Liability Insurance: Crisis In Supply

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Insuring catastrophes and the role of governments

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Abstract. In this paper we model the cost of providing insurance coverage against natural and man-made hazards. We propose an insurance market model that explains (1) the use of reinsurance to help finance the cost of catastrophic events and (2) the implicit (or explicit) presence of government entities acting as (re)insurers of last resort. Using an economic model, we show how insurance programmes should be designed to cover the losses due to a possible catastrophic natural hazard. Our results show that the optimal structure of a reinsurance programme minimizes the cost of offering insurance protection. We also show how government intervention can reduce the cost of insurance against natural catastrophes and increase policyholders' welfare. Our paper therefore offers public policy implications as to the role and presence of government as an insurer of last resort and the minimum insurance premium necessary to cover the cost of catastrophic events.

1 Introduction

1.1 Motivation

The insurance industry's capacity to absorb large, catastrophic losses is a concern not only for insurance providers, but also for consumers, regulators and, perhaps even more importantly, for public policymakers. Insurers operate efficiently when there are a large number of relatively small, uncorrelated individual risks to insure. When these risks are correlated, however, insurers have a more difficult time offering protection (see Borch, 1962). As a result, their cost of capital can become so expensive that insurance is no longer economically sound (see Cummins and Trainar, 2009). Reinsurance contracts – that is, insurance protection for insurers – have traditionally been used to share catastrophic risk within the insurance industry. Lately, however, the cost of large natural hazards has become so large that alternative capital market products, such as cat bonds, have become increasingly popular to offset very high losses (see Cummins et al., 2002; Albertini and Barrieu, 2009). That being said, reinsurance (i.e. insurance for insurers) remains the main risk-sharing vehicle used by insurers to transfer the cost of catastrophic risk.

Motivation for this paper stems not only from the magnitude and uncertainty regarding potential natural hazard losses, but also from the public policy discussions of the best methods of financing losses associated with these risks. The optimal methods of catastrophe risk financing will delineate the respective roles of the private insurance market, reinsurers, capital markets, and government entities – irrespective of their ability to properly evaluate natural hazards (see Plattner, 2005; Plattner et al., 2006). With the discussions in the United States and in Europe of national or multistate catastrophe pools to spread the cost of natural hazards, the roles of insurers, reinsurers and public entities increasingly become a public policy issue. A more exhaustive study of the optimality of insurance and reinsurance programmes can aid public policymakers in making decisions in the best interests of their constituents. As meteorologists, oceanographers, wind and structural engineers, and other earth and wind scientists work toward developing more accurate estimates of expected losses, actuaries, economists, and financial engineers need to work toward developing better and more efficient methods of financing these potential losses.

Worldwide, the costs and damage associated with catastrophic events continue to increase (Kunreuther and Michel-Kerjan, 2009). These events can be natural (earthquake,

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nearly half their respondents suffered a doubling of their liability insurance premiums Critics of the industry relate the insurance supply problem to the move-.Abstract. Insurance-industry accounts of the liability insurance crisis of the mids often cite disruption of supply in reinsurance markets as an important contributing factor. This article investigates the extent to which events in reinsurance markets affected liability insurance market outcomes.The liability insurance crisis in the United States of America refers to a volatile economic period cost of liability insurance premiums to excessive levels. Reinsurance: Disruption of supply in reinsurance markets cited as a contributing factor.Insurance-industry accounts of the liability insurance crisis of the mids The apparent disruption in reinsurance supply during the liability crisis is some.danger and opportunity created by the liability insurance crisis of Fluctuation in price and supply is a fact of life in commercial liability-insurance markets.Available in the National Library of Australia collection. Author: Gill, David, ; Format: Book; viii, 39 p.: ill. ; 22 cm.Download Citation on ResearchGate   Causes of the liability insurance crisis   In this article the reasons for The Demand for and Supply of Liability Insurance.Insurance-industry accounts of the liability insurance crisis of the mids often cite disruption of supply in reinsurance markets as an important contributing.First, the theories focus on the supply of liability insurance and ignore the demand. The demand for commercial liability insurance during the crisis period, while.Liability Insurance: Crisis in Supply: David Gill: skiathosmemories.com: Books.Abstract: Insurance-industry accounts of the liability insurance crisis of the mid- s often cite disruption of supply in reinsurance markets as.Legislators addressed the mids crisis in liability and insurance both 2The focus in this paper is on the supply side of the liability insurance market.Effects of a Malpractice Crisis on Specialist Supply and Patient Access to Care .. Liability insurance costs were identified as the primary reason for the.The demand for and supply of liability insurance in the United States concern about the "liability crisis" reached a peak during the mids as liability.The causes of the insurance crisis are generally summarised as: Trowbridge Consulting, Public Liability Insuranceanalysis for meeting . Where supply of capital is tight and insurers have become more risk-averse.The liability insurance crisis and the general recognition of an insur- . insurance as much as the supply price; therefore it cannot account for other aspects of.INTRODUCTION. THE so-called liability insurance crisis of and cycles, the supply of insurance is relatively plentiful: Premiums are comparatively .

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