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Use ILS to reduce emerging market government nat cat exposures, say panelists

By Catrin Shi

Governments from emerging markets should harness insurance-linked securities and the collateralized reinsurance space to address the financial losses arising from natural catastrophes, industry experts have argued.

At the C5 Reinsurance and Capital Markets Convergence Forum in London on July 8 and July 9, panelists and speakers discussed how to address the gap between insured and economic losses arising from natural catastrophes.

In countries with a low primary insurance penetration, governments are left to foot the often substantial bill arising from a natural catastrophe. Typhoon Haiyan, which tore through the Philippines in November 2013, racked up an economic loss of $10 billion — 5% of the Philippines' total economic output — but only $700 million in insured losses.

Coming up with solutions to narrow this gap have been discussed for around 10 years, but little action has been taken, Luca Albertini, CEO of Leadenhall Capital Partners, said at a July 9 panel discussion.

"We have seen some increasing interest from emerging markets to create insurance solutions for this," he said, noting that a catastrophe bond-type structure with a parametric or modeled-loss trigger could work well.

"We need to communicate to politicians and governments that it is the taxpayer who is paying for this," he added.

Turkey took a step to transfer its earthquake risk to the capital markets through its Bosphorus Re issue in August 2013, which was received well by the market, noted Kirill Savrassov, CEO of Phoenix CRetro Reinsurance Co.

"Now many of the neighboring countries … are thinking of following this framework," he said during a separate panel discussion July 8. "[Using the capital markets] is definitely the fastest, and to some extent maybe the cheapest and easiest, way to move cat exposures from the governments of central and eastern Europe."

Transferring risk to the capital markets could be more cost efficient than establishing state catastrophe pools, he added.

Flooding is one major natural peril facing the CEE region — most recently, heavy thunderstorms caused severe flooding across Serbia, Bosnia, Romania, Slovakia and Croatia, resulting in estimated economic losses of between €1 billion and €1.5 billion.

Investors may be attracted to taking on new risks from different geographies, given that this provides diversification away from the market concentration of U.S. windstorm risk. But one of the barriers to the use of ILS for government cat exposures in these regions is the general lack of understanding around the instruments and their benefits, noted Savrassov.

"The general understanding of the ILS market, its mechanisms and instruments is far more underdeveloped," he said.

"It will take 10 or 15 years to get where we are [in the more mature markets] at the moment."