

Best's special report

Catastrophe Schemes - Issue Review

Future Proofing: The Value of Natural Catastrophe Schemes in Europe

Review of a report of the rating agency A.M. Best on the different options in Europe for catastrophic risks insurance and how each of them tries to solve the various problems arising to this kind of insurance.

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This report, published by the insurance industry credit rating agency, A.M. Best, reviews the range of natural catastrophe insurance programs in Europe, focussing particularly on flood risk, which is responsible for causing the highest losses. Following an overview of natural catastrophe insurance programs, of their nature and the covers they provide, the report centres its attention particularly on the cases of France, Spain, the United Kingdom, Germany and Italy. The first two countries have specific public institutions, the third has a new program recently started up, sharing with the first two different degrees of public-private partnership, while the last two do not have specific programs for catastrophe insurance, which is provided directly by the private market.

The report addresses the issues which ordinarily arise in the international forums concerned with analysing the role of natural catastrophe insurance:

Should this kind of insurance be offered exclusively by the private sector? Or is there scope for alternatives with public participation? Should this public intervention be permanent or occasional and transitory? Does this participation obstruct the development of the private market or does it constitute a factor of stability? Should the premium for catastrophe insurance be based solely on the risk level of the insured, in such a way as to act as a signal of the level of risk and encourage the insured to take self-prevention and mitigation measures? Or should it be calculated globally, including a criterion of solidarity among the insured, making the premium affordable and in this way expanding the number of policyholders, preventing the adverse selection of risks? And, finally, to achieve this high rate of penetration necessary for facilitating the feasibility of the coverage of natural catastrophes, should such coverage be compulsory to some degree?

The first conclusion is that there is no single solution, and that this will depend on each market, its current situation and historical evolution. The authors argue, however, that the penetration of catastrophe insurance is noticeably greater in those countries with specific programs for coverage, thereby reducing the burden on the budgets of governments which must, ex post, meet the costs and, moreover, sending a message to citizens indirectly that insurance is unnecessary.



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In any case, the report underlines the importance of the mechanisms of collaboration between governments and the private insurance sector, in the form of partnerships between them; of the complementary role of the natural catastrophe insurance programs with public participation; of the existence of incentives and limits for preventing the adverse selection of risks and of consistent technical frameworks for assuring the financial stability of the programs in the long term.

The report also reaches the conclusion that markets such as the French or the Spanish ones are less volatile and have a greater year-on-year stability than their European counterparts, for which reason the insurance programs for protection against natural catastrophes exert a stabilising effect on the domestic markets. Moreover, in the case of Spain, the report notes that there are no signs of obstacles to competitiveness for the private sector, as the program for the insuring of extraordinary risks presents no problems of adverse selection, weakness or financial instability in the long term.