CURRENT ISSUES OF CATASTROPHIC RISKS REINSURANCE

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Abstract: Without reinsurance, the profile world market would fail to meet the multiple risks, of high intensity and high production rate. Expanding the business developed by different companies and the first signs of leaving the global financial crisis are factors which should draw attention to the increased risks faced by insurance companies. But the greatest danger comes from the catastrophic risks that will not disappear in any of the previous assumptions as to which requires the development of viable reinsurance programs.

Key-Words: - catastrophic risk, loss reserve, catastrophe reserves, mandatory housing insurance, pool insurance, reinsurance cessions.

1 Introduction

Defined as a logical extension of the business of insurance, the reinsurance process helps from a financial point of view, the increased economic stability of insurance companies (Văcărel, 2006: p. 236). Reinsurance is the main instrument of an insurance company to transfer their risk exposures, homogenization of the taken risks and the achievement of the financial stability in order to protect their business and therefore customers and partners. Insurance treaties extend the definition of "reinsurance is a means of equalization, through the division of responsibilities
among several insurers, spread out over large geographical areas possible, of maintaining a reasonable balance between earned premiums and compensation due to each insurer in part”. In terms of insurance companies (Patricia Grossi, 2005: p.42), accidental disasters are events that cause severe losses, damage to property or injury to a large population of exposures. The exposure refers to the size units of the dimension of an insurance portfolio (eg. no. of policies, no. of goods provided by type of settlements, the value of the amounts insured, etc.).

The classification used in the international insurance practice distinguish between natural disasters and technical disasters. Thus, natural disasters are those events that cause great material damage, affect the lives and physical integrity of a large number of people and causing major problems on the national economy of time intervals. Technical disasters are associated to risks related to human activities, development of science and technology (Tănăsescu et al 2009: p. 82).

2 Key issues
2.1. Active and passive reinsurance of catastrophic risk in Romania

The active reinsurance is when an insurer agrees, under the terms of the contract of reinsurance, to take over its part of responsibility which has assumed a different insurance company.

In contrast, the passive reinsurance is meat when an insurance company assigns under the insurance contract, to another institution or to an insurance-reinsurance society a part of its assumed liability.

In a mature market economy, an insurance-reinsurance should accept, in the same time the two forms of reinsurance, in order to achieve a balance between rights and obligations relating to the disposition, or the reception of the reinsurance. Moreover, it is useful to achieve good dispersion of the catastrophic risks by combining internal with external reinsurance. The ways of obtaining the mutual information system, the organization of professional organisms for the re1insurers for catastrophic risks contribute to a better conduct of business of reinsurance.

In Romania, the insurers authorized to insure catastrophic risks are required to reinsure to achieve the best possible dispersion of risk (Văcărel, 2006: p. 239). In practice, these risks are taken by first class international re-insurers.

A feature of the Romanian market for reinsurance is that the insurance companies primarily occur in a position of re-insurers (passive reinsurance) and only in small measure that of re-insurers (reinsurance assets). This phenomenon can be explained by the immaturity of the insurance and reinsurance market in Romania, characterized in that point of view by:

1. Lack of specialized reinsurance companies.
2. Poor development of the Romanian insurance market as a basis for the reinsurance market.
3. Poor coverage of catastrophic risks by insurance companies in Romania.
4. The absence of a reinsurance pool consisted of domestic insurers approved by I.S.C.
5. Poor legislative cover of reinsurance for catastrophic risks.

To analyze the reinsurance indicators characterizing the Romanian market, I.S.C. prepares an annual Report, from which we can distinguish the following data.

Table no. 1
Main indicators of the business of reinsurance for the insurance class in the years 2005/2007 in the insurance market in Romania

Source: processing by the authors based on the data of I.S.C. reports

<table>
<thead>
<tr>
<th>Indicators</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>Var (2/1)</th>
<th>Var (3/2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Gross premiums subscribed</td>
<td>919</td>
<td>1357,6</td>
<td>1586,3</td>
<td>47,7%</td>
<td>16,8%</td>
</tr>
<tr>
<td>2 Admission to the reinsurance</td>
<td>8,7</td>
<td>23,2</td>
<td>7,6</td>
<td>166,7%</td>
<td>-67,2%</td>
</tr>
<tr>
<td>3 Commissions received for admission to the reinsurance</td>
<td>0,5</td>
<td>8</td>
<td>0,7</td>
<td>1500%</td>
<td>-91,25%</td>
</tr>
<tr>
<td>4 Premiums ceded to reinsurance</td>
<td>252,3</td>
<td>435</td>
<td>466</td>
<td>72,4</td>
<td>7,1</td>
</tr>
<tr>
<td>5 Commissions received for reinsurance cessions</td>
<td>54,5</td>
<td>98,9</td>
<td>77,8</td>
<td>81,5</td>
<td>/21,3</td>
</tr>
<tr>
<td>6 Premiums ceded to reinsurance / gross premiums</td>
<td>27,5</td>
<td>32</td>
<td>29,4</td>
<td>4,5 pp</td>
<td>-2,6 pp</td>
</tr>
</tbody>
</table>

However it mustn’t be overlooked that a strong reinsurance market is based mandatory on an insurance
market at a national level severe enough to stimulate new product development. The insurance market in Romania is on a positive trend, although the growth rate is not exactly the one desired. The results are satisfactory, and the current trends are part of the kind estimated by the experts of the European Union. Thus the trend towards a greater concentration of insurance companies, although it can be interpreted in competition terms as hazardous, increases the confidence in the "new" competitors, which will attract an increased number of customers. This concentration may lead, in terms of competition, to concerted pricing practices (as was the case of liability insurance of motor vehicles in 2000), the main losers of such practices being the consumers. But in the lack of evidence or of infringements of the competition law, all these mergers and acquisitions should not be viewed only as a sign of increased financial potency of insurers.

2.2. International reactions at the process of catastrophic risks reinsurance

2.2.1. World Bank

International Financial Corporation (I.F.C.), World Bank's investment division, will allocate 20 million U.S. dollars to hold 20% of the stakes in a new company for reinsurance for catastrophic risks, which will be established together with the company PartnerRe Ltd.

According to the I.F.C., the total corporate funds’ value of the newly created company for reinsurance for catastrophic risks will be around 100 million U.S. dollars, amount that will be subscribed by two shareholders, I.F.C. and PartnerRe Ltd, in annual installments. The reinsurance company that will be established by I.F.C. and PartnerRe Ltd will have the name of the Global Index Reinsurance Facility (GIRIF) and will have as main activities incurring risks of weather and other catastrophic risks in developing countries and technical assistance and financial area governments, businesses private, farmers and institutions in financial intermediation.

G.I.R.I.F. will reinsure the risks of disaster that threatens the economic progress of developing countries and especially of poor rural communities. Establishing GIRIF project will have a strong impact on economic development in developing countries by providing them a financial instrument able to mitigate the economic effects of natural disasters, covering, in part, the losses caused by these communities in these countries.

2.2.2. Austria

Country with developed economy, Austria was hit in the last decade of three disastrous floods and storms. Unlike Romania, insurance and reinsurance Austrian economy is well developed, but was strongly affected by the high volume of paid claims. Austria was hit by natural disasters over the past nine 10 years, including large-scale flooding in 2002, 2005 and 2009. Only the 2002 floods caused damage of 400 million euros, and if this phenomenon would repeat the compensation would amount to 600 million euros. Also, the Wolfgang last winter storm brought damages of 360 million euros on the property segment.

Increased frequency and intensity of catastrophic risks in Austria causes an increase in the price of reinsurance contracts on the segment of natural disasters / property.

There is a huge gap between premiums collected for the risk of natural disasters and paid claims. Obviously, this is not sustainable, so are being required necessary action accordingly in the market in Austria. Thus, insurance-reinsurance societies and reinsurance specialist companies will continue the increase process of the reinsurens premiums in 2010.

Meanwhile, in Central and Eastern Europe, where market prices for natural disasters were relatively small, the representatives of SWISS Re advocate for increasing the insurance and reinsurance premiums contracts. Capacity is not a solution for Austria and C.E.E. markets, where the insurance and reinsurance industry may create a sufficient capacity for managing the natural disasters.

2.2.3. France

Unlike elsewhere in the world where the risks took the form of catastrophic natural disasters, France has faced in the XXI century the so called modern catastrophic risks. Factory AZV explosion in Toulouse in September 2001 was a turning point in the interpretation of the concept of catastrophic risk. First, the number of deaths (30 pers.) and wounded (approximately 2,700 pers.), but also the high volume of claims affected the French insurance and reinsurance industry. Secondly, the mere comparison of the total insurance benefits paid to security of supply in France (420 million euros) and total compensation paid in this case (1,200 million euros) leads us to the idea that we are dealing with a new type of catastrophic risk, of industrial type with strong environmental harm.

The solution of reinsurance in France is moving towards reinsurance pools with the participation of state and other state institutions. The reinsurance solution process is generally a characteristic of the developed countries of the world, which support joint public-private insurance economy.

2.3. Compulsory insurance of housing
In this broader context is required an implementation of much tougher rules to protect not only insurers but also their customers, because once the risk has been placed in the insurers’ level, the insolvency and lack of liquidity of these can easily lead to problems including the level of economical agents’ management. On this line have also appeared new rules on insurance prudence (Novac 2008: p. 178), the Solvency II principles desiring to strengthen the financial force of insurance companies active in the market.

On the same trend occurred the Insurance Supervisory Commission’s concerns translated into various laws and rules, which either bring a new breath to the management of insurers, or call into question the eternal problem of compulsory insurance of housing, which should eliminate some of problems posed risks of earthquake, flood and landslide in the Romania level (Şerbănescu 2008: p. 63). From this perspective it seems that we will have a compulsory insurance since 2010, because the rules are based.

From this point of view of the compulsory insurance of housing, perhaps the most interesting question remains, depending on the situation, that of co-insurance or over-insurance as many of us already have voluntary insurances, which protects the insured’s property, or to certain risks, such is earthquake, or for all risks. In this situation calls into question what should be done, because customers can not be informed about changes in terms of sums insured and other elements of the contract immediately.

If we make an optional housing insurance for the actual market value, the risks underwritten by the insurer is among other earthquakes, landslides and flooding, to avoid the situation of the over-insurance (which actually means throwing money out the window), should be given different amounts insured. This could be considered difficult, especially in the situation in which we discuss the transfer policy over to the banks, the insured amount and the amount of credit being identical.

Since there is no question for the elimination of compulsory insurance for those having optional insurance, the must be under-insured automatically with 10,000, 20,000 euros respectively. Many insurance companies entering into voluntary policies already have entries for the existence of a mandatory policy, but what happens if two products are different insurers.

When increasing the market value of housing is relatively simple as it may require the insurance company to increase the amount of insurance to the difference between desired value and the amount of the insurance sum required consistent with the housing mandatory insurance. The problem is really obvious if the market value of that property reduces (current situation in the Romanian real estate market), because in this situation should be sought reducing the insurance, whereas in the case of total damage will not receive compensation until the value of the house even if the total sums insured exceed this level. In addition the housing market fluctuations in value do nothing but cause disturbance and to the claims of policyholders. Regardless of how you will resolve these differences is obvious that it must speed up approval of the insurance practice.

4 Conclusion

Catastrophic risk insurance and reinsurance them is a priority for countries in the world who faced different natural disasters. Note that, gradually, the business of reinsurance is increasingly considered in the light of financial profitability.

On compulsory insurance of houses on all these issues will find answers through the I.S.C. rules, but we must not forget that there remain others to be discussed. However, regardless of how easy or difficult it will explain things, adopting this law is a step towards civilization insurance, not to call into question the happiness that before he could not provide housing of causes related to building resilience.

Critical is how they will be implemented for the reinsurance contracts of insurance pool of natural disasters, because rates are low and should include administrative costs of which are not known very many details at this time.

Reinsurance remains the main means of dispersing risk, but should not be considered as the unique, because as example, the mandatory insurance involves including in the insurance a very large number of insured property, even if rates are lower than facultative insurance.

References:


