FINANCIAL MANAGEMENT OF LARGE SCALE CATASTROPHES IN OECD COUNTRIES

FIRST CONFERENCE
Organized under the auspices of the OECD International Network for the Financial Management of Large-Scale Catastrophes

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FINANCIAL MANAGEMENT OF LARGE SCALE CATASTROPHES

**KEY ISSUES AND QUESTIONS:**

- Are governments adopting efficient strategies to manage the increasing financial burden of catastrophes?
- Are financial sector institutions prepared to withstand disasters both from a financial and an operational viewpoint?
- What are the key features of existing institutional solutions in OECD countries?
INSTITUTIONAL SOLUTIONS

- **Ex post v. ex ante solutions**
  - Key limitations of *ex post* approach to disasters
  - Samaritan’s Dilemma ➔ negative impact on prevention
  - The issue of “mega risks”

- **Public private partnerships (PPP)** ➔ *trend*
  - Role of the private insurance sector
  - Role of capital markets (securitization of cat risks)
  - Role of public authority
INSTITUTIONAL SOLUTIONS

• **Indirect intervention of public authority**
  – Insurance regulation (pricing, reserves, terms and conditions)
  – Design and implementation of the legal framework
  – Prevention / mitigation measures (land use, building codes, disaster response strategies, emergency planning)

• **Direct financial commitment of the public authority**
  – Primary insurer
  – Reinsurer of last resort
  – Lender of last resort
  – Guarantor
INSTITUTIONAL SOLUTIONS

● Types of RISKS covered by the scheme
  – All catastrophic risks
  – Only selected risks (cat nat, earthquake, flood, terrorism, industrial accidents, etc.)
  – Definition of the risks covered and formal requirements

● Types of LOSSES covered by the scheme
  – Property damage
  – Business interruption
  – Liability
  – Life, Accident and Health
INSTITUTIONAL SOLUTIONS

- Mandatory purchase of cat insurance coverage
  - Enforcement issues
- Mandatory offer of cat insurance coverage
  - To make coverage available
- Mandatory extension of coverage
  - On policies marketed on a voluntary basis
- Mandatory participation of insurance companies in the scheme
  - Pooling / reinsurance
INSTITUTIONAL SOLUTIONS

- Risk-based pricing v. flat pricing
  - Risk indicator ➔ proper incentive mechanism
  - Equitable issues (access to coverage, solidarity)

- Competition law issues
  - Insurance pools
  - Product-tying mechanisms
  - Pricing mechanisms
  - Information sharing, etc.
INSTITUTIONAL SOLUTIONS

- No standard solution for all countries
  - Different exposure to disaster risks
  - Different social and political instances
  - Different legal and cultural backgrounds
  - Path dependence (*high cost of exiting sub-optimal routines*)
INSTITUTIONAL SOLUTIONS

- KEY ➔ clear and transparent allocation of risks and responsibilities among public authorities, firms and individuals (a crucial aspect of risk awareness)

- KEY ➔ Linking policy tools (e.g. the technical features of a scheme) with the underlying policy objectives pursued by the government (e.g. providing adequate financial protection to all individuals and entities, or simply making coverage available)
SHARED GOALS

- INCREASE disaster awareness and preparedness
- LINK coverage with prevention/mitigation
- REDUCE the total cost of disasters:
  - Cost of disaster events (loss)
    - Insured / uninsured losses
    - Direct / indirect losses
  - Cost of preventive / remediation measures
    - Cost of reducing exposure and vulnerability
    - Amount of liquid assets set aside to cover potential losses
  - Transaction costs
    - Cost of implementing and administering the scheme
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