



## **High-Level Roundtable on the Financial Management of Earthquakes**

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### **ASSESSMENT OF 30 YEARS OF EXPERIENCE WITH THE FRENCH NATURAL CATASTROPHE INSURANCE MECHANISM**

**Pierre Michel**  
CCR, France

## Assessment of 30 years of experience with the French Natural Catastrophe insurance mechanism



OECD

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### What the law of 1982 says - simplified description

- Fire insurance contracts covering tangible assets (buildings, contents located in France) or Automobile physical damage (motor vehicles licensed in France) must cover damage ensuing natural catastrophes
  - ❖ *Note: this does not apply to marine hull & cargo, to crops & other agricultural risks, nor to bodily injury & death*
- This applies equally to residential risks, commercial risks, industrial risks, municipal facilities, farming buildings & facilities, etc.
- The same limits as per the Fire cover apply in respect of Nat Cat including, where relevant, business interruption.
- Specific provisions apply:
  - ❖ The premium surcharge is uniform and set by law: 12% of the base Fire rate for non-Auto policies and 6% for Auto PD policies
  - ❖ *Note: The base rate itself is completely unregulated*
  - ❖ Deductibles are also regulated by law:
    - ✓ 380 euros
    - ✓ except for commercial risks: 10% of damage with a minimum of 1140 euros



## What the law of 1982 says (Cont'd)

- Increased deductibles apply to risks located within a commune that has suffered multiple occurrences of the same peril in the recent past (5-year look-back) and has taken no prevention measures
- For the mandatory Nat Cat cover to come into play, the government must issue a decree stating that a natural catastrophe has effectively occurred.
- The decree describes the nature and dates of each event, and states the areas (in practice a list of communes) where it took place.
- Insurers of the damaged assets must pay the claim if they find that the damage has been caused by the event described in the decree.
- “Uninsurable direct physical damage caused by the abnormal intensity of a natural force, in spite of the usual prevention measures having been taken” may be eligible under the Nat Cat regime.



## What the law from 1982 says (Cont'd)

- Perils deemed to be insurable are therefore not covered by the Nat Cat regime: typically the case of continental windstorms.
  - ❖ Windstorm cover is in fact another mandatory rider in Fire policies under French law, but it does not fall within the Nat Cat mechanism
  - ❖ For other insurable natural hazards, the cover is left entirely up to the market: snow, hail
- Perils typically covered under the Nat Cat mechanism:
  - ❖ Floods of all types
  - ❖ Earthquake including tsunami and/or fire following
  - ❖ Volcano eruptions
  - ❖ Subsidence
  - ❖ Landslides & mudslides
  - ❖ Avalanches, etc.



## What the law from 1982 says (Cont'd)

- The government issues the decree after hearing an expert group on whether the natural phenomenon was of “abnormal” intensity: typically, a 10-year or more return period is required
- Insurers may seek judicial recovery of claims from third parties in case it is arguable they have some responsibility in the damage.
- Financial backstop provided by government on an optional basis:
  - ❖ Any insurer operating in France may, in respect of Nat Cat risks, purchase unlimited reinsurance cover from CCR, a 100% government-owned reinsurance company whose solvency is, in turn, guaranteed by government should it run out of reserves on any given year.
  - ❖ In practice, a large majority of insurers have chosen to buy reinsurance with CCR.
  - ❖ The reinsurance cover offered by CCR consists in a 50% quota-share and an unlimited stop-loss on retention.



## Some numbers

- Non-Life annual premium income in France: EUR 45 bln
- Nat Cat annual premium income: EUR 1.3 bln
- Average annual Nat Cat claim charge: 0.9 bln...But there is no such thing as an average year! The historic experience has been between 150M and 1 200M€ but the potential “big one” is above 10 bln€:
  - ❖ Major earthquake in South-East France
  - ❖ Extreme flooding in the Paris area
- So far, the Nat Cat mechanism has been self-funded, i.e. no government payout with one small exception in 1999. But what really matters is the extreme loss potential.
- Nat Cat decrees:
  - ❖ Usually one per month
  - ❖ An average of 8 000 communes (out of 37 000 overall in France) are concerned yearly



## Comments regarding « state » assets

- The following are usually (but not always) insured against Fire:
  - ❖ municipal facilities: school buildings, other municipal buildings & contents, bridges, monuments, etc. (but not streets & roads)
  - ❖ private utility companies: wind farms, solar farms, electrical and other power plants, hydroelectric dams, water or power distribution including electrical cables and pylons, oil pipelines, etc.
  - ❖ Seaport facilities such as cranes and warehouses
- These assets are automatically insured for Nat Cat
- The following are, in practice, not insured against Fire:
  - ❖ the French state has chosen not to insure its own assets: government buildings & contents, universities, national museums, ministries' vehicle fleets, etc.
  - ❖ the same goes for state-operated public services: railways, highways, public utility companies, etc.
- Physical damages to these assets will therefore not be take care of by insurers.



## Main successes of the Nat Cat mechanism

- After almost 30 years of existence, there is a consensus that it has well served its purpose
- All physical and legal persons who can afford Fire or Physical Damage insurance –and chose to buy it – are automatically covered
- Payment is ultimately state-guaranteed, therefore there are no sub-limits for natural disasters in insurance policies and in CCR's reinsurance treaties
- CCR has been in a position to gather data and resources to model exposures and provide feedback to the market and the government



## Areas for improvement of the Nat Cat mechanism

- Nothing prevents insurers from offering optional covers for natural disasters that do not meet the Nat Cat decree criteria. In practice, they rarely do so.
- After a disaster has struck, the outcome and issuance delay of the government decrees are sometimes difficult to predict for victims (and insurers).
- No strong incentives to take prevention measures: no measurable reward for good risks and no clear extra-cost for bad risks.
  - ❖ Note: The increased deductible provision in case of multiple hits in the same area has not proved efficient enough (and in fact is often considered unfair)



## Areas for improvement (Cont'd)

- Solutions currently considered by the French lawmakers:
  - ❖ Let the Nat Cat premium surcharge vary depending on exposure
  - ❖ Deny the cover vis-à-vis policyholders that disregard risk prevention regulations
  - ❖ Draw up an explicit list of covered perils
  - ❖ Set measurable, observable criteria for an event to qualify as “Nat Cat”
- No other significant changes are deemed necessary:
  - ❖ The Nat Cat rider will remain mandatory in Fire policies
  - ❖ The premium surcharge will continue to be affordable to all physical and legal persons
  - ❖ Reinsurance with CCR will remain an option for insurers who wish to purchase unlimited coverage with state financial backstop
  - ❖ The covered perils will not change in a significant way
  - ❖ The trigger for Nat Cat decrees will continue to be equivalent to one-in-ten-year occurrences.



Thank you for your attention

Pierre Michel  
pmichel@ccr.fr

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CCR, 31 rue de Courcelles, 75008 PARIS, FRANCE  
+33 (0)1 44 35 31 00 – [www.ccr.fr](http://www.ccr.fr)