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Eye on Economics: Stormy Weather

Why trade disruption insurance can be an essential risk management tool

The U.S. fresh fruit and vegetable sector is a thriving component of the nation's economy, with U.S. agricultural exports topping $96.4 billion in 2009 and the U.S. Department of Agriculture forecasting increases to $107.5 billion for 2010 and $113.0 billion for 2011. While an ever increasing trade network is a sound operational goal, worldwide commerce is replete with complex risk factors beyond the usual and customary transacting of business. Planning for such contingencies is paramount to success, though many of these occurrences are entirely outside our control.

Natural disasters like hurricanes and earthquakes can have a profound impact on international trade, interrupting delivery by road, rail, air, or sea transport. Take, for example, the eruption of Iceland's Eyjafjallajökull volcano, which caused flight suspensions over European airspace in April 2010. European importers and exporters sustained considerable losses, including many in the fresh fruit and vegetable industry. Even large global logistics companies such as Fedex and DHL felt the impact. Trade disruption insurance (TDI) is intended to protect companies against such developments and their potentially devastating effects. It is an essential risk management tool that all businesses within the perishables supply chain should understand.

Key Elements

Trade disruption insurance (TDI) manages risks associated with worldwide trade, should there be unexpected interruptions:

- designed to protect companies, TDI can serve as an essential risk management tool
- important distinctions separate business interruption (BI) and TDI coverage
- TDI can give investors, banks, and supply partners confidence a firm has planned for unforeseen events.

To learn more about each key element, look for the symbols throughout the article.

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Stormy Weather

A TDI Primer

Trade disruption insurance was developed to protect businesses against disruptions to the supply chain and related financial setbacks. It was initially written for the London market in the 1990s and designed to offer protection from losses related to labor strikes, political violence, wars, terrorism, embargoes, and confiscation of goods, as well as unexpected occurrences such as disasters, port closings, waterway blockages, vessel breakdowns, and natural disasters (earthquakes, floods, hurricanes, volcanoes, windstorms, etc.).

These threats, while indirect, can cause significant interruptions in trading activities. Having a TDI policy offers protection against loss of revenue, including expenses related to the business insolvency of a key supplier, costs of alternative sourcing, or other extra expenses due to the disruption.

TDI vs. Business Interruption (BI) Coverage

An important distinction between traditional business interruption (BI) coverage and TDI is that with BI, a claim is triggered by direct damage to a company's product or cargo, whereas with TDI, indirect effects and damage are covered.

Consider the example of an American wholesaler importing vegetables from Latin America. The region suffers a major earthquake causing a landslide that blocks the only road in and out of the area. A shipment to a major customer—a large chain of nationwide supermarkets—will be delayed. The retailer reacts by cancelling the order. With TDI coverage, the wholesaler is protected against the financial losses associated with the order cancellation, as well as costs to cover an alternative means of transportation, in this instance, air to get product to its destination.

If this wholesaler had a BI policy, financial losses and costs would not have been covered since the loss was sustained outside of the policy's coverage territory, and the wholesaler did not sustain direct damage.

TDI Coverage = Peace of Mind

In the event of an unforeseen complication (political coup, military blockade, embargo, riot, strike) or catastrophic event (fire, hurricane, flood, tornado, volcano) that interrupts business flow and supply chain functions, trade disruption insurance (TDI) can provide coverage for the following:

- Loss of revenue or profit
- Loss of tax credits
- Extra costs to fund alternative plans
- Debt repayment
- Out-of-pocket expenses related to supply chain disruption.

Resting Assured

In addition to its role in risk management, TDI serves businesses in another important way. Investors or financial institutions with a vested interest in a company's supply chain activities gain a level of comfort and confidence knowing there are protections in place against unforeseen contingencies.

Financial backers are more likely to fund an enterprise with the foresight to plan for potential trading disruptions so it will be able to continue its business relationships. Similarly, customers at the receiving end of product shipments will regard TDI as a measure of assurance that a supplier is conscientious and proactive in meeting its contractual obligations.

Following the September 11, 2001 terrorist attacks, the term "bioterrorism" took on a greater meaning and posed an enhanced threat to the U.S. food supply. New legislative measures were implemented to increase security, including the 2002 Bioterrorism Act, so the Food and Drug Administration could evaluate risks posed by companies shipping foods into the American market. In addition, the U.S. Customs and Border Protection launched the Container Security Initiative in 2002 to combat potential terrorist acts targeting containers within the international maritime container system.

Concurrently, there was expansion of the European Union and U.S. customs cooperation agreement whereby all participating nations agreed to uphold minimum standards relating to transport security. Other initiatives designed to protect the food supply included mandatory country of origin labeling requirements.

Beyond regulatory developments affecting food trade activities, there has been increased market integration, particularly as it relates to North and South America. This, in turn, introduced additional risks. When food products from participating North American Free Trade Agreement (NAFTA) nations are compromised, there is a significant disruption across the Americas' supply chain with even greater potential for adverse consequences and losses.

In the years since 9/11, there has been a more pronounced focus on improving food security and mitigating hazards. While all of these measures are vital in addressing threats of bioterrorism, agro-terrorism, food system disasters, or natural disasters affecting food and water supplies, perils exist and trade can be disrupted at any time due to a host of reasons. Even the best written and intended legislation cannot prevent or protect against an unexpected contingency—trade disruption insurance can.

High Stakes

Despite the prominence of terrorism worldwide, international trade is not waning. It is no longer the domain of just the Fortune 500; small and middle market companies are also actively trading. While ongoing economic crises have had a calamitous effect on global trade, there are considerably more players in the game today than in years past. Each company has a financial interest to protect, maintain, and sustain its supply chain and long-term viability.

Without the right protections in place, disruptions can set a company on a downward spiral. Trade disruption coverage can prevent these vulnerabilities and the resulting losses or devastating consequences, regardless of whether they concern financial aspects, trading partners or relationships, or market confidence issues.

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