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Catastrophe Reinsurance Newsletter

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LOS ANGELES SUFFERS EXPENSIVE QUAKE WARNING

California confirmed its position as one of the most hazardous places on earth this month with a major earthquake striking the Northridge area, in the San Fernando valley north west of downtown Los Angeles.

Surprisingly the San Andreas fault was not to blame. Northridge lies on the Oak-ridge fault system, thought to be inactive.

At the time of writing the quake had killed 34 people, injuring nearly 3000 more and leaving 20,000 unable to return to their homes. The state has recently had to contend with the Los Angeles riots of 1992 and the fire storms in October and November last year.

It seems a little inappropriate to talk of luck, but as so often with natural catastrophes the devastation could have been much worse. The earthquake registered 6.6 on the Richter scale, but it occurred at 4.30 in the morning of a public holiday. The same event at rush-hour on a working day would probably have caused greater loss of life and damage.

The first loss estimates indicated that the Northridge earthquake would cause greater overall and insured damage than the October 1989 earthquake at Loma Prieta, near San Francisco, because it caused more damage to homes and businesses and affected a wider area.

Loma Prieta cost insurers US$960 mil

Visayas and the eruptions of Mou[illegible] in 1992 and Mount Mayon in 1993.

EQE's Review magazine for [illegible] includes an article on the econo[illegible]quences of the Midwest floods of [illegible]. Although private insurance losses [illegible] to an estimated US$655 million, th[illegible] loss was put at about US$12 [illegible]. Insurers therefore bore about 0.5[illegible] the loss, compared with 10% of the 19[illegible]ma Prieta earthquake (US$10 billion [illegible]ll loss) and 60% of Hurricane Andrew [illegible]25 billion).

The secondary costs from the flood are likely to be larger than for other disasters. Rebuilding work can start straight after a hurricane or earthquake, but in the case of a flood, those affected have to wait a long time before the waters disperse.

The worst affected states were Missouri (US$3 billion), Iowa (US$2.2 billion), Illinois and North Dakota (both US$1.5 million).

The flood was categorized by some as a 500-year event, equivalent to a "maximum credible event" in earthquake terminology.

The article notes that the Federal Emergency Management Agency (FEMA) moved much faster to provide help because of experience gained from the previous catastrophes. When the threat of catastrophic flood first became apparent, several of the potentially affected communities that had previously elected not to participate in the National Flood Insurance Program were allowed emergency entry.

ISO Commercial Risk Services is producing a system to grade the effectiveness of communities' building-code enforcement. It already provides similar grading of municipal fire protection and flood mitigation efforts. Many insurers reflect the grades in their insurance rates for individual properties.

CRS expects to phase in the grading programme by state beginning next year and to grade every municipality in the USA by the end of the decade. It will start by targeting states that have suffered catastrophes.

In the first quarter of this year CRS will ask more than 100 communities to complete a questionnaire on their administration of building codes, reviews of building plans, field inspections and building programmes.

Zurich Insurance has bought out the remaining minority shareholders of Centre Reinsurance Holdings. Zurich has held a controlling stake in Centre Re since the company's formation in 1987. In 1991 Zurich increased its stake to more than 70%. Now it has agreed to take the remaining shares from Kemper Corporation, ACE Ltd, Northwestern Mutual Life and Marsh & McLennan Risk Capital.

[illegible] THE SPANISH

[illegible] vice chairman of Spanish insurer Mapfre, examined the role of the state and how to cope with catastrophic risks in a paper presented at the 20th General Assembly of the Geneva Association in Vienna last year. He outlined the working of the Consorcio de Compensacíon de Seguros, set up in Spain in 1940 and soon after used to write catastrophic and political risks through ordinary policies written by private insurers, on an exclusive and compulsory basis.

Every 10 years, new regulations were issued covering rates, terms and definitions. The new political regime at the end of the 1970s received some opposition when it proposed liberalizing catastrophic risks and closing the Consorcio. Reinsurers were not against the Consorcio as they had been keen to keep Spanish catastrophic risks out of their portfolios.

The Spanish authorities changed the regulations again in 1990, bringing the position more into line with the rest of the EC. The Consorcio no longer had a monopoly of catastrophic risks but it continued to be active in providing its historical covers on all insurance policies issued in most of the branches as a compensation and social public fund. Risks could be written by the private market, but as there was a differential rating for the same cover, nobody took the private cover.

Between 1971 and 1991, catastrophic and political risks in Spain attracted a premium income of PTS 300.8 billion, with losses of PTS 295.3 billion, producing a loss ratio of 98.1%. Flood accounted for 67.5% of the loss ratio distribution, followed by storms (20.1%), terrorism (7.9%) and others (4.5%). Losses were recorded in 1971 (586%), 1982 (248%), 1983 (569%), 1987 (186%) and 1989 (127%).

Mr Candel said international reinsurers had expressed their opposition to any private cover of catastrophic risks in Spain. The Spanish system of cover had proved its viability, he said, and given the current lack of catastrophe capacity elsewhere in the world, the Spanish market was in an enviable position.

A similar method of cover, backed by support from international reinsurers, could help areas of relatively low population with high catastrophic risk potential, such as the Caribbean. He suggested several steps to improve the efficiency and availability of cover:

- investors, authorities and individuals all need a better understanding of the risk, brought about by a more specific analysis of the catastrophic potential;
- there should be greater attention paid to protection measures such as construction rules and emergency plans. Statistics need to provide the basis for a more detailed rating structure, differentiating between areas and types of premises;
- local authorities should aim for lower frequency and lower loss consequences from catastrophes. This would entail more attention to education, general emergency plans, forecasting, construction rules and inspection surveys of buildings and facilities;
- a compulsory risk financing programme should be enforced by authorities, preferably through local insurers. Both government and insurers should retain a part of the risk, ceding the rest to international reinsurers on a long term basis. Regulations should permit a favourable fiscal consideration of the reserves which should preferably be invested in foreign assets;
- catastrophe programmes need to be applied to all countries in the same hazardous region so as to create supranational plans and compensation;
- general co-operation among programmes from different regions would be desirable
- international financial institutions and powerful governments could use these organizations to channel official help in case of large catastrophes.

The existing system, however, is seen as less than adequate even in the developed countries, and European countries suffering from the recent flooding of the Rhine, as well as the USA, Canada and Australia, have taken rapid steps to help set up more centres in their territories.