Reinsurance Section News

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SPRA Pools in Light of September 11th Tragedies

by James B. Keller

Editor's Note: As mentioned previously in this newsletter, this article was originally part of the Special Edition Newsletter that never was. The Reinsurance Section asked Jim to prepare this article on the SPRA for the newsletter. While SPRA is associated with Swiss Re, this is not an advertisement for business, but is for informational purposes only. Thank you, Jim, for the article.

September 11, 2001, was unprecedented in its tragic ramifications on both a personal and business level. Insurers, whose business is to manage risk, are now looking at new issues and questions about how to manage a world whose risks include such horrific acts. The property and casualty industry has a proposed bill in Congress for establishing a terrorism reinsurance pool. The ACLI has been discussing a potential high-level government backstop for the life insurance industry.

Insurance companies use various mechanisms to control volatility of risks, and ultimately, solvency. Companies set a maximum amount, i.e., a retention, which they will retain on any one life. Some may also use first-dollar quota share to further reduce volatility. Even with these elements, many insurance companies take steps to reduce the effects of a catastrophe, which, in insurance terms, is defined as an event causing the insured to have three or more claims that add up to more than some predetermined deductible.

One way to reduce a catastrophe's effects is to buy traditional catastrophe coverage. Another is to participate in a catastrophe pool. Both are typically one-year coverages. With a traditional coverage, the premiums (the insured costs) are known upfront. The pool, on the other hand, should result in longer-term lower net costs and can cover risks that are too unpredictable to be priced for in a traditional cover.

SPRA's assessment pools

Special Pooled Risk Administrators, Inc. (SPRA) administers both an ordinary and a group assessment catastrophe pool. Each member has a share of the pool (either ordinary or group) based on the company's in force and number of policies relative to all others in the pool. When a catastrophe does occur and a member has three or more claims above its deductible, all members are assessed. To make an assessment pool work well, you need a significant number of companies. This allows a substantial maximum claim cover while still limiting the potential assessment to any single member.

SPRA pools are fortunate to enjoy a wide number of companies with substantial in force. Currently, the ordinary pool represents 111 life companies with more than $3 trillion of in force (roughly a third of the industry). Through unique formulas to determine the deductibles and pool shares, large and small companies are treated equitably. As such, a wide variety of company sizes are represented. The pool maximums are $50 million per company and $125 million in aggregate. The group pool has 42 life companies with $1 trillion of in force (roughly a sixth of the industry). The maximums are $0.20/1000 ($200 million) and $0.50/1000 ($500 million).

Questions after September 11

The tragedy of September 11, 2001, was unprecedented for the SPRA pools. Although the pools have been around for more than 25 years and have administered more than $50 million of catastrophic claims, nothing has ever come close to the impact of September 11. Estimates from the ordinary members total $250 million, and estimates from the group members total $160 million.

Not surprisingly, experience is anything but uniform by company. Several companies, both large and small, had very few claims. Several other companies (again both large and small) had a disproportionate amount of claims. The pool will do what it was designed to do—spread the effects of the catastrophe evenly over its member base.

The terrorist attack does cause some challenges in administering the pools. For example:

- **How many insurable events were there?** Most within the industry have argued the World Trade Center's Twin Tower attack of Sept. 11 was a single event, citing the "cause" analysis with various case law examples. But others (such as the owner of the World Trade Center's Twin Towers) have suggested each tower attack should be treated as a separate insurable incident. SPRA has informed its members that it accepts the "cause" analysis and intends to administer the attacks as one event.

- **Should the ordinary limit be raised?** Given that one event occurred, an aggregate limit of $125 million and estimates of $250 million, only 50 percent of the claims are being spread.

- **Where do we go from here?** Many are saying the world has now changed. Several companies are finding at renewal that traditional catastrophe covers are more limited in scope (excluding terrorism and/or war) and premiums have been increased. SPRA is soliciting input from its members on any potential changes going forward.

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