

**POOL RE**

REINSURING TERRORISM RISK

# The role of Pool Reinsurance Company Ltd

*(A private company with a public policy objective)*

Presentation to the Advisory Committee on Risk Sharing Mechanisms

Washington, 9<sup>th</sup> June, 2017

## Background to Pool Re

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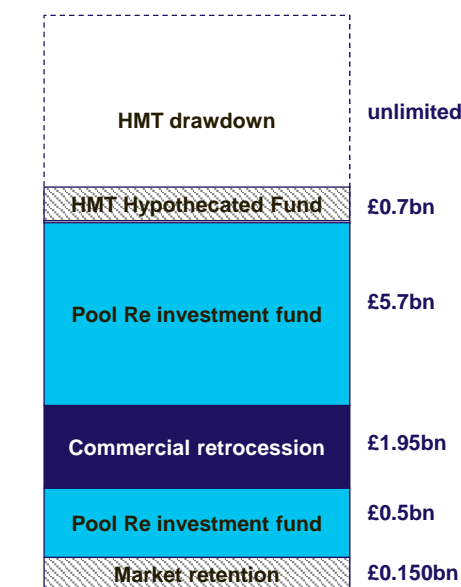
- Pool Re was established in 1993 by the insurance industry acting in partnership with the UK Government
- Formation due to inability to obtain reasonable commercial property cover for prevailing terrorist events from mainstream insurance markets
- Operates at nil cost to the taxpayer as a private industry mutual supported by a Government guarantee (repayable in the event of use)
- Reinsures assets to the value of £2.2Trn
- Largest claim paid to date (Bishopsgate Bombing in the City of London in 1993) amounted to £262m. Same event today would be in excess of £1bn due to increased property density and values
- Pool Re has to date dealt with 13 certified claim events costing £635m\*
  - 8 claims accounting for 95% of losses occurred between 1993 and 1996
  - The relatively small claim payments from the 7/7 bombings highlights the terrorism insurance gap discussed later
  - There are currently five active claim notifications arising from the events at Westminster on 22 March, 2017 and many more from the event in Manchester on 22 May, 2017 (see slide 7)
- Governance is via a Board of Directors comprised principally of insurance industry representatives

*\* This figure would be significantly higher if the same events were to occur today*

## Economics

- Pool Re operates a pre-funding model – there is currently a £9bn+ buffer before the requirement to drawdown funds from HM Treasury\*
- The capital stack operates as follows:
  - Each insurer must pay losses up to a threshold, determined individually for that insurer, equating to an industry retention per event and in the aggregate
  - When losses exceed that threshold the insurer can claim upon the reserves accumulated by the insurance industry on a mutual basis within Pool Re
  - An additional layer of protection is provided by a commercial retrocession arrangement, purchased by Pool Re since 1 March 2015 (first time the commercial market has participated in terrorism reinsurance in the UK for 23 years)
  - Should claims exceed all layers described above then Pool Re can draw funds from the Government to enable it to meet its obligations in full, regardless of the scale of losses
- Pool Re charges insurers a premium for the reinsurance cover provided; in turn 50% of these premiums are passed on to HM Treasury for providing the Government guarantee and further payment is made for the commercial retrocession; annual profits in Pool Re (if any) are distributed 25% to HM Treasury and 25% to Members
- For the 2015 financial year, £154m in premiums and an additional £33.5m share of surplus is payable to HM Treasury; this is expected to increase for 2016
- It is the intention over time to encourage greater insurance industry risk participation - through increased market retention, involvement in additional retrocession and/or similar arrangements (e.g. Insurance-linked securities) and potentially by segmenting the risk

### Current capital structure



\* Excludes any increased premium receipts and/or revision to premium split post event; any money drawn from HM Treasury would need to be repaid from future premium receipts

## Proposition

- Pool Re provides reinsurance cover for damage to commercial property caused by a terrorist event; the nature of the cover has changed over time in response to the evolving terrorism risk landscape
  - Initially Fire & Explosion
  - Cover was changed to 'All-Risks' with two exclusions - War and Electronic (Cyber); CBRN no longer excluded
- The traditional approach to terrorism (focused on property damage and related business interruption) has however not kept pace with the evolving nature of the threat (focusing primarily on achieving propaganda of the deed by murdering individuals); as such, coverage gaps have emerged in the terrorism insurance market

### Changes to the terrorism landscape



#### Domestic terrorism

**Method of attack:** Large vehicle bombs (LVBIED)

**Intent:** Economic disruption (discriminate targeting)

**Risk transfer needs:** Property damage and BI

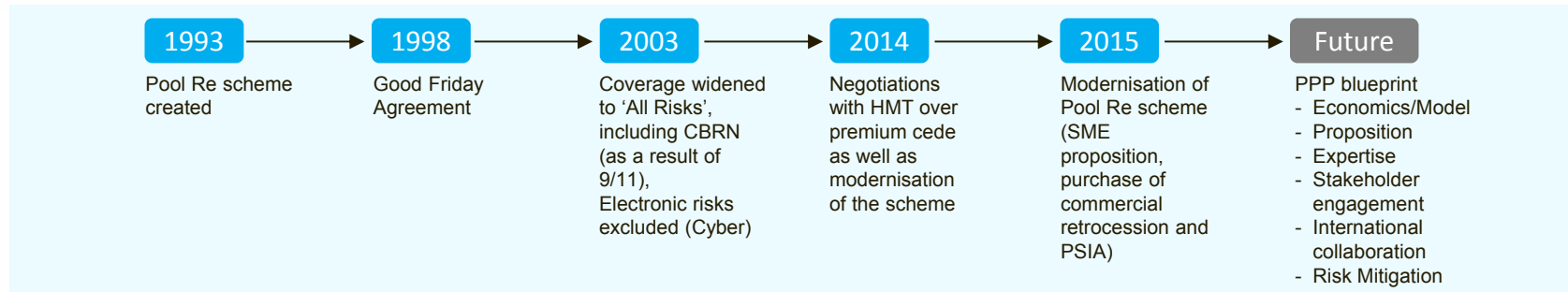
#### Islamist extremism

**Method of attack:** MTFA / PBIED / VBIED / CBRN / Cyber

**Intent:** Mass casualties (indiscriminate targeting)

**Risk transfer needs:** Property damage, BI, loss of attraction, non-property damage BI, cyber, impacts on people and damage to brand and reputation

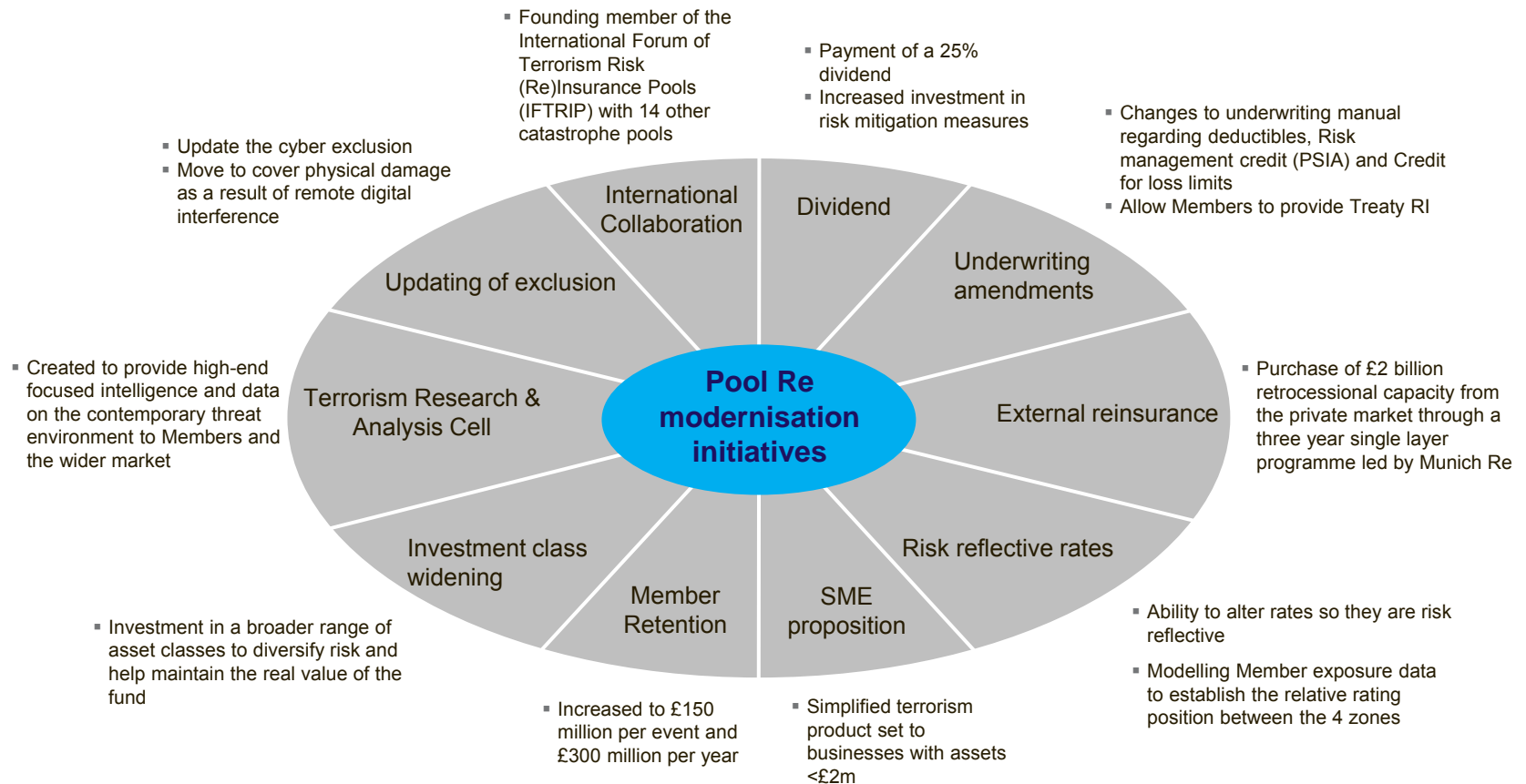
## Pool Re's evolving role as a Public Private Partnership (PPP)



- Originally formed in response to the spate of terrorist attacks related to the situation in Northern Ireland at that time. As the IRA threat reduced, terrorism nevertheless went from being a localised issue to being a global threat post 9/11
- In 2015, as a result of the conclusion of negotiations regarding the terms and conditions of Government support and a major strategy review, there was a significant shift in the premium allocated to Government in return for the modernisation of the scheme
- As a result, we introduced a number of modernisation initiatives; these initiatives sought to bring the organisation into the present day in the context of significant changes in both the macro, and the insurance market environments
- We have now started introducing a series of changes, wider in scope and more far reaching, shifting the focus from passive fund/mechanism to a proactive buffer organisation engaged in resilience building. These changes (see next slide) will define the evolution of Pool Re over the coming years and towards the next Government review of its involvement in terrorism insurance starting in mid-2020
- Our goal at the next Government review is that HM Treasury, rather than adopting a narrow focus, will take account of broader national security issues and the role that Pool Re can play in these. We aim to promote this by engaging in dialogue across Government

# Modernisations to the scheme

Since 2015 Pool Re has implemented a number of modernisation initiatives, a selection of which are highlighted below:



## Pool Re Objectives

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- Reduce market failure. The scheme should only cover risk which the market could not or would not cover.
- Incentivise the market to take as much risk as it can cope with
- Return more pricing control to the market
- Ensure that there is the widest possible cover for UK plc
- Adapt the scheme to the changing nature of the threat and loss
- Mitigate risk to the taxpayer. The scheme should keep the taxpayer as far away as possible from risk and cost
- Provide a fair basis of compensation, broadly related to the risk take by different parties.

## The potential of the Pool Re model

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- Pool Re is an example of an effective market-oriented collaboration between the public and private sectors
  - It promotes financial resilience within the UK economy, providing UK Plc with continued access to appropriate terrorism insurance cover as well as influencing mitigating behaviour
  - It is the vehicle through which premium is collected from the market and claims paid out, over time building a significant buffer between potential loss events and the UK taxpayer
  - It brings government agencies, academia and the industry together to promote greater understanding of the risk and develop the product as the risk evolves, as well as facilitating the re-emergence of the commercial terrorism reinsurance market
  - It benefits from a government guarantee in order to do so
- We intend to continue to develop as an organisation – developing our economic model to maximise value to our stakeholders, evolving our proposition in line with the nature of the threat and positioning ourselves as a global terrorism expert
- We aim to become a blueprint for a successful public/private partnership that can potentially be applied to other situations where significant risk is currently sitting on the Government balance sheet – e.g. non property related Terrorism exposures, Foreign Aid (DFID), Cyber, Pandemic and Climate Change
- By way of example, in the area of Strike, Riot and Civil Commotion, in the event of serious rioting resulting in property damage and business interruption, police authorities will be liable to pay compensation under the Riot Compensation Act 2016. If there were to be a funding gap, police forces may need to be ‘bailed out’ by central government. A government endorsed ‘risk pooling scheme’, with private market reinsurance support for large losses, could address this ‘gap’ without additional central government funding



## Pool Re - Harnessing the private market

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- We buy as much retrocession as we can - £2bn
- Government is compensated for their guarantee
- Government also shares in the surplus
- Over time Government layer being pushed ever higher – taxpayer protected.
- Scheme is balanced. Private market provide working layers of cover, but are not exposed to the systemic event that might destroy them
- Cover remains ‘back to back’ with property – important.

## Pool Re's Focus – Adding value to HMG

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### Terrorism Insurance Gaps:

- We are currently focusing on bridging terrorism insurance gaps in the following areas:
  - **Cyber** – knowledge and awareness around cyber threats and attack vectors has changed enormously in recent years as has the capability of hackers. This is currently an excluded peril
  - **Non damage Business Interruption (BI)** – total BI from the recent Paris attacks could reach US\$12bn even though the property damage was negligible, leading to questions over the efficacy of the French Pool and Terrorism Pools in general
  - Losses in these areas are NOT currently covered by the insurance market or Pool Re and could therefore result in **loss to HMG**. In France by way of example, the French state has been forced to raise taxes on insurance policies following three major attacks which resulted in no pay out from the French Pool
  - The events at Westminster are an illustration of this since the claim notifications relate to non-damage BI, not currently covered by either Pool Re or the private market. Discussions on this with HMT have been halted due to the General Election
  - In addition to the above gaps, the **SME** segment and exposures outside London remain underpenetrated, with therefore potentially increased vulnerability in the event of a terrorist attack

### Risk Mitigation:

- In collaboration with the National Counter Terrorism Security Office (NaCTSO), Pool Re introduced **Loss Mitigation Credit and Protective Security Improvement Activity (PSIA) initiatives**. This has the potential to improve resilience by driving a significant increase in the implementation of counter terrorism security measures in public and private buildings across the UK. We are now working with OSCT/NaCTSO to explore widening of the scope
- Opportunity to drive compliance with **Cyber Essentials**, ISO 27001 once scope of cover is extended to Cyber Terrorism
- Potential future activities to include involvement in **information dissemination** (e.g. National Counter Terrorism Awareness) and the launch of new product
- Sponsor a **Professor of Terrorism Risk Management and Resilience** at Cranfield University

## Pool Re's Focus (continued)

### Expertise:

- As the terrorism threat landscape changes, Pool Re has begun to leverage its expertise to become a global thought leader, setting up the **Terrorism Risk & Analysis Centre** to coordinate all research/knowledge based activities and produce regular Threat & Mitigation Reports for our Members and our clients in the wider business community so as to enable better assessment and pricing of risk
- Provide analytical support to the **OSCT**, as part of the refresh of CONTEST:
  - Project Dulverton** - (how the (re)insurance sector might support UK interests in fragile states)
  - Engaged in wider discussion within the private sector about how to close the terrorism "**Information Gap**" between HMG and businesses - Pool Re (along with other recognised counter terrorism entities) could potentially have a significant role to play (Project SIDE - Security Information and Data Exchange)
- Ongoing external projects on **CBRN exposure modelling** (Project Nighthawk with Cranfield University) and **cyber-terrorism** with the Judge Business School, Cambridge University

### Enhancing our model:

- Participating in a research study led by Cass Business School, City University London) titled *State-sponsored pools as centres of expertise in the changing market for risk* will determine if our model can be an effective one for removing liability from the Government's balance sheet

### Pool Re's Terrorism Risk & Analysis Centre

#### Objective

- To position **Pool Re as a global expert in terrorism insurance**

#### Workstreams

- 1 Equip Pool Re to better understand the terrorism threat and, through **research**, to better inform our decisions
- 2 **Generate "value add / thought leadership"** products benefiting Members, partners, and other stakeholders relating to the terrorism environment
  - Export Pool Re's PPP knowledge to **markets** where terrorism risk pools are being investigated as a risk financing option
  - Lead thinking on how terrorism risk should be **priced**
- 3 **Enhance relationship with HMG** and those responsible for the UK's Counter Terrorism policy development
- 4 **Lead on risk management solutions** for, and communication with, insureds and delivery partners thereby mitigating claims on Members and ultimately, the Government

#### KEY OUTCOMES:

- 1 Develop capability to provide **innovative solutions** to new and **emerging risks** and help to drive **national resilience**
- 2 Establish a brand as the '**go-to organisation**' for the most complex issues in the **terrorism insurance space**
- 3 Provide terrorism information/data to underpin the **terrorism information gap** between HMG and the private sector

## Pool Re's Focus (continued)

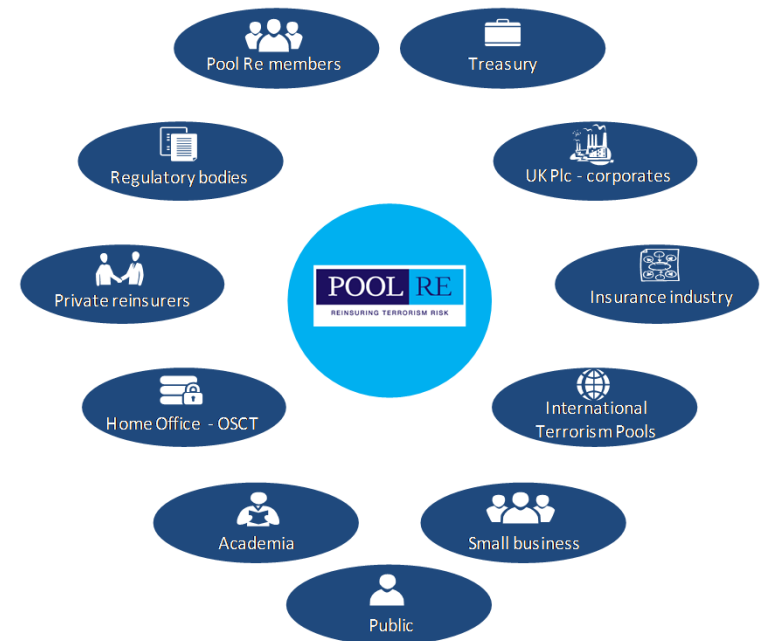
### Supporting Government initiatives:

- Pool Re has driven its agenda in the absence of specific policy guidance from HMG but now seeks enhanced collaboration with the Home Office in particular
- Pool Re is looking to engage more closely with its stakeholders to **align strategic thinking and drive consensus**, and has been actively involved in a number of collaborations in addition to those described in previous slides
  - Organised a joint **Home Office/Pool Re event** (re. CONTEST) in July 2016
  - **Seconded** an employee to the Home Office (OSCT) to assist with the proposed working groups aimed at bringing together the private sector, the third sector, Government and Government agencies to facilitate the private sector's role in counter-terrorism by enabling two way communications
  - Attended the first meeting of a cross departmental **Insurance Task Force** in September, chaired by DfID with other key departments and agencies including Treasury and FCO
  - Assisting a Home Office/FCO initiative on how insurance can help protect British interests abroad

### International:

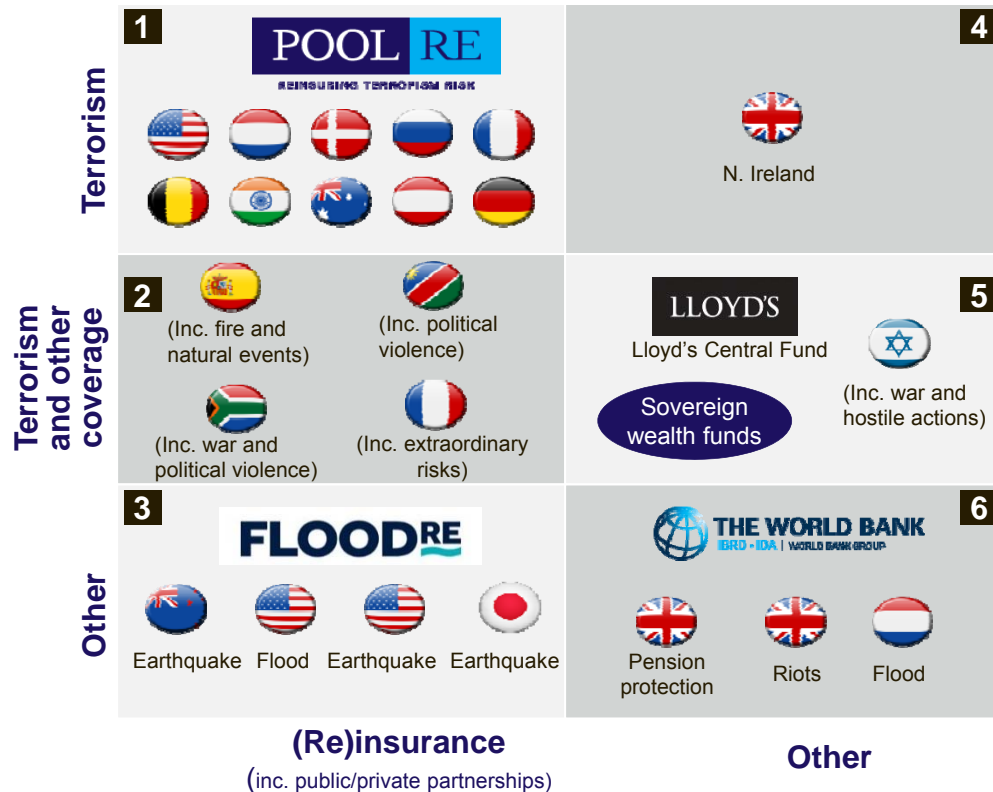
- Pool Re has been the driving force behind closer collaboration between international terrorism pools
  - Hosted the first National Terrorism Pools Congress in October 2015; the second annual congress was held in Canberra the following year
  - The **International Forum of Terrorism Risk (Re)Insurance Pools (IFTRIP)** ratified in October 2016, conceived as an independent working group serving as a discussion body for issues relevant to any kind of state-backed terrorism (re)insurance solution providers, and as a forum for the discussion of relevant developments in the (re)insurance industry

### Stakeholder engagement



# We analysed a broad range of international schemes to understand pros and cons of various models and potential learnings for Pool Re


















































## Scheme examples – terrorism and others



## Shortlisted schemes for deeper analysis

- Offers terrorism cover for two sections: Large Risks ( $\geq$  £15M) and Small and Medium Risks ( $<$ £15M), with state backing
- State owned global reinsurer (CCR) provides unlimited excess coverage to GAREAT
- Private pool administered by GIC Re – State owned reinsurance in an emerging market
- TRIPRA offers terrorism coverage in the largest insurance market, with post-funding mechanism
- Most comprehensive unlimited coverage provided by State
- Privately funded but publicly managed non-profit providing earthquake cover in California, a high seismic risk zone
- Public earthquake commission with large claims history with potential post-crisis learnings

# There are interesting elements in each model that Pool Re can learn from and potentially apply in the UK in the pursuit of the optimal model

	Public schemes	Private schemes	Pre-Funded public/private partnerships		Pre-Funded public/private partnerships	POOL RE	
	 Consorcio: catastrophe risk pool in Spain	 India terrorism pool	 California Earthquake Authority	 GAREAT & CCR: terrorism pool in France	 Earthquake pool in New Zealand	 TRIPRA: terrorism scheme in the USA	
Government guarantee	 Unlimited			 Unlimited	 Unlimited	 Limited	 Unlimited
Perils covered	Terrorism, including CBRN, plus other perils	Only conventional terrorism	Earthquake cover for residential properties	Terrorism, including some CBRN, plus other perils	Earthquake cover for residential properties	Terrorism, potentially including CBRN	Terrorism, including CBRN
Mandatory to offer							
Mandatory to cover				 With fire cover	 With fire cover		
Reserve buffer and reinsurance							
Active involvement in prevention efforts				 *CCR only			
Active involvement in response efforts							

## Currently

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### Pool Re adds value by:

- Pool Re is an example of an effective **market-orientated collaboration between the public and private** sectors
- It has been approached by a sub-committee of the **5 eyes** as well as countries considering a terrorism pool, with a view to how to establish a pool and incentivise resilience measures
- It promotes **financial resilience within the UK economy**, by providing UK Plc with continued access to appropriate terrorism insurance cover and by encouraging businesses to implement government accredited risk management strategies (PSIA and Cyber Essentials)
- It is the vehicle through which premium is collected from the market and claims paid out, over time building a **significant buffer** between potential loss events and the UK taxpayer
- It acts as a framework facilitating the ongoing and **increasing involvement of the insurance industry** in terrorism insurance in the UK
- It has to date operated at **nil cost to the tax payer**, paying the Government around £200m per annum
- It helps to facilitate the **flow of information** between the government and the private sector (SIDE)
- It acts as a think tank for ways in which to **mitigate new forms of risk** (British interests abroad, Terrorism Insurance Gap)
- It is an **incubator** of new ideas (Pool Re Chair of Terrorism Risk Mitigation and Resilience at Cranfield)
- It is a model for cooperation in risk management **globally** (IFTRIP and a potential Insurance Linked Securities solution as per the recent Bank of England and Financial Services Bill)

## Looking Forward

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### It could, however, be used further:

- We intend to continue to move forward as an organisation – developing our economic model to maximise value to our stakeholders, evolving our proposition in line with the nature of the threat thereby closing gaps in cover and positioning ourselves as the leading global expert in terrorism insurance and reinsurance
- We also aim to provide a blueprint for a successful public/private partnership:
  - To propose innovative ways to **remove risk** from the government's balance sheet (Civil Injuries Compensation Scheme, strike riot and civil commotion by way of example)
  - As a **model** for other “uninsurable” perils that threaten society and where partnership between government, academia and the private sector could yield world leading ideas (cyber, climate change, pandemic)
  - To promote **behavioural change** by developing a private sector version of the PSIA concept beyond NaCTSO's crowded places solution thereby ensuring broader take-up and therefore resilience
  - To help ensure that the London Insurance Market post-Brexit remains **world leading** with ideas such as a Terrorism Bond
  - To back other **Home Office initiatives**