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

Hyderabad, 26-27 February 2007

Prof. Alberto Monti
Bocconi University
Email: alberto.monti@unibocconi.it

Bocconi

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

CONTACT INFORMATION

Prof. Alberto Monti
Bocconi University
School of Law
5, via Ulisse Gobbi
20136 - Milano (ITALY)
E-mail: alberto.monti@unibocconi.it
www.unibocconi.it

Bocconi