

interview

GAREAT is a consortium which covers all acts of terrorism without imposing a deductible

François Vilnet

Vice-President of GAREAT (Gestion de l'Assurance et de la Réassurance des Risques Attentats) and President of the Reinsurance Committee of FFSA (Fédération Française des Sociétés d'Assurance), and also of the Re Club.

As a result of the terrorist attacks of 11 September 2001 in New York, the world insurance industry suffered an unprecedented upheaval. It was immediately apparent that there were no specific insurance solutions to adequately counter the risk of small or large-scale acts of terrorism.

In the case of France, in order to mitigate the problem to some extent, one month after the attacks steps were taken to set up the Gareat Pool, which was modelled both on Spain's Insurance Compensation Pool and on Pool Re in the United Kingdom.

This interview gives an overview of its development, structure, mission and future.



François Vilnet is Vice-President of GAREAT (Management on insurance and reinsurance of risks deriving from terrorist attacks). He is President of the Reinsurance Committee of the French Federation of Insurance Companies (FFSA), and also of the Re Club, a private reinsurance association. He studied engineering at the School for Industrial Physics and Chemistry in Paris (EPCI) and he is also an economics graduate. In the 1970s he worked as an engineer for the Air Liquide group. In 1980 he joined SCOR as a facultative underwriter and in 1984 he became the head of this reinsurer for the French market.

In 1992 he was appointed senior underwriter of Abeille Re and in 1995 he took up the position of Secretary General of AXA Re. In 1996 he joined SAFR as Director of Planning and in 1999 he assumed responsibility for Partner Re's planning and risk management. Since 2003 he has been deputy head of properties and claims for Partner Re Global.

What circumstances brought about the creation of a pool to insure against terrorism risks in the French market?

The French pool for terrorism, GAREAT, was the first in the world to be set up with a state agreement following the tragedy of the World Trade Centre.

The main reason for quickly setting up a pool in France without the need for legal changes, was that reinsurers had excluded cover against terrorism for major industrial risks. In addition to this, a law in 1986 stipulated the obligation to offer full cover against terrorism in all property policies.

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How was the pool started?

Discussions about the pool started at the FFSA (French Federation of Insurance Companies) in October 2001, between insurers and reinsurers. It was difficult to reach agreement but the idea slowly emerged of a cover similar to the terrorism reinsurance scheme offered by Pool Re (UK), the Consorcio de Compensación de Seguros (Insurance Compensation

Pool), Spain, and the CCR (Caisse Centrale de Réassurance), which existed in France in the eighties. The GAREAT pool was set up in December 2001, following an agreement between the state, the two federations of insurers (FFSA and GEMA), the brokers, risk managers and the main reinsurers of the French market.

The basis of this agreement was to set up a pool for one year, mandatory participation of all French insurers, cession of all French property risks in excess of EUR 6 million (sum insured), unlimited cover by the state following a market annual total of EUR 1.5 billion and a reinsurance pricing policy of around 12% of property premiums.

The discussions were difficult, and most of the insurers cancelled their industrial risk policies, as they no longer had reinsurance cover for terrorism. Finally a consensus was reached on the pool and, to a large extent, was ultimately a compromise between insurers and insureds, as it allowed all the major industrial risks to be insured in January 2002. The agreement was completed by a decree allowing a possible limitation of only 20% of the property sum insured for specific cover of industrial risks against terrorism.

What advantages does GAREAT offer to its participants?

There are several main advantages of the GAREAT scheme:

For insureds it provides complete mutuality (no exclusion of any risk) with extensive cover against terrorism, including NBCR terrorism (nuclear, biological, chemical and radioactive), offering unlimited cover

per risk and per event with a reasonable pricing policy (average of 12% of property premiums).

For insurers it enables them to apply a limited retention limit on larger risks (with a maximum per year), having full reinsurance without limitation per risk or per event at a fixed price regardless of loss experience. It is a safe scheme with joint liability for insurers, high quality reinsurers selected on ratings, and a full state warranty.

For re-insurers it limits their responsibility (with a maximum per year), without any accumulation for this type of cover or with other countries.

How was the structure of the GAREAT cover defined? Is there a risk exposure model?

The GAREAT discussions took place, not only after the WTC tragedy, but also after a major industrial catastrophe that took place in the AZF chemical plant, near Toulouse. At the time, the cause of the explosion was unknown and it was generally thought that it was the first major terrorist attack on an industrial risk in the world.

Thus the studies of GAREAT's capacity concentrated on the Toulouse plant loss and surroundings. The loss was roughly estimated at around EUR 1 billion for the risks covered by GAREAT. This was taken as a benchmark plus a margin and a EUR 1.5 billion market capacity limit which was agreed with the state.

As regards modelling the terrorism exposure in France, GAREAT does not yet have full information from ceding compa-

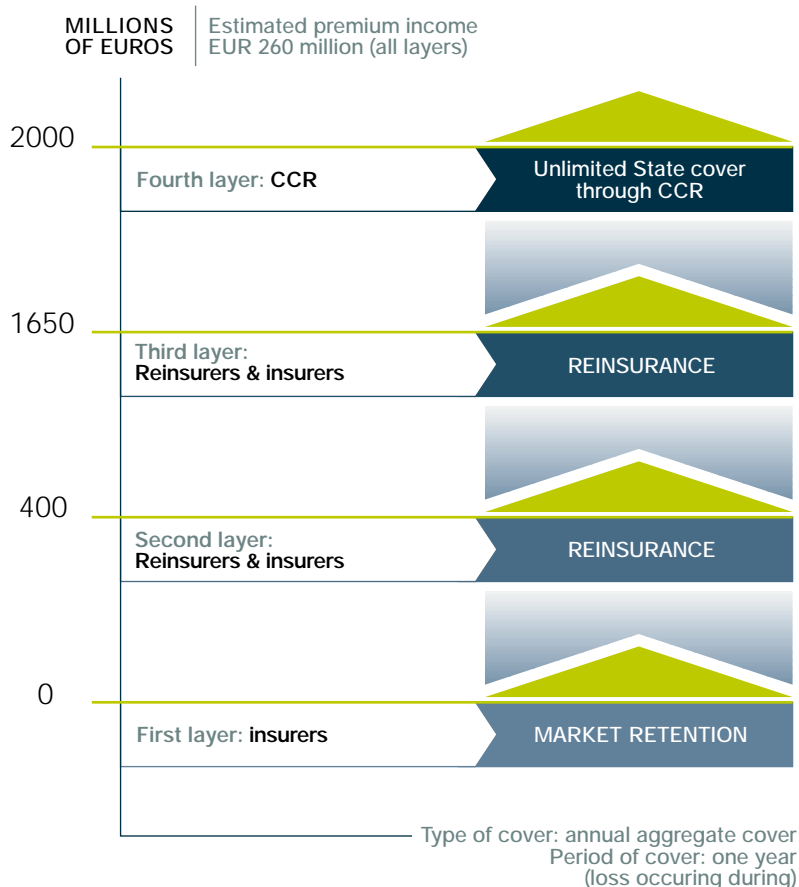


2004 Reinsurance scheme

nies, as it is acting as a reinsurer and not as underwriter of each individual risk. GAREAT is starting to gather information on the major industrial risks (above EUR 150 million) which will provide a good view of the pool's exposures.

What is the price of reinsurance cover? How is it applied?

The reinsurance price is calculated according to a decreasing factor based on the size of the risks, to take into account the fact that property rates decrease usually with the size of the risks. The reinsurance scale is thus a way to have an almost constant terrorism rate of the sum insured and is calculated as a percentage of the property premium of the risks. 6% for risks with a sum insured of less than EUR 20 million, 12% for risks between EUR 20 and EUR 50 million, and 18% for risks in excess of EUR 50 million.



How is Gareat structured?

Gareat has been structured as a pool covering all causes of terrorism without excesses (except those stated within the policies). The cover is divided into various layers, which include the insurers' retention, the reinsurance layers and an unlimited cover reinsured by CCR (the French public reinsurer). The level of the layers has been increased over time as the state's intention was to be involved only above the EUR 2 million level.

Gareat is a co-reinsurance market pool which encompasses all insurers and reinsurers in the market. The structure

for 2004 is divided into the following 4 layers on the basis of an annual aggregate:

- ▲ A market retention of EUR 400 million by the insurers
- ▲ Two layers of reinsurance of up to EUR 2 million by the reinsurers
- ▲ Unlimited cover over EUR 2 million by the CCR.

The main difference between GAREAT and previous terrorism pools such as the Consorcio de Compensación de

Seguros (Spain) and Pool Re (UK) is that the reinsurance market is able to reach the level at which the State becomes responsible. The insurers and the insureds (when they have captive insurance companies) can also participate in the reinsurance layers and subsequently allocate part or most of their reinsurance costs.

The agreement for 2004 with the state was based on a 3 year period, which gives a good outlook for the scheme until the end of 2006.

The average rate of the GAREAT portfolio is close to 12%, which seems to reflect the direct rate for natural catastrophes in France on all property policies. GAREAT rates are reinsurance rates applied to the portfolio of insurers, so in theory each insurer could create its own mutuality and apply different direct rates to different categories of risks. In fact, the whole market has used the GAREAT rates as a reference point and they are applied to insureds, sometimes with a commission to cover insurance or broking costs.

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What minimum limit has been set to cede risks to the Pool?

The minimum limit of cession of EUR 6 million has been chosen to maximise the reinsurance capacity offered to the market. A sufficiently low amount has been chosen to transfer an adequate premium to GAREAT (to pay for the high reinsurance capacity needed) and also high enough to allow reinsurers to give the market the largest capacity possible for small risks, under normal treaties.

Is there a possibility of setting up equalisation reserves?

The discussions with the State in 2001 have made it possible for insurers to put

up to 500% of the terrorism premium in equalisation reserves. As the insurers so far have not generally charged a terrorism premium for insureds under EUR 6 million, they just pay the terrorism reinsurance premium without transferring the cost to the insured and are able to set up tax free equalisation reserves.

The creation of GAREAT has forced insurers to charge terrorism premiums on industrial risks, but generally to date they have not set up equalisation reserves as the results of the last two years have been unsatisfactory in the whole market.



GAREAT does not manage the equalisation reserves as is the case in some other pools, as they depend on the policies of each insurance company.

The 2004 agreement with the state stipulates that from 2005 onwards, insurers will have to increase their retention limit in GAREAT (second reinsurance layer) by the amount of the theoretical equalisation reserves, and set up equalisation reserves (if possible to the full theoretical amount).

How is terrorism defined for the purposes of cover?

Terrorism is defined by the French criminal code, which is very extensive. The GAREAT board will have to define an act of terrorism with the agreement of the state. In the event of any doubt an insurer can go to the courts.

All insurers and reinsurers are bound by GAREAT's decisions.

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How does the GAREAT concept vary from other pools?

The GAREAT concept has been based on the example of the the Consorcio de Compensación de Seguros (Insurance Compensation Pool) - Spain, and Pool Re (UK), as well as the CCR terrorism reinsurance scheme (France), which was available to French insurers between 1986-1995.

The main differences with the pre-WTC tragedy public schemes was the creation of a public-private scheme with insurers, the introduction of the private reinsurance market and the possibility for insurers and reinsurers to participate in various reinsurance layers.



What role can Europe play in managing this type of risk?

The idea of a European pool was discussed by the CEA at the end of 2001 and has been promoted by some risk managers, as it would solve their need for a pan-European cover.

However this seems very unlikely, for some very strong reasons. Europe does not favour market solutions and pools in general, and is focused on full competition. By its nature, terrorism is dependant upon the state's attitude (foreign policy and internal policy) and can only be dealt with on a national level. Finally, some states do not even want their own country to be involved, let alone other countries.

It is clear that a European pool would solve some issues, but schemes are already difficult to develop at country level and current models are completely different, so it would first be necessary to reach a common viewpoint.

It can only be considered as a second step, once all European States have accepted having national pools or, once viable, regional pools (if the critical mass is not enough in one country, potential aggregation of similar/nearby countries).

What future does the pool expect?

It is very difficult to predict the future of a terrorism pool, as it is completely subject to the political situation in Europe.

For example, some insurers predicted that GAREAT would disappear after a year, although it was developed as a long term scheme. Terrorism in whatever form can be viewed as a long term issue, which is why it is important to have built this market solution.

The experience of the Consorcio de Compensación de Seguros (Insurance Compensation Pool) of Spain and Pool Re (UK) seems to indicate a need to create reserves for periods of 10 to 20 years.

Our pricing policy is based on this time frame and must not be volatile or cyclical, unless the scope of the cover or the situation changes dramatically.

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Our target is to improve GAREAT over time and to build an excellent scheme that is flexible and transparent. We also want to give stability to insureds and insurers with long term capacity, assisted by reinsurers, the majority of whom consider themselves as market partners and not opportunistic players.

We would also like all European countries to protect their industry and their people by appropriate policies, laws, insurance cover and fundamentally with appropriate reinsurance schemes. ■