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**LARGE INDUSTRIAL RISKS, CATASTROPHES AND ENVIRONMENTAL  
THREATS; DEFINING INSURABILITY, THE ROLE OF PRIVATE INSURANCE  
INDUSTRY AND THE STATE.**

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On this broad topic, I would like to make some brief reflections on three specific points in which my professional experience could perhaps be of some assistance. These are: (1) the catastrophic risks in Spain and the exemplary experience of the "Consortio de Compensación de Seguros"; (2) the current situation on Latin American Catastrophic Risks. How long can the present system persist?; (3) Risk Management Services as insurance industry's new approach to environmental and large industrial risks.

1. The "Consortio de Compensación de Seguros": Past, Present and Teachings:

This Spanish Governmental Organization was created in 1940, to solve some insurance problems derived from the civil war but it was very soon after used to write catastrophic and political risks through ordinary policies written by private insurers, on an exclusive and compulsory basis. Approximately every 10 years, new regulations were required to update this Monopoly to the changing situation (esp. covers, rates, definitions and so on) but keeping the market of these risks under strict control.

In fact, for decades very little information was given to the public about technical results, loss ratios, reserves and other data related to this insurance supposed to be very profitable for the governmental institution. Due to this, the Spanish Insurance Authorities received opposition when the deregulation of the Insurance Market came into effect along with the new political Regime at the end of the 70's claiming the liberalization of Catastrophic risks and the closing of the Consorcio.



I should point out that most reinsurers were not among those against the Consorcio. On the contrary, they have been lending their support very enthusiastically in the past in order to keep catastrophic risks out of their portfolios in this corner of Europe.

However, when Spain joined the E.C. in 1986, Monopolies should have been eliminated to allow for market transparency and so should have the Consorcio. Instead, the Spanish Insurance Authorities amended the specific Regulation in 1990 yet again in a very subtle manner: catastrophes risks were no longer the exclusive field of the Consorcio but this Organization would continue 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.

Nevertheless should a risk have been written by way of private Catastrophic cover, the Consorcio would only become involved in a loss in the case of the insurer's insolvency. This peculiar scheme led to double rating for the same cover and, of course, practically not one insured has asked for private catastrophic cover since the new Regulations came into force.

However, on the other hand, the Consorcio has been more willing to provide information on its activity and improving relations with the insurers which have been involved in a Board where discussions and exchanging of information have taken place.

The following tables show recent figures provided for these covers in Spain. According to these, the program is overall hardly balanced not taking into account financial income and general expenses.

The present situation has not been fully clarified as formal Regulations must still be issued to complete the new Law concerning rates, special consideration for large risks, double cover and other topics. Some international insurance brokers and large industrial clients do not fully accept this delay and expect more liberal consideration for their specific cases.

In the meantime, international reinsurers (mainly European) have clearly stated their total opposition to any private cover of catastrophic risks in Spain reducing all possible changes to a very few cases controlled by large industrial organizations and their specific reinsurers.

In brief, the Spanish system of cover has shown its viability although with certain drawbacks and at present the lack of world catastrophic capacity, the situation in Spain is enviable compared with other countries. Now, the teachings and possible future evolution of these markets in our countries:

- a) On the compulsory insurance basis, catastrophe risks can basically be covered in specific regions.
- b) This system must be accompanied by special regulations which should be amended in accordance with real experience. Regulations must allow reserves for a long period without taxes and a limit or protection for possible large scale catastrophes (called Calamidad Nacional in the Consorcio Laws).
- c) Today, local insurers are the key tool in distributing these covers and provide other complementary services, especially to adjust losses and they should take a share in the risk and participate in the ruling of these Organizations which should be so combined (private-government).
- d) Further technical studies could provide better knowledge of these risks and in turn provide a fairer system for the policyholders. Today in the Consorcio there is a flat rate which can certainly be considered a pure tax scheme.

In many countries, the rating system for catastrophic risks is not representative of the real hazard in different places or for types of premises and so produces a lower level of insurance among individuals even those educated who are aware of this difference between perceived and rated risk.

- e) Large industrial risks deserve special consideration and perhaps could be exempt from this obligatory cover.
- f) International reinsurers should be invited to take a share in this new scheme in order to obtain their financial support and experience in dealing with this kind of risk.
- g) This combined Organization could take a part in institutions of other countries created on a similar basis in the future. This could promote a better spreading of these kinds of risks worldwide and improve international solidarity other than the present occasional assistance which has often proved very inefficient.

Moreover, perhaps this is the only way to cover Catastrophic Risks in small regions of the world of strong potential hazard (e.g. Caribbean Zone) where reinsurers are starting to limit their capacities and to withdraw.

## **2. The current situation on Latin America Catastrophic Risks**

Large catastrophes in recent years in Latin American regions, especially hurricanes in the Caribbean or Gulf areas, have produced deep instability in the local insurance and reinsurance markets. Rates are considered very low and the total premium collected unable to cope with a potential threat in some regions. In other parts, like in Colombia, terrorism is a cover which is difficult to reinsure in international markets. Some countries are looking for joint solutions among local insurers and for the collaboration of international institutions.

Unfortunately and as far as I am aware, very little progress has been made. Moreover, some reinsurers are threatening withdrawal from some markets and insisting upon high premium increases as well as reducing, in any case, their capacity. This situation is really very difficult.

Which is the way out? Can the situation continue? There are very personal views on this:

- a) A real awareness of the risk involved is needed in each market for investors, authorities and individuals in general. This should be made by way of a more specific analysis of the catastrophic risk in accordance with past experience and tendencies.
- b) This information should require a more intense concern on protection measures such as construction rules and emergency plans. Also, the statistics should provide a better understanding of the risk in different areas and type of premises in order to allow a more detailed rating system and avoid the flat schemes which are so negative and demoralizing for individuals in many countries.
- c) The "reduction" of the risk (lower frequency, if possible, and mainly lower consequences) should be an important goal for local Authorities. This is the best way to face catastrophes in the long run. In this approach, governments should devote more attention to education, general emergency plans, forecasting, construction rules and inspection surveys of the buildings and facilities.

- d) A compulsory risk financing program should be enforced by Authorities preferably through local insurers. Both Government and insurers should retain a part of this risk, according to their financial capacity, and cede the rest to international reinsurers on a long term basis with flexible conditions. Regulations should permit a favorable fiscal consideration of the reserves which preferably should be invested in foreign assets.

The rate applied should be correct and nobody would be shocked by high levels if they were correct and justified.

- e) Those Catastrophes Programs should be applied in all countries involved in the same hazardous region trying to create supranational plans and compensation. Otherwise small countries (e.g. some islands in the Caribbean Sea or small countries in Central America) could not survive on a risk financial standpoint.
- f) General cooperation amongst Programs from different regions would be desirable. This seems science fiction but in fact is what reinsurers do in general business thanks to the worldwide spreading of their activity.
- g) International financial institutions and powerful Governments could use these organizations to channel official help in case of large catastrophes and, why not lend money should these organisations not have enough resources or reserves to face huge losses.

If a limit is applied, as happens in the Consorcio Regulations e.g., a soft loan given by international banks or financial institutions could perhaps be a good solution.

### 3. The Risk Management Services for Environmental and Large Industrial Risks

I am not referring to the same topic insurers usually refer to on risk prevention and control. Unfortunately, this has been commonplace for many insurers but not very efficient. The reason behind this is that insurers, when offering those services, are only trying to keep their client or to reduce loss ratio through better risk selection.

In my opinion, things are changing when some risks (environmental risks for instance) are not quite insurable and the size of the risk or the financial strength and risk experience of the insured can be higher than that of the traditional insurer. Roles are changing on both sides and this has not been recognized in many cases. This should be the beginning of a new era in which insurers should state if they are ready to play, of course in a different manner than the traditional one.

This new role could be directed to specialized Risk Management services not linked to insurance programs and offered on a fee basis. This kind of services should include engineering, consultancy and laboratory analysis especially for environmental topics. This is a real contribution to the future perhaps better than symbolic facts as the use of recycled paper, donations or other common institutional activities.

With regard to the environment impairment, looking for financial solutions could be very important since in most cases insurance is not possible and so other risk finance methods need to be designed. Here, the traditional insurer may be out of place and techniques closer to Risk Management practices might be useful.

Pollution Pools have been developed in some countries with limited capacity and covers. Though a valuable help, the deep and large problems derived from real air, water and soil contamination can be hardly saved by these schemes. However, an Environmental Service Organization could be the solution for defining and limiting perils and auditing the facilities, in a line started in those countries and, recently, in Germany as a result of the new Environmental Act which imposes compulsory insurance to classified activities.

Furthermore, insurance institutions can cooperate in this field in these kinds of services, joining forces in a practical way with other organizations to keep our planet alive.

The new role for Large Industrial Risks could be orientated also through Risk Prevention activities and also by offering analysis services of new risk financing methods with more risk retention and using captives or Self-insurance programs. In fact, the insurer can only survive in this field by selling those services and playing the role of an XL reinsurer perhaps in the last layers.

CATASTROPHIC AND POLITICAL RISKS IN SPAIN

(1971-1991)

1. PREMIUM INCOME (Thousands of Millions of Ptas deflated Jan. 1, 1992);  
1 US\$ = 114 Ptas).

<u>Property Lines</u>	<u>Personal Lines</u>	<u>Total</u>
282.9	17.9	300.8

2. LOSSES

<u>All Lines</u>	<u>Loss Ratio</u>
295.3	98.1%

3. LOSS RATIO DISTRIBUTION PER RISK

Flood:	67,5 %
Storms:	20.1 %
Terrorism:	7.9 %
Others:	4.5 %
	<u>100 %</u>

4. YEARLY LOSS RATIO DISTRIBUTION

1971	586%	1978	38%	1985	19%
1972	22%	1979	29%	1986	48%
1973	2%	1980	60%	1987	186%
1974	--	1981	41%	1988	60%
1975	2%	1982	248%	1989	127%
1976	15%	1983	569%	1990	19%
1977	84%	1984	23%	1991	21%