

### PROTECTING YOUR SUPPLY CHAIN WITH TRADE DISRUPTION INSURANCE

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In his bestselling book, "The World is Flat: A Brief History of the Twenty-First Century," New York Times columnist Tom Friedman posits that an enormous shift has taken place in the international marketplace. To remain competitive, businesses must look past historical boundaries and geographic limitations and embrace global supply solutions. So it's no surprise that world trade is increasing. In the 2007 edition of "International Trade Statistics," the World Trade Organization estimated that global merchandise trade grew by 8 percent in 2006 — more than double the estimated 3.5 percent increase in world gross domestic product.

While ripe with opportunities, the shifting global marketplace has given rise to new and potentially devastating risks associated with supply-chain disruption. Importers and exporters must be aware of these exposures to loss and take measures to mitigate their impact. Trade disruption insurance should be a vital component of their risk-management strategy. This coverage was specifically designed to protect businesses against disruptions to the supply chain, regardless of whether there is any physical loss to their assets. Understanding the history of this insurance and how it functions to protect companies competing in today's global economy is important for the management of any organization involved in international commerce.

Initially written for the London market 20 years ago, trade disruption insurance was developed to protect organizations from financial setbacks triggered by covered causes of loss that occur as part of the supply chain. Among the causes of loss that TDI addresses are political risks such as embargoes; confiscation; terrorism; strikes; political violence or war; blockage of waterways or closing of ports; natural perils, including hurricanes and windstorms; as well as the insolvency of a dedicated supplier or customer.

"There are specialist underwriters, particularly in the London market, who are prepared to look at named event coverage for trade disruption insurance," says Rupert Sawyer, associate director of special risk at Miller Insurance. "Shortage in itself is not insurable but there are various supply-chain coverages available to address the proportionately increased interruption risks that are experienced in the current tight raw material market."

Sawyer points out that there doesn't have to be a physical loss or damage to the raw materials in the supply chain to trigger a loss under specific supply-chain insurances. "Alternative sourcing following a named event — such as vessel breakdown, waterway blockage, political intervention and supplier insolvency — can be very expensive. Therefore, it is possible to cover the extra costs and/or loss of revenue with trade disruption insurance."

A TDI policy provides for loss of earnings and extra expenses arising from supply-chain disruptions such as loss of revenue, profit and tax credits, debt repayment, costs to implement a contingency plan, and certain out-of-pocket expenses.

TDI coverage can be customized to meet the particular needs of the insured company. One compelling aspect of the coverage is that there need not be direct damage to a company's product/cargo to trigger a claim as is the case with business interruption coverage. Rather, trade disruption insurance is triggered by indirect events arising from delays in transit because of a host of conventional perils. In this way, TDI is somewhat of a hybrid insurance product in that it is designed to cover property and business interruption losses arising from both physical and political risks. The following example provides further clarification.

Assume a business had a key product manufactured in China. An earthquake in a remote province causes a landslide and blocks the only road out of the area. Consequently, there is a delay in the delivery of that product to a retailer, which causes the retailer to cancel the manufacturer's order. This action would trigger TDI coverage. Furthermore, any additional expenses incurred to mitigate the loss, such as flying the product out of the area in an effort to meet a preset deadline, would also be insured. In contrast, under a standard domestic business interruption policy, there would be no coverage for such an event. First, the loss occurred outside the territorial limitation of the policy — typically the U.S., its territories and possessions, including Puerto Rico, as well as Canada. Secondly, business interruption coverage requires direct damage as a trigger for the policy to respond. Thus, the closing of a road or port or the resultant damage of a flood preventing transit within a foreign country is excluded because the insured's property has not sustained a direct loss arising from a covered peril under the business interruption policy.

Companies have often underestimated the complexity of the process of sourcing, manufacturing and transporting goods. Many have not paid sufficient attention to the consequences that could stem from a disruption in their supply chain. Yet the severity and frequency of such disruptions are common and bound to increase as businesses seek to become more efficient and profitable by taking advantage of low-cost labor in poor regions plagued by unstable governments.

In these environments, a manufacturer's property could be confiscated by local, regional or national authorities at any time. In addition, roads, bridges and ports may be poorly constructed or located in areas susceptible to natural disasters. Trade disruption insurance is a risk-management tool designed to protect businesses from these and other types of supply chain exposures.

In short, TDI delivers a level of confidence to those operating along the global supply chain that other insurance policies do not. It secures supply-chain dependent income and mitigates unexpected expenses required to correct the problems stemming from unplanned perils to the supply chain.

International traders also benefit from the role trade disruption insurance plays in assuring lenders, strategic partners and other investors that the revenue stream is protected. Similarly, TDI helps importers and exporters gain and retain customers' confidence in preserving order and delivery commitments.

To remain competitive, companies have had to rethink how they do business and consequently are seeking partners in other parts of the world. Trade disruption insurance can provide critical protection.

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