Now we are in control

Geoff Bromley explains why the reinsurance industry can help empower developing nations to become masters of their own destiny

"The revolutionary idea that defines the boundary between modern times and the past is the mastery of risk: the notion that the future is more than a whim of the gods, and that men and women are not passive before nature." – Peter L. Bernstein, *Against the Gods: The Remarkable Story of Risk*

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As economic development advances around the globe, emerging economies can take advantage of developed countries' expertise and technological advancements in risk-management solutions. This will enable them to develop more effective strategies for risk mitigation and catastrophe protection.

The Asian tsunami, the Pakistani earthquake, the European floods and the US hurricanes provided ample evidence of the vulnerability of all economies to natural disasters. Each year, we are painfully reminded that the world of risk is not bounded by any geographic or socioeconomic factors. However, emerging countries often suffer more as they lack the infrastructure to deal with natural disasters. Reducing these countries' exposures to catastrophe risk therefore requires careful management and risk transfer.

These thoughts were reinforced at a conference in Cairo I attended this March entitled 'Effectiveness of Catastrophe Insurance Protections in the Developing Countries', where speakers emphasised the importance of loss prevention and protection to the growth of developing economies. In 2004, the insured losses among emerging economies totalled approximately $6bn, but were only a fraction of the total economic loss of over $20bn.

Losses from catastrophic events such as natural disasters can place enormous strains on already struggling economies, which in turn may lead to recession or thwarted GDP growth. In addition, these countries may be grappling with underdeveloped insurance sectors, excessive reliance on the government as the reinsurer of last resort, lack of access to financial services and poor quality of information about risks.

Government pools

For countries without a developed insurance market, government pools that cover catastrophe perils can be a solution. Keeping economic development on track is a main argument for using pools. Through pools, the international reinsurance market can provide financing for capital-constrained nations. In addition, pools can assist in the balance of payments with foreign-exchange inward transfer after a disaster, as well as supporting broader risk-mitigation initiatives.

Many countries have instituted pools in response to natural perils. In Turkey, the impact of earthquakes and the low levels of insurance coverage after the 1999 Marmara earthquake provoked the Turkish government to create the Turkish Catastrophe Insurance Pool (TCIP). The goals of the pool are to limit the financial burden that earthquakes place on government budgets, ensure risk sharing among its residents, encourage a higher standard for building practices and establish long-term financial resources.

Taiwan has followed a similar path with the creation of the Taiwan Residential Earthquake Insurance Pool (TREIP) in 2002. The lack of residential earthquake insurance cover in the face of Taiwan's exposure to frequent earthquakes led the government to pursue the pool solution as a way to mitigate risk. The pool was designed to diversify earthquake risk through a combination of local co-insurance, a catastrophe bond, reinsurance and a government guarantee.

These two pools are only a few of the many catastrophe programmes to have emerged in the last 50 years. The California Earthquake Authority in the US, Norsk Naturskadepool in Norway, the Icelandic Catastrophe Fund and the Catastrophes Naturelles in France are just a few examples. The final structure of any pool is as unique as the individual peril, social and political milieu, structure of the economy, and organisation and development of the insurance sector in each country.

Exposure analysis and catastrophe modelling tools can be used to design and establish government pools. Used in tandem, these processes combine risk assessment with historical records, thus enabling a government to estimate the potential loss distribution. From the loss-distribution estimate, accurate price assessments can be laid out along with the necessary capital structure to support the pool. In addition to the above-mentioned uses, exposure analysis and catastrophe modelling are valuable resources in maintaining the smooth operation of a pool, including claims handling.

In order for catastrophe modelling to add value, there must be accurate information on exposures, perils and vulnerability. The World Bank and other international organisations have stepped in to provide assistance for developing countries that do not have access to the financial means to acquire this information.

In the words of Peter Bernstein, "The mastery of risk defines modern times." We now have the tools to master risk. Developing economies have the advantage of the knowledge and expertise of their predecessors to find effective solutions unique to their country's risk-management needs. Modern risk-management tools like catastrophe modelling can play an invaluable role in designing and managing catastrophe pools, as well as the very important task of risk mitigation, which allows countries to surge forward. The challenge now is not how to help developing economies to leap ahead, but when. re

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