

Inaugural meeting of the
HIGH LEVEL ADVISORY BOARD
OECD INTERNATIONAL NETWORK
ON FINANCIAL MANAGEMENT OF LARGE-SCALE
CATASTROPHES

8 September 2006 (Room D)

REMARKS BY THE OECD SECRETARY-GENERAL,
MR ANGEL GURRÍA

The issues at stake

I am very pleased to welcome you to the OECD. I wish to thank you for accepting my invitation to join the High Level Advisory Board of the International Network on Financial Management of Large-Scale Catastrophes.

In recent years there has been a dramatic rise in the frequency and severity of catastrophes. This meeting falls, for instance, between the first anniversary of Hurricane Katrina and the fifth anniversary of the World Trade Centre terrorist attacks. There is, of course, the tragic human dimension. But, in addition, the economic and financial impact of disasters has also been increasing. And we see higher degrees of vulnerability and exposure, leading to bigger losses.

While technological innovation, globalisation, the growing interdependence of critical networks, and the high concentration of populations and assets all have

their well-recognised positive effects, they also dramatically increase vulnerabilities to natural, technological and terrorism hazards.

Moreover, the 21st century will have to cope with the emergence of new threats, such as epidemics of previously unknown diseases, technical failures causing major disruption to critical infrastructures, or new forms of terrorism, including chemical, nuclear, biological, or radiation and cyber attacks. Possible changes in climatic or weather trends and geopolitical issues are other sources of concern.

Risks of catastrophes, therefore, pose financial challenges of unprecedented magnitude. Policymakers and a wide range of private sector actors, including insurance and reinsurance companies and financial sector institutions have a role to play.

Our societies must be prepared. Among other impacts, the terrorist attacks of 11 September 2001 and Hurricane Katrina in 2005 were the most costly disasters ever for the insurance industry – their direct cost for insurance are estimated to be respectively around 35 and 50 USD billion. But insurance losses are only the tip of the iceberg. Total economic damages inflicted by Katrina, for instance, are estimated in the range of USD 150 to 200 billion.

Insurers and reinsurers assumed their part of the losses. They showed how a well capitalised insurance sector is crucial both to compensate losses *after* a major disaster and more generally to help economies run smoothly.

However, these events fundamentally changed the perspective on expected losses from catastrophes. After the attacks of September 11, fearing further, possibly imminent large-scale terrorist actions, most insurers and reinsurers

drastically reduced their exposure to catastrophic risk, revised the terms of their policies, and increased their premiums.

The series of recent large-scale catastrophes casts doubt on the ability of the private insurance and reinsurance markets alone to absorb losses resulting from large-scale disasters in the future. And “mega-risks” are beyond the capacity of the insurance industry or even governments to insure and clearly call for private-public partnership and international co-operation.

Preparing to deal effectively with the hugely complex threats of the 21st century and their financial consequences is a major challenge for decision makers in government and the private sector alike, and one that needs to be addressed as a matter of urgency.

The time has come for governments to act, not merely to react. The costs associated with natural and man-made disasters must be properly assessed and financially managed *ex ante*, before the occurrence of a major loss, and this requires a proactive role of governments in direct and continuous co-operation with the private sector.

The OECD role and initiatives

The financial management of large scale catastrophes has become a central topic in the political agenda of governments in OECD and non-member economies. And OECD governments have asked us to undertake substantial work in the field during the past few years.

In 2003 the OECD International Futures Programme undertook a major work to define the Emerging Risks in the 21st Century. The OECD took the lead in the area of terrorism risk insurance with the publication in 2005 of a major report on

Terrorism Risk Insurance in OECD Countries. We have also invested in gaining a better understanding of Environmental Risks and Insurance. A major conference in 2004 on Catastrophic Risks and Insurance was an opportunity to reach beyond the OECD membership on these issues.

But there is a lot more to do. The present initiative of the OECD Committee on Financial Markets and the Insurance and private pensions Committee to establish an **International Network on Financial Management of Large-Scale Catastrophes** is indeed timely. The Network will comprise national representatives ('Network General Members') of OECD countries. The Network will also be open to non-OECD countries, with a view to sharing experiences and information with them and to achieving global reach.

The **main objectives** of the **Network** are to:

Identify emerging financial threats and vulnerabilities;

Exchange information and experience on the financial mitigation and compensation of disasters;

Review the related tools and schemes implemented in OECD and non-OECD countries;

Develop policy analysis aimed at improving financial catastrophe mitigation and compensation strategies; and

Address systemic financial risks that may arise from large scale disasters, including mega-terrorism.

The Network will also reflect on the financial risks associated with the simultaneous occurrence of different types of large scale events.

[What we expect from the Board Members]

Against this backdrop, we expect Board Members to perform a very important task. You have been invited on the basis of your outstanding skills and professional achievements in the field of financial management of large scale risks.

This Board is expected to provide intellectual leadership to the activity of the Network, to give advice on the content of the work of the Network, and on priorities for research, analysis and public initiatives. You are the ones who will help us identify the major policy issues related to the financial management of large-scale catastrophes and making relevant recommendations. The OECD and more particularly, the two Committees involved, the IPPC and the CMF will be listening intently.

In this context, I would like to draw your attention to **two main sets of issues**:

First, governments of OECD and non-OECD countries are interested in how best to financially manage catastrophic risks from a public policy perspective, **with a view to reducing the total cost of disasters**. Key questions include: what should be the respective roles of financial sector participants and public sector authorities in catastrophic risk management? How do incentives change with the introduction of different forms of public sector participation in the financial management of catastrophic risks? Do different types of catastrophic risks require different approaches and different solutions? What is/could be the role of international co-operation and international agreements in this field, especially for mega-risks?

Second, governments of OECD and non-OECD countries wish to assess the level of **preparedness of financial sector institutions** to withstand disaster events both from a financial and from an operational viewpoint. If governments rely on the financial sector to manage, at least in part, large scale catastrophes, they must be sure that financial sector participants are able to do this in case one or more catastrophes occur.

Catastrophic risks may also have an impact on financial systemic stability. Major financial institutions have a critical role in exiting a crisis. Their role is even more important when as a result of a catastrophe the environment becomes chaotic: astronomical direct costs, cascading damages that are impossible to assess, beneficiaries that can't be reached, public institutions and essential operators that are profoundly destabilised. How is the financial sector preparing to manage extreme crises?

Under the leadership of this **Board** and coordinating its efforts with other international bodies (including the World Bank, the IMF, the IAIS and the Joint Forum), the Network and this Board are set to become a strategic forum that will advise policymakers on financial management of large scale catastrophes.

Let me tell you once again how impressed I am by the richness of expertise and experience that you bring to this meeting. I am sure it will be a very stimulating and productive day.