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**PUBLIC-PRIVATE PARTNERSHIPS TO COVER
TERRORISM RISKS IN OECD COUNTRIES**

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Powerpoint presentation

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***Public-Private Partnerships to Cover
Terrorism Risks in OECD Countries***

Terrorism Insurance in OECD Member Countries

Eight OECD Members have Public-Private Partnerships
(of various kinds) for Terrorism Insurance:

Australia

Austria

France

Germany

Netherlands

Spain

United Kingdom

United States

No Two Systems Identical

All have in common some partnership or cooperative approach between the public sector (or government) and the private sector, to provide insurance or reinsurance for terrorist risks for which cover might not otherwise be available/affordable.

But there are variations in:

- History and Purpose

- Definition of "Terrorist Act"

- Operation, Extent, Lines covered, Perils covered

- Exclusions

- State Involvement & Layers of Cover

- Non-State reinsurance & Retrocession

- Extent of compulsion and Choice

- Period of Operation

Variations: History and Purpose

- Most OECD schemes (Australia, Austria, Germany, Netherlands, United States) came into being after 11 September 2001
- But three schemes are pre-2001 - France (1983), Spain (1941), UK (1993)
- The three pre-2001 schemes reflect different historical circumstances (e.g. Spain)
- The post 2001 schemes also reflect some different pressures (e.g. Australia)

Variations: Definition of Terrorist Act

- E.g. The UK definition: “Acts of persons acting on behalf of, or in connection with, any organisation [i.e. any association or combination of persons] which carries out activities directed towards the overthrowing or influencing, by force or violence, of [the UK] government...or any other government de jure or de facto”
- In some OECD members, a competent authority must declare an act to be a terrorist act

Variations: Operation, Extent, Lines covered, Perils covered, Exclusions

Examples:

- Spain: Consorcio covers all extreme risks
- France: GAREAT's wide coverage, with mandatory provisions
- US: TRIA as program offering state support for free risk-based approach
- All schemes vary in scope of exclusions, from least to most

Variations: State Involvement & Layers of Cover, Non-State reinsurance & Retrocession

Examples

- Austria: no state involvement (other than recognition of the scheme)
- Spain: Consorcio is a state company, attached to the Finance Ministry, but managed as a private company
- Many schemes have varying patterns of a primary layer of cover (provided by primary insurers and/or reinsurers) one or more further layers (provided by international reinsurers) and a final layer (state funding/guarantee)

Extent of Compulsion and Choice, Period of Operation

Many variations

- Major variations in compulsion and choice
- Spectrum from non-compulsion for insurers to participate in scheme (e.g. Germany), through conditions for participation (e.g. UK) to compulsory participation (e.g. US)
- Only US has time limit

Rationale for Partnerships (1)

Technical Insurability a Key Issue.

Technical Insurability partly depends on
Assessability of Risk (in terms of quantifiable
probability, frequency and severity of losses).

BUT Assessability is not equal or identical in
importance for the public and private sectors:

Rationale for Partnerships (2)

For *private sector* insurers, **prospective assessability** is a prerequisite: private sector insurers cannot cover risks where the probability, frequency and severity of losses cannot be satisfactorily assessed in advance, and the correct premium charged.

Rationale for Partnerships (3)

For *government* insurers (as financiers/insurers of last resort) **assessability may be retrospective**: if a government entity is providing the ultimate layer of cover in the form of, effectively, a loan from potentially unlimited contingent capital, it has the option of charging an initial premium which may or may not be finely calculated, relying on its ability to **recoup the balance** of retrospectively-assessed losses over an extended repayment period.

Motivation for Partnerships

Governments are influenced by questions of social and economic welfare (“externalities”) in devising public/private partnerships for terrorism insurance cover.

Insurance, like any other good or service, is subject to costs of production (from which the supply curve is derived); and its price can be expected to reflect the costs to insurers of supplying the service. But in certain cases a good or service imposes external costs or provides external benefits (“externalities”) to society that are not captured in the supply curve.

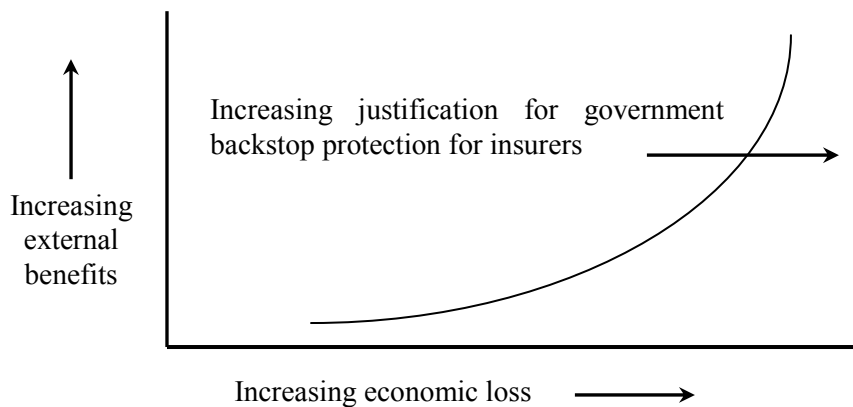
Positive Externalities of Terrorism Insurance

Pre-Loss Benefits: businesses with adequate terrorism insurance may be less prone to forego otherwise beneficial activities (e.g. construction projects) than businesses lacking such insurance;

Post-Loss Benefits: insured businesses suffering losses from terrorism events may be less likely to be subject to financial distress or failure, so preserving jobs and minimising destabilising economic effects.

Social/Political Pressures to capture Positive Externalities

Positive Externalities and Magnitude of Possible Losses



Market Failure

In certain circumstances (e.g. when certain risks become more expensive to insure, or uninsurable, through conventionally available or affordable insurance cover) the insurance market, left to itself, will not deliver all these positive externalities.

There is then “market failure” (total/partial) – the core economic justification for public sector involvement in the insurance market.

Good Practice in Public-Private Partnerships (1)

Timescale, flexibility and balance:

Timescale: any approach should take account of the long term, rather than a “quick fix”;

Flexibility: any approach will probably need to allow for flexibility and modification to match actual levels of threat and market conditions, present and future;

Balance: a balanced and proportionate approach needs to be taken, assigning an appropriate role to the insurance industry, financial markets and (where relevant) the government as insurer/financier of last resort, and taking account of the (probably changing) balance between these;

Good Practice in Public-Private Partnerships (2)

Questions: Crowding Out and Externalities:

“Crowding Out”: how important is it to avoid institutionalising a role for the public sector that “crowds out” competition from the private sector and discourages adaptation in insurance markets and/or limits the attractiveness of insurance markets for new investment?

Externalities: how important is it to look further than the immediate cost and availability of insurance, so as to take account of the wider economic costs of insufficient cover, and resultant hazards such as business interruption, economic instability and discouragement of investment and wealth-creation?

Good Practice in Public-Private Partnerships (3)

Four further cross-cutting questions:

How do different schemes approach market failure, and how do they structure the role (if any) of the state?

Are scheme dynamics compatible with theoretically desirable good practice?

How far can terrorism be regarded as a separate peril, and is it viable to offer “stand-alone” insurance cover for it?

The significance to be accorded to elements of compulsion in any system?

Approaches to Market Failure

Logical to expect public/private partnerships to be prompted by market failure.

But views of market failure may vary between countries:

- Is public sector involvement justified simply if there is evidence of *insurance* market failure (i.e. evidence that the insurance market, left to itself, would fail to provide cover for certain risks)?

OR

- Must market failure have *wider economic* consequences going beyond mere transfer of risk (e.g. threats by mobile businesses to migrate to lower-risk countries)?

Variables and Predisposing Factors

Politics (country significance and terrorist targeting);

Geography (conurbations/vulnerability);

Economic Culture (traditional role of public and private sectors);

De Novo vs. Existing Institutions

Internal Partnership Dynamics (1)

Public/private partnerships without truly “willing” participants:

- Insurers wary of unpredictable risks;
- Governments resistant to using government funds;
- Uncertainty about duration/exit/“sunset”;
- Consumers unconvinced of need to insure non-target assets;
- Distributors uncertain about role.

Internal Partnership Dynamics (2)

Need to steer approach catering for:

- Aggregating risks in adequate and diversified risk portfolio;
- Avoiding fall-off in demand/policyholder defections;
- Working with market distributors;
- Achieving continuing price stability/price-smoothing.
- Maintaining confidence while limiting public sector liability (if limit operates).

Three Further Questions

1. “Sunset” - What are the implications of a terminal date for a public/private partnership in terrorism insurance?
2. Can public/private partnerships cater for terrorism as a stand-alone cover?
3. Compulsion?

Some Conclusions

Current Practice:

- Timescale: only one scheme has “sunset”;
- Flexibility: all OECD schemes are flexible;
- Balance: some schemes under strain;
- “Crowding Out”: too soon to tell;
- “Externalities”: significant driver in all schemes.

Ongoing Predicament

Can public/private partnership dynamics (driven by the need for diversity and volume in a scheme's risk portfolio, distribution requirements, and pressure for continuing price stability) be kept consistent with policy objectives (timescale, flexibility, balance, avoidance of "crowding out", reversibility)?

OR

Are they doomed to conflict, given that any partnership's internal dynamics require building strong and durable relationships and marketplace practices, so entrenching a permanent and non-reversible role?

The Future

Terrorist threats continue to affect national economies in different countries, both OECD and non-OECD

Role of insurance in countering terrorism is a matter of continuing debate:

- Ongoing reforms of existing schemes
- Debate on new schemes (e.g. Italy, Japan)
- Debate on continuing existing schemes (e.g. TRIA)