries in the Asia i.e. India, Malaysia and Hongkong have continued to maintain a Tariff Insurance Market-
- ◆ Insolvency of a insurer is rare in a Tariff environment.

Advantages of De-tariffing

- ◆ Competition will drive the rates down, which will ultimately benefit the client.
- ◆ The present Tariff is partly out dated and is not compatible with current businesses and processes.
- ◆ Warranties, which are inappropriate can be withdrawn.

- ◆ By withdrawing the Tariff, the market could develop new policies with wider coverage.
- ◆ The fire underwriting would come into a sharp focus rather than "referring the book".
- ◆ As there are more violations of the Fire Tariff than complying with it, the insurers would start maintaining statistics and the rating structure would be much more stable. However, each insurer would have differential rating system rather than a uniformed rate for any particular class of risk.

In conclusion, we are of the opinion that as the fire underwriters have not developed and due to hardening of the reinsurance market, this is not the proper time to withdraw the Tariff. If a decision is made to maintain the Fire Tariff, a set of experts should be assigned to re-look at the entire Tariff to bring it up to the current days exposures and risk factors. However, this decision will have to be backed by proper statistics maintained in a uniformed manner across the market for at least three years.

With proper monitoring tools and supervision of the fire portfolio by the regulators to safeguard the interest of the policyholders and long-term viability of the insurance companies, the Fire tariff could be withdrawn.

Be it under tariff or otherwise, the Insurance Industry, through the IBSL and *lor* IASL, has to monitor and closely supervise the insurers so that no insurer would be insolvent.

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