

INTEGRATED INSURANCE

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While no human system is perfect, a wider use of commercial insurance organisations and methods to meet the exigencies of natural disasters could have benefits in several ways. These are preparing for the event, carrying out the physical recovery, and providing the funds for that.

Before The Event

Generally, insurers expect property owners to take good care of their property. However often before accepting a property for cover, an insurer will conduct a physical survey of the premises. Traditionally, the surveyor focused on the fire and crime hazards, and provided optional recommendations and mandatory requirements for improvements to the physical fabric (and management of operations in the building, if it were a business). This has the obvious benefit of reducing the chance of losses, and of placing some of the financial cost where it belongs, with the property-owner. Smaller properties will not be visited, but insurers often provide cheap but effective guidance through literature. Sometimes this process of risk management is carried out by the insurance intermediary.

As the seriousness of natural disasters has become apparent, the insurance industry has refined its approach by coding areas according to the degree of hazard, based on geographical data and claims history. For uninsured existing premises, it may be necessary to adopt some form of centrally controlled pool, or allocation system, perhaps with government backing. There is then the issue of insuring new premises. As long as financial ruin is averted by easily available insurance, unwise developments will continue. But without the promise of insurance, prospective owners and lenders will be deterred. The price mechanism is an essential discipline of the free market, serving to prevent uneconomic use of resources. If it proves impossible to provide 100% cover for earthquakes or volcanoes in some locations this may not be unreasonable. If too many "uninsurable" risks are assigned to the insurers then the whole system may collapse.

Paying For It

Insurers and their agents do make considerable efforts to provide guidance on the matter of the appropriate values, and may be accused of overselling in fact.

The collapse of insurers from being unable to meet their obligations will of course prevent the recovery, and has occurred from time to time. To some extent this can be averted by appropriate reinsurance programmes, and by government supervision to ensure that insurers have sufficient "solvency" or free capital to face unexpected demands, but this is an area which will see further development.

General Aspects

The whole system of assessing risks, collecting premiums, maintaining registers of insured property, and settling claims is a huge administrative burden. The profit motive ensure that updated office technology restrains the inevitable escalation in costs. By using the same system for non-catastrophe purposes, enormous savings can be realised. It is a sad fact that claimants may invent or exaggerate losses, and contractors may overcharge for work, particularly in emergency situations. The commercial sector is used to dealing with such problems. Rapid effective communication on property damage can mitigate the effects of disasters. Whereas in 1987 UK insurers were overwhelmed by the one million claims caused by the October “hurricane”, in 1990 they coped with three million claims by providing general advice at once in the media. Individual claimants had access to dedicated (often free) phonelines on a 24-hour basis, enabling repairers to be contacted and many emergencies handled without the involvement of the authorities.

Control of Acceptances

It has been customary for insurers to accept 100% of the value of a property for insurance. Again, it has been customary for the total of all such accepted values to be greatly in excess of the financial resources of the insurer, in much the same way that a bank extends credit beyond its available funds. Obviously, in a natural disaster very many claims can occur simultaneously. One way in which insurers can cope with hazardous risks is to ration their acceptances, to perhaps a fixed amount per property, and to a total number of properties in the worst areas. Where the demand for cover is unsatisfied, the risk may have to be borne by the individual property-owner.

Catastrophe Funds

It is vital that funds are available to deal with the recovery process. Public funds or charity are not ideal. International reinsurance is available but may be limited in amount. Allowing the commercial sector to build up disaster funds out of untaxed income would be attractive to insurers. It would defer the receipt of tax revenue, but that might be preferable to the other routes suggested. (There may be some debate about how such funds should be invested e.g. to assist public deficit funding, but short-term political ends must not prevail). It is significant that in the UK the government has just announced a review of this option after many requests by the insurance industry.

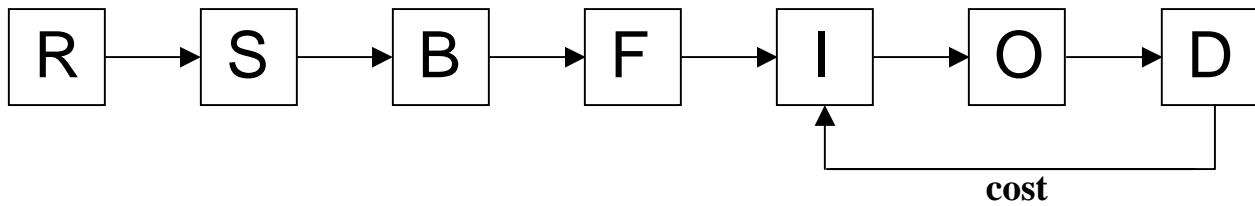
The problems facing less-developed countries are particularly difficult. In some cases the local economy may be insufficient to generate the necessary catastrophe funds ever, and local institutions may not be reliable enough to efficiently handle massive reconstruction. If the advanced economies use commercial insurance to tackle their own natural hazards, then public funds may flow more freely from them to other disaster-prone countries. It would be more efficient if this were done in a systematic way with individual countries linked together in an overall programme of premium pooling and risk management.

To underpin the national and international pools, governments should encourage a local commercial insurance market, providing products which cover as many hazards as possible voluntarily, with proper regulation. The insurers would administer “uninsurable” hazards, placing them with the national pool, although again it would be

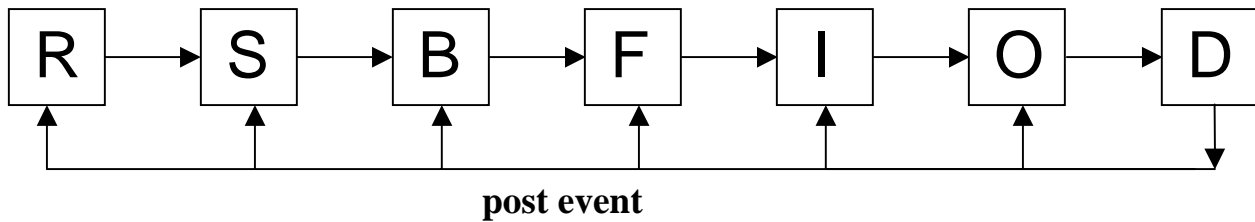
desirable for at least a part of each risk to be retained by the insurer and certainly by property-owner. This method would assist the process of risk management and the charging of risk-related premiums. Administration of policies and claims would be efficient, since the infrastructure would already be in place to deal with non catastrophic claims and risks. Those countries not already having a commercial insurance industry could seek technical assistance in setting them up, as Poland has recently from the UK. Again there would be many questions of principle and detail to decide – what charge would be made for administering catastrophe policies and claims, how would payments be audited, what proportion of risk would be retained by each party, what premium levels would be charged and so forth.

AN INTEGRATED PROPERTY DAMAGE SYSTEM

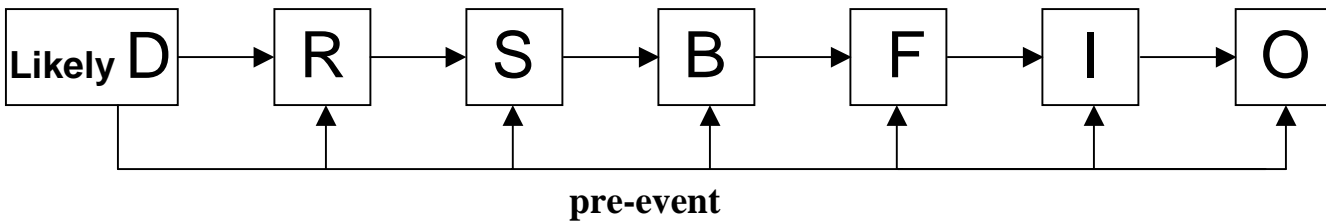
Passive



Inactive



Proactive



Key:

R - Regulation
S - Specification
B - Building

F - Finance
I - Insurance
O - Occupation

D - Damage
 (Extreme)