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Insurance of terrorism and natural catastrophe risks

The subject of the insurance of terrorism and natural catastrophe risks sadly remains highly topical. The Insurance Committee has considered the issue of terrorism cover and aviation insurance in the past (notably in 2001 and 2002¹) and at that time expressed a clear preference for market-oriented solutions. In the meantime the OECD has carried out a considerable body of work on the insurance of both terrorism risks and natural catastrophe risks. The Comité Européen des Assurances (CEA), the voice of the European insurance industry, continues to show an active interest in these matters, advocating public/private partnerships "where the interplay of market forces is insufficient to establish balanced and durable solutions". Given the great importance of these issues, it is proposed that the Commission services should monitor closely developments in this area, and that the questions of terrorism and natural catastrophe insurance should once again form part of the EIOPC work programme. The Committee could provide an appropriate forum for discussing developments in these areas, considering best practice and, if appropriate, examining any particular matters where a specific European Union reaction or approach might be appropriate.

Background

It is clear after 9/11, Madrid and London that the terrorism risk remains a real one. With the fear that a future attack may be of a chemical, biological, radiological or nuclear nature (CBRN), possible losses could be of a vastly increased magnitude. It is equally clear after the 2003 heat wave, various massive flood and fire events, not to mention the record hurricane seasons in the Americas in 2004 and 2005, that extreme climatic events are becoming more frequent and may, together with gradual climatic change, have considerable ramifications, not only in terms of property and economic loss and disruption but also in terms of mortality and morbidity.

Essentially the insurance of such risks raises a whole series of questions of interest to the Member States, the Commission in general and DG MARKT in particular. These relate to the question of the insurability of such risks, the role and solvency of the insurance industry, the respective roles of the private sector, governments and the financial markets in ensuring that these risks can in some way be covered so that our modern economy can

¹ See minutes of the 29th, 30th and 31st meetings of the Insurance Committee.

function and that various lines of economic activity can remain viable. There are also important aspects of competition, transport and environment policy. It is important that the expert Committee on insurance matters should monitor this area. It is also appropriate that DG MARKT should follow these issues much more closely, should familiarise itself with the work already accomplished and the documentation already available (notably via the work of the OECD) and discuss with the Member States whether they see particular Community aspects or possible Community approaches to the coverage of these risks.

Terrorism risks

Before 2001 terrorism risk was widely considered by insurers to be a manageable exposure, and private non-life insurance routinely covered most terrorism risks related to property loss. This changed with 9/11. Reinsurers withdrew from the market, judging that the principles of statistical predictability and ability to quantify loss were no longer met.

In the USA the President signed the Terrorism Risk Insurance Act legislation in November 2002, whereby private insurers and the federal government share the risk of future losses from terrorism. It is now likely that TRIA will be extended, with changes, until end 2007.

In the EU only the UK and Spain had large scale experience of terrorism risks and already had in place in 2001 mechanisms whereby terrorism risks beyond a certain size were state reinsured or pooled, since it was acknowledged that full protection could not be made available through private (re)insurance alone.

Other Member States have since introduced various mechanisms to deal with large scale terrorism risks while others have not intervened. Even if the availability of insurance and reinsurance cover has improved, the insurance industry would maintain that certain risks (such as CBRN terrorism risks) are basically uninsurable. The rating agencies too appear concerned by excessive exposure to mega risks.

It would seem appropriate for the EIOPC to provide a forum for Member States to discuss their approach and policy choices in this area.

Aviation insurance

Following 9/11 insurers in Europe (as in the USA) withdrew cover for risks related to war and terrorism and Member States were forced to step in to provide government guarantees. The Commission coordinated the government guarantees to minimise any possible market distortions. At the end of 2002 commercial cover became available once again, albeit at a much higher cost, which prompted an investigation by DG COMP.

However new problems may be emerging. DG TREN currently foresees problems resulting from the gradual withdrawal of cover for risks resulting from the use of weapons of mass destruction, despite the fact that Community legislation itself imposes a legal requirement to have full insurance cover for liability for air carriers. Although DG TREN leads on this dossier, MARKT also follows developments closely.

In this, as in the insurance of other mega-risks, there seems to be some tension between the views voiced by the experts in the OECD, where it seems to be accepted that governments cannot avoid being involved to some extent in the coverage of such risks, and official pronouncements that the role of governments should be reduced or even eliminated.

Natural catastrophes

As regards natural catastrophes, the last two years have seen unprecedented events both in the US and in Europe (in the USA there were in 2004 and 2005 a record number of severe hurricanes, while in Europe repeated floods and fires have caused enormous damage and economic loss).

There is no conclusive evidence yet that these disasters are directly related to climatic changes, but as losses increase the insurance industry seeks closer cooperation with governments to improve predictability, early warning systems and to introduce other measures to limit and/or to reduce the extent of damage and losses. Also in this case the insurance industry is pointing to the principles of statistical predictability and the need to be able to quantify possible losses, on which insurance depends and without which it becomes impossible to provide insurance cover against storms and floods on a commercial and actuarially sound basis.

Here too the Member States have reacted in various ways, some providing government intervention while others still leave the question of coverage to the commercial insurance market. It would seem appropriate for the EIOPC to consider questions such as the principles governing the payment of compensation by states in the event of large catastrophes and also the appropriateness of the establishment of a certain public-private partnership between governments and the insurance industry, as advocated by the CEA.

Conclusion

It is proposed that the Commission and the EIOPC should follow matters relating to the insurance of terrorism and natural catastrophe risks more closely. The issues are highly topical and extremely important and the insurance industry would certainly be supportive of an increased interest on the part of the Commission and the Member States meeting in the EIOPC. The Commission services would report regularly to the EIOPC and would seek discussion of important issues as appropriate.

The EIOPC is requested to give its support for the Commission services' proposal to follow these issues more closely and include them in the work programme of the EIOPC.