

# Capital and finance: Thai my kangaroo down sport

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The flooding in Thailand is the latest major insurance event from an unexpected source. But will rates harden significantly?

FEBRUARY 3, 2012

Thai my kangaroo down sport is a hit single by Rolf Harris. It reached number 1 in Australia in 1960 and got into the top 10 in the UK. The four unknown Australian musicians who recorded the song with Harris were offered 10% of the royalties, but opted for £28 pounds between them as they thought that the song would flop.

Just as Harris' song has led to significantly more royalty payments than anyone anticipated, the recent floods in Thailand have led to significantly more insurance and reinsurance claims than anyone might have predicted. This is yet another major insurance market loss from an unexpected source.

## More stray cats than a cattery

It is now getting on for 24 months where the insurance and reinsurance industry has been taking losses from natural catastrophes that fall well outside the zones where losses are expected – eg Florida wind, California earthquake, European windstorm etc...

The last two years have seen earthquakes in Chile and New Zealand, floods in Australia and now floods in Thailand.

## The river to Bangkok

The 2011 monsoon season in Thailand started with significant rainfall from May 2011. Late July to early August saw the arrival of Tropical Storm Nock-ten making landfall in the north of the country. The impact of this storm was small on Thailand compared with its effect on The Philippines and China, but it was the trigger that caused the first flash floods in northern Thailand.

The floods in the north soon spread down through the north east and central plains of the country along the Yom and Nan Rivers. The Nan River then flows into the Chao Phraya River which passes through Bangkok.

The £28 pounds that the session musicians charged Rolf Harris for recording Tie My Kangaroo Down Sport, compared to the value of the 10% of the royalties that they were offered – helps put into perspective the pricing of some add-on-to-cat business interruption insurance versus what a full pricing review might give. The Thai floods have brought the losses home to roost.

## Waking up to the insurance loss

The insured loss estimates for the Thai floods are a little all over the map, but the range seems to be between \$15bn and \$30bn. Some insurers in Japan are putting up some big numbers with NKSJ recently trebling their loss estimate to ¥100bn (\$1.29bn).

Of most interest is the extent of the losses through insurers that are not usually associated with natural catastrophe losses. Whilst Everest is a writer of property treaty reinsurance, it is not in the same league as Ascot, Montpellier, Kiln and the like for catastrophe risk. The firm is considered far more of a specialty lines writer. However the company has just posted a loss estimate for Thailand of \$145m, up from an estimate of \$100m to \$125m.

## Eating someone else's cooking

So the question is: what has caused all these large insured losses from Thailand? Property insurance does not look like the likely culprit. The tsunami on Boxing Day 2004 did enormous property damage, but led to very small insurance claims – so it would seem unlikely that this is the cause. Moreover, the insurers reporting the losses fall outside the mainstream property catastrophe insurers. In addition, the property catastrophe insurers that are in business today are those that have become good at what the industry calls managing their aggregates – which simply means not being too exposed to any single event, no matter how unlikely it might seem.

Understanding the risk dynamics of a global supply chain is possibly not within the skill set of a traditional property underwriter.

There is very interesting insurance business within the business interruption market, but the risks do not sit well as an add-on to catastrophe cover.

The Thai losses seem to be developing through the market from less expected sources. As a industry pal and BRAVE Partners were joking in a New York bar the other day – the losses are probably accumulating to underwriters who can't point to Thailand on a map and don't like the food – and if the food is too spicy for you, you should not take the risk in that country.

## Ford has more to do with insurance than your auto policy

BRAVE Partner Christopher Cloke-Browne is in New York right now (hence the reference to auto policy – not motor policy) and watching CNBC avidly in the mornings. Recently, Ford reported its largest earnings in any quarter since 1947. The USA proved to be the driver of revenue in these results. Sales and profits were weak in Europe – due to the crisis there. However, Asia – the current driving force of any growth in the world – was also weak. The reason for the weakness was due to the manufacturing plants and those of their suppliers being shut due to the floods in Thailand.

The insurance losses from the Thai floods are all about supply chain insurance and not direct physical damage to property.

## BI BI (Miss American Pie)

Just as the meaning of lyrics to Don McLean's epic song, Bye Bye Miss American Pie are unclear, a lot of business interruption, or supply chain, insurance is written without a detailed understanding of the inter-relationships and the risks. Most tellingly, Bye Bye Miss American Pie is the only place most Brits had heard of a levee before Hurricane Katrina hit New Orleans.

The above aside, the current market losses once again highlight a major issue in the insurance markets on which BRAVE partners has commented frequently – Business Interruption insurance.

In a highly interconnected and interdependent world, small disruptions to localized supply chains can have a major impact globally. Ford was perhaps one of the least affected companies in the Thai floods. The most impacted industry was PC manufacturing and its supplies. Most of the world's hard disk drives are manufactured in Thailand. The floods halted a significant amount of production and drove prices higher – slowing down PC sales. This impacted everyone from Acer to Intel and Nvidia to Advanced Micro Devices.

## Business interruption: be sure that you only bite off what you can chew

BRAVE Partners believes that there is significant opportunity in the business interruption market. Business interruption cover cannot be written simply as an addendum to physical damage, or natural catastrophe cover. While businesses are often interrupted by a catastrophe event, so that the event probabilities are similar, the loss dynamic is completely different. In an interconnected, globalised world, disruptions in one place soon ripple round the world. Loose underwriting costs livelihoods in this market.

BRAVE Partners has worked on a number of convergence (insurance and capital markets) products for business interruption and believes that this is often the path forward. These losses are a combination of an insurance event creating a financial loss. The risks are best analysed and managed by incorporating both sets of expertise.

## BRAVE Partners services

BRAVE Partners can advise insurers and reinsurers on the capital markets' appetite for insurance and other risks. The firm can arrange and place such transactions, as well as provide mentoring and advice on establishing the infrastructure and a presence in the market. Such advice can include the key terms of a cat bond and the major negotiating points to consider for each.

- Business interruption is a fascinating and potentially fertile area for insurance.
- A lot of business interruption risk is driven by natural catastrophes, but the loss dynamics are driven by the intricate supply chains of the businesses.
- The latter risks are often best assessed by financial markets that are familiar with analysing business models and the risks inherent in them.
- BRAVE Partners LLP has built up considerable expertise in developing hybrid insurance – capital markets solutions for business interruption risks.

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