

NATURAL CATASTROPHE INSURANCE PROGRAMME IN ALGERIA

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INTRODUCTION

The climatic, geological and geophysical conditions in Algeria have left the country highly exposed to climatic imbalance as well as earth and underground movements.

During the last 30 years, earthquakes, floods, storms and earth movements have hit various regions in the country causing significant human and material damages. Earthquake constitutes the most expensive and recurrent natural catastrophe. For example, the loss estimates for the earthquake incidences of El Asnam (1954 & 1980), Mascara (1989) and Zammouri (2003), illustrate the degree of exposure to this hazard. Other risks regularly occur in exposed areas resulting in significant losses. The flood of November 2001 in Bab El-Oued and the storm in Oran (1980) show the extent of damages that can be caused by such natural events. Given the effect of these catastrophes and their economic and social importance, the issue of preventing and managing natural risks have taken an ever-increasing importance in public policy within the last 25 years. Such efforts involve rescue strategy, public financing of losses (natural catastrophe fund), expert research on natural phenomena by science institutes.

Insurance, as a means of preventing and financing natural catastrophes, has so far provided limited support. Covers are only provided for facilities and equipment owned by large and medium size companies. In Algeria, natural events are excluded from covers given under personal and property insurance. Insurance share in the cost of natural catastrophes cover in the past 20 years, though low, is on the increase. While insurance



companies did not contribute to financing the resultant cost of the El-Asnam earthquake, they committed up to AD 500m and AD 4bn towards the flood incidences of Bab-el-oued and the Zammouri earthquake respectively.

The limited nature of insurance against natural catastrophe stands in contrast with the volume of need for cover, which itself can be measured by the scope and diversity of the risk incurred.

This paradox is attributable to a situation of limited supply and ineffective demand. In Algeria, as in other places, the availability of insurance against natural risks is hampered by insurability. Indeed, statistical quantification of possible risks as well as the availability of underwriting capacities remain the main determinants of this insurability. The propensity for insurance is low. In 2002, money spent on insurance products hardly attained 0.48% of overall household expenditure of Algerians. Social attitudes towards insurance as a means of prevention and protection are hardly improving.

The facultative nature of insurance, combined with the highlighted financial and cultural constraints, impedes the growth of natural catastrophe insurance. Thus, with each catastrophic occurrence, there is excessive financial pressure on public expenditure budget from which funds are drawn to cover both collective losses (roads, bridges, social, educational and health establishments) and private losses (houses, commercial centres and personal properties).

Government Act N° 03-12 of 12/08/2003 on compulsory natural catastrophe insurance and compensation for victims has produced an insurance model for natural catastrophe, which attempts to overcome the two

constraints that hamper the opening up of natural catastrophe insurance to the general public, namely, finances and social behaviour.

Two issues are involved in this regard:

- Redefine the share of the catastrophe cost to be borne by the community as a whole on one hand and by persons at risk on the other hand.
- Manage in time and space the financial consequences of catastrophes.

This paper shall describe the insurance scheme for natural catastrophes and defines the rules that govern them. It covers five main areas:

- Purpose
- Scope of application
- Implementation
- Financing
- Supervision

PURPOSE

In addition to providing natural disaster victims with insurance cover that would enable them recoup the economic consequences on their personal property, the proposed insurance scheme has four objectives:

Increased access to insurance

Natural catastrophe insurance used to be limited to companies whose assets were partly covered by foreign reinsurance.

Properties belonging to individuals or smallscale enterprises only received minimal cover. The situation was a result of a weakness in both demand and supply relative to the factors mentioned in the introduction. Compulsory insurance will stir up insurance awareness but also allow for a proper distribution of cost to the exposed population. Therefore, based on the number of insured persons, the unit cost shall be as low as possible.

The interest of the insured is at the core of the principle of compulsory insurance. The geographical distribution of insured assets is a prerequisite for achieving a

balanced portfolio in an insurance company because it brings together average costs and frequencies, which form the basis of actual cost of insured risks. Consequently, the insurance companies' interest is also strongly tied to the principle of compulsory insurance.

Combine individual preparedness with national solidarity

The consequences of natural catastrophes in human and economic terms call for a strong and efficient mobilisation of the whole nation.

This can be achieved when the majority of citizens as well as institutions in charge of managing such risks participate in the prevention, reduction and repair of losses after a disaster.

Effective mobilisation is achieved through technical controls, institutional organisation and a national savings mechanism, which would ensure successful rescue, supply and reconstruction missions without any serious disruptions or excessive delays. Such effort is required not only after but prior to a disaster occurrence. Natural catastrophe insurance is founded on this principle in that it ensures that resources pooled together for catastrophe financing are spread over time.

The financial resources to be mobilised by insurance will be the product of individual provident arrangements by physical or moral persons who are exposed to catastrophe risks.

As regards national solidarity, this initiative will be supported by the whole nation – represented by Government – who will intervene where necessary to ensure the financial stability of the natural catastrophe insurance scheme.

Preserve the social and economic assets of the nation

In addition to the human loss and its tragic effects, more often and depending on the degree of gravity, natural catastrophes affect the social and economic

asset base of the country.

When earthquakes occur in Algeria or other parts of the world, residences and industrial or commercial outfits constitute the bulk of damages experienced by households and business owners.

The damages are of a serious and diverse nature: material damages, loss of income, psychological effects... etc.

Insurance has been acknowledged as an avenue through which probable losses can be spread over time, by way of insurance premium, and in space, by way of mutualisation of insured persons.

Insurance enhances preventive management of replacement cost for affected assets and promotes rationalisation of time limits for reconstruction.

Natural catastrophe insurance as determined by Government Act 03-12 will first and foremost focus on losses classified as heaviest, namely, material damages to properties as well as industrial and commercial activities.

Alleviate public spending on natural disasters

The financial responsibility after natural disasters in Algeria has often been totally borne by Government budget. It is generally known that damages to collective public property (schools, government buildings, public hospitals) as well as economic losses (bridges, roads, seaports and airports) are repaired using public funds.

In contrast, moral or physical persons from the private sector ought to bear responsibility for damages to their property or business.

However, the constraints of purchasing power compared to the requisite financial effort to pay for damages require that individual contributions be pooled together so as to be able to face each disaster occurrence.

Insurance is proposing this particular service by basically transforming the stakeholders into a community that would mutualise its risks and jointly finance losses.

Through reinsurance, this mutuality will extend to other persons affected by the same risks who live in other countries of the world.

Introducing insurance as a source of finance for natural disasters does not result in lifting the public financial burden, but in rationally sharing the costs between the Government and persons affected by the risk.

Government can then dedicate public funds to repairing public assets, while insurance can pay for private property.

As insurance is a commercial activity with financial capacity limited by the volume of its resources, Government, by way of national support, have to assist insurance companies (which organise mutuality for insured persons) financially in cases where the damages exceed their financial capacities.

SCOPE OF APPLICATION

Government Act 03-12 of 26/08/2003 on compulsory natural catastrophe insurance and compensation of victims institutes a programme whereby the scope of application is determined by three parameters: the object, the persons involved and the risks to be covered.

Object of insurance

Two categories of property constitute the object of natural catastrophe insurance:

- Landed property located in Algeria: buildings, private constructions and collective residences, offices together form properties to be insured under the first category.
- Industrial or commercial facilities - buildings used for commercial or industrial activity, as well as their contents, including equipment, materials, goods and others - make up the items to be insured under the second category.

The persons involved

Article 1 of Act 03-12 earlier mentioned specifies the physical or moral persons who should take up natural catastrophe insurance, namely;

- Proprietors (moral or physical persons) of landed

properties located in Algeria, under the first category.

- Physical or moral persons who are involved in commercial or industrial activity under the second category.

Risks to be covered

Natural catastrophe insurance shall be applied to previously determined risks. The identification of the nature of natural catastrophes to be covered arises from the need for insurers to assess potential damage and capacities required to finance it.

The natural catastrophe risks to be covered under the scheme were selected based on their observed or likely scope.

The risks, could result from the following:

- Earthquakes
- Floods and mudflows
- Storms and violent winds
- Earth movements

The legal provisions provide a definition for each of these risks, which serves as a reference for the insurance contract.

OPERATING MODALITIES

The operational rules for the scheme set up through Act 03-12 are summarised in the insurance contract, which is the binding document.

Apart from the normal property insurance rules, which also cover insurance products for natural catastrophes, four conditions form the basis for the peculiarity of this product: covers, exclusions, claims and rates.

Covers

Natural catastrophe insurance as defined by the Act covers insured property (buildings, commercial or industrial facilities and their contents) against direct damage caused by catastrophes related to the earlier mentioned natural phenomena: earthquakes, floods,

storms and landslides.

Three parameters define this cover: cover limit, sum insured and deductible

- Cover limit: this amount represents the insurer's maximum liability in the event of claims covered by natural catastrophe protection.

This limit stands at 80% of the sum insured for property (1st category) and 50% of the sum insured for industrial/commercial facilities (2nd category).

- Sum insured: this amount represents the figure stated on the insurance contract and computed from:

(1) Reference prices by square metre fixed by the Ministry of Finance for property; these reference prices distinguish between communal and individual buildings.

(2) The amount declared by the insured for reconstruction of buildings and replacement of amenities, materials, goods in the case of commercial/industrial facilities.

- Deductible: this is the share of each loss to be borne by the insured. It stands at 2% (a minimum of AD 30,000) for properties and 10% for industrial/commercial facilities.

Exclusions

The specific domains excluded from the natural catastrophe cover are those prescribed in Article 10 of the Act, viz, losses recorded on the following:

- Unpreserved agricultural products
- Crops
- Soils
- Out-door livestock

Damage to the following is also excluded:

- Aircraft hulls
- Ship hulls
- Transported goods

Claims payments

Claims payment modalities to victims are included in

the operating conditions of the natural catastrophe insurance scheme which have been assigned special treatment by the legislator.

These modalities operate in three stages: declaration of loss, loss adjustment and claims payment.

- Declaration of loss: the cover becomes active as soon as the catastrophe event is announced officially.

The announcement is released through an official declaration jointly signed by the Ministries of Finance and Internal Affairs.

The declaration specifies the nature of disaster, the date of occurrence and affected communities, classified by "daïra" and "wilaya".

- Loss adjustment: all observations and assessments must be noted by the designated adjuster and presented in a report to the insurer not later than three months following the declaration of loss.

If the deadline is exceeded, in addition to the compensation owed, the insured has the right to claim damages and interests.

Where the insured contests the first adjuster's report which was carried out at the instance of the insurer he can seek a counter-adjustment. In event of inconsistency between the two adjusters, a third one can be commissioned by mutual agreement or judicial means.

- Claims payment: taking into account the deductibles earlier mentioned, the insurer is bound to settle his client's claims within three months with effect from the submission date of the adjuster's report, failing which the insured has the right to claim damages and interests.

Rates

Premium rates for natural catastrophe insurance are based on exposure to seismic risks mainly and secondarily to three other risks covered by natural

catastrophe insurance. Exposure to risk is measured by two parameters: risk-prone areas and structural vulnerability.

Risk-prone areas have been identified according to the demarcation established by the "Centre du Génie Sismique - CGS (Centre for Seismology) and graded by order of increased risk: Zones 0, 1, 2a, 2b, 3.

Structural vulnerability is first of all measured by the level or absence of compliance with Algerian seismic-resistance regulations (Rpa99) of 2003 or previous versions.

Then, on the basis of the declaration by the insured, vulnerability is measured in relation to the existence or absence of each of the other three catastrophe risks (floods, storms and landslides).

The two factors mentioned earlier provide a template for premium rates applied on sums insured.

Proprietors of unapproved buildings or insured persons operating unregistered industrial/commercial concerns shall pay a surcharge of 20% on premium due.

Natural catastrophe insurance rates are backed by an order from the Minister of Finance. The rates shall apply to all types of risks except policies covered under facultative reinsurance.

FINANCING

The insurance and reinsurance scheme shall mobilise, from the premium paid by the insureds, the resources for financing natural catastrophe losses. Government shall provide financial support where the insurance and reinsurance capacities have been exhausted.

The three parties, insured persons, insurers and Government are expected to play their role according to the rules determined for each party.

Insured persons

Insurance is issued annually and can be attached to a global contract or sold separately. Premium is paid according to rates determined by order of the Ministry

of Finance.

Insurers and reinsurers

In the event of disaster, insurers' liabilities are to be financed from the yearly premium as well as the reserves that insurers would have constituted in order to level out the insurance company's results on natural catastrophe risks.

Up to 95% of the technical results on natural catastrophe insurance are to be booked as reserves yearly. The technical results are calculated net of reinsurance premium and charges. By the end of the 21st year from their constitution, unused yearly transfers to reserves are released.

Natural catastrophe portfolios are doubly protected through reinsurance.

The risk is distributed through quota-share treaty between the insurer and the reinsurer based on a fixed proportion: 30% for the insurer and 70% for the reinsurer.

A second reinsurance cover (stop loss) protects the insurer's net retention on natural catastrophe risks against any technical loss.

Where the net annual loss charge is higher than 100% of premium earned for the year in question, the reinsurer finances the excess.

Government

Only the reinsurer who is beneficiary of government security offers the reinsurance covers described in the previous paragraph.

Government's role in the insurance scheme is to ensure financial solvency in the case where the loss charge exceeds the scheme's claims payment capacity.

Government guarantee is provided to CAT reinsurance operations carried out by Compagnie Centrale de Reassurance (CCR).

The public Treasury finances all technical deficits net of retrocession from CCR's CAT cover account.

Conditions and modalities for benefiting from this guarantee (advances or liquidation of the excess due) are determined by way of regulation.

Financial relations between the Treasury and CCR are managed within the framework of a bilateral agreement.

SUPERVISION

The natural catastrophe insurance scheme is subject to continuous supervision by relevant authorities in charge of monitoring risk development, supervising portfolio management of insurance companies and also ensuring compliance with insurance regulations.

Risk control

Catastrophe risks and the level of management by insurers can only grow with time. For instance, adapting of covers, price factors, reinsurance covers and skills stand as the conditions of ensuring a normal and long-lasting functioning of the scheme.

The natural catastrophe committee, which is headed by the Director of Insurance and comprises professionals in the national insurance industry, designed a regulatory document that governs catastrophe insurance. The committee will continue to maintain supervisory efforts towards the smooth functioning of the scheme.

Portfolio Management

The role of the insurance supervisory authority over insurance companies' portfolio focuses on underwriting, reserving, IT systems, internal control, reinsurance and claims management, particularly claims adjustment and time limits for claims payment.

Compulsory nature of the scheme

The compulsory nature of the scheme requires a system that involves both control methods and penalties.

The methods of monitoring compliance regarding

CAT cover issues have been considered under two perspectives: real estate transactions and companies' annual tax returns.

Real estate transactions must be backed by a valid insurance document against natural catastrophes.

Such control falls within the responsibility of any institution that is authorised to authenticate such transactions, namely, notaries and the Land Registry Department.

Companies involved in commercial or industrial businesses must attach documents confirming purchase of CAT cover to their tax returns. The tax offices are in charge of this control.

Two kinds of penalties for non-compliance with compulsory CAT insurance are prescribed in the Government Act: a fine of 120% of premium due as well as possible exclusion from government assistance.

These sanctions are to be applied either by tax inspection offices, if the offence is detected during tax returns or by the insurance company if discovered while subscribing to a new insurance policy.

Related measures

The process of implementing a CAT scheme involves a host of other actions that contribute to extensive information dissemination on the product, appropriate training of staff of insurance companies as well as creating awareness on risk prevention and loss minimisation.

- Communication: the insurance sector should design and put in place a collective communication plan so as to popularise the new CAT product and develop foresight and prevention reflexes.

The association of insurers, UAR and CAN are naturally expected to take on the task of institutional communication as complementary effort to marketing by individual insurance companies.

- Training: the innovative nature of natural catastrophe

covers and the relative uniqueness of the underlying mechanisms (underwriting, pricing, reserving, reinsurance, skills etc...) imply more pertinent training for the staff in charge of managing the portfolios.

To that end, insurance companies are expected to design internal or inter-company training programmes to increase knowledge of the product as well as organise the risk management chain from subscription to payment of claims.

Support from national or foreign experts in that respect could contribute to a remarkable improvement of the quality of human resources.

Prevention

Insurance being an essential means of reducing the potential cost of risks, the insurer who wants to minimise his overhead costs and the insured who desires the best rate possible have an interest in taking preventive regulations into account where such exist. While accepting risks, insurers must guide the public as well as the relevant authorities on the land occupancy practices, types of construction, maintenance of sewage systems and general organisation so as to minimise the extent of damages after a natural disaster.

In establishing a difference between rates applied to authorised and unauthorised constructions or activities, insurers already indirectly contribute to ensuring compliance of actual practices with the operational regulations.

CONCLUSION

The departure from a system of financing losses arising from natural disasters mainly from public funds and government intervention, to an insurance dependent compensation scheme will be achieved gradually. Indeed, as the CAT cover scheme commences, the number of policies sold as well as the total amount of assets protected by insurance is expected to increase accordingly.

The incubation period for the programme will largely

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depend on the communication efforts of the insurers as well as the corresponding reaction from insurable persons.

The insurance companies will also need an accurate assessment of the aggregate exposure of their portfolios and the reinsurance covers commensurate with their shareholders' funds.

Indeed, government guarantee is designed to add appropriate reinsurance support to cover the liabilities of

the national CAT insurance scheme. The introduction of this insurance system should at least ensure that public funds thus far used to repair national assets destroyed by the natural disasters will be redirected towards the socio-economic developmental needs of the country. In reality, providing insurance for the aftermath of natural disasters results in a rational mediation between national solidarity and the responsibility of individuals for their property.