



HM Treasury

HM Treasury Review of Pool Reinsurance Limited 2020-2021: Call for Evidence

October 2020

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Preface

Subject of this consultation: HM Treasury (HMT) is seeking input to inform the management of its relationship with Pool Reinsurance Limited (Pool Re) and its ongoing intervention in the UK terrorism (re)insurance market.

Scope of this consultation: This call for evidence covers how the guarantee HMT extends to Pool Re impacts the market for terrorism (re)insurance and how any amendments to the terms of the guarantee and the rules that govern HMT's relationship with Pool Re would impact the availability, affordability and take-up of terrorism insurance.

Who should read this: All stakeholders in the UK terrorism (re)insurance market.

Duration: The call for evidence will run for 6 weeks starting on 12 October 2020 and ending on 22 November 2020

How to respond or enquire about this consultation: Please send your response to this call for evidence to PoolReReview@HMTreasury.gov.uk.

After the consultation: Responses to the call for evidence will be used to inform the outcome of HM Treasury's review of Pool Reinsurance Limited 2020-21. The outcome of the consultation is due to be published in Spring 2021.

Getting to this stage: The Government announced its intention to launch this call for evidence in its press release on 3 September 2020.

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Foreword

When Pool Re was established in 1993, a series of terrorist attacks in central London had led to a lack of terrorism (re)insurance cover being available on the private market. In the subsequent 27 years Pool Re has played an important role in encouraging the growth of the terrorism insurance market, allowing businesses to get the cover they need. Its work has helped to support the UK economy and delivered a reputation for global excellence.

On 3 September 2020 HM Treasury (HMT) announced the latest review of Pool Reinsurance Limited (Pool Re). This is in line with HMT's commitment to review its relationship with Pool Re regularly to ensure the UK's terrorism (re)insurance market continues to function effectively and in the public interest.

This five-year review will help us ensure that the rules, systems and risk sharing arrangements remain in the best interests of Pool Re and its members, the government, the taxpayer and the wider economy.

In Spring 2021 HMT intends to announce the outcome of this review, which will influence the strategic direction for Pool Re over the coming five years.

I invite all stakeholders in the UK terrorism (re)insurance market to use this opportunity to contribute formally to the review.

John Glen

Economic Secretary to the Treasury

Chapter 1

Introduction

- 1.1 In 1993, following a series of terrorist attacks in Great Britain, in particular in the City of London (the Bishopsgate and the Baltic Exchange bombings), reinsurers withdrew from the terrorism insurance market. They deemed terrorism to be too expensive, and too difficult to model, for them to insure.
- 1.2 To correct this market failure, the Government intervened and committed to act as the reinsurer of last resort to Pool Re, a mutual reinsurer launched by the UK insurance sector. The government guarantee meant that insurers were able to access adequate and affordable reinsurance cover for terrorism losses, and as such continued to offer affordable terrorism cover to businesses.
- 1.3 The Government's intervention in the terrorism (re)insurance market was intended as a temporary measure whilst the private market for terrorism reinsurance recovered and developed. In the 27 years since Pool Re was established the private market for terrorism reinsurance has developed significantly, in large part due to Pool Re's commitment to developing the UK market and global excellence.
- 1.4 HMT is the Government department responsible for the relationship with Pool Re. As part of the agreement between HMT and Pool Re, HMT is committed to reviewing it regularly to ensure that the organisation and the unlimited guarantee remain necessary and appropriate for the correct functioning of the insurance market. This call for evidence forms part of the most recent review, [announced on 3 September 2020.](#)
- 1.5 HM Treasury encourages all stakeholders connected with the terrorism (re)insurance market to respond to this call for evidence.

Chapter 2

Scope

- 2.1 The scope of HMT's review of Pool Re is set out in the [terms of reference](#) for the review.
- 2.2 This call for evidence seeks to gather views to inform the first and second objectives of the review; to assess if the risk share between HMT and the private sector remains appropriate for the good functioning of the UK's terrorism (re)insurance market and to consider if the scheme rules that govern Pool Re require updating.
- 2.3 The third objective of the review is to ensure that the requirements HM Government (HMG) sets for companies classified by the Office for National statistics (ONS) to the central government sub-sector are met, without compromising Pool Re's ability to operate effectively. Given this is about HMG's own processes, we do not ask any questions on this issue in the call for evidence.
- 2.4 The scope of the review is limited to Pool Re's role as a terrorism reinsurer and does not extend to the (re)insurance market for wider catastrophic risks.
- 2.5 Pool Re Nuclear is a separate company to Pool Re and is not directly included in the scope of this review.

Chapter 3

Responding to this call for evidence

- 3.1 Responses to this call for evidence should be sent to PoolReReview@HMTreasury.gov.uk.
- 3.2 Wherever possible we ask that you provide evidence to support your answers, and welcome quantitative data to support your response. It is helpful to include details on the monetary impact certain potential changes might have for the UK terrorism insurance sector where possible.
- 3.3 There is no obligation for you to submit an answer to every question in this document if you do not wish to do so.
- 3.4 Submit your return by 22 November 2020 in order for it to be considered as part of this review.

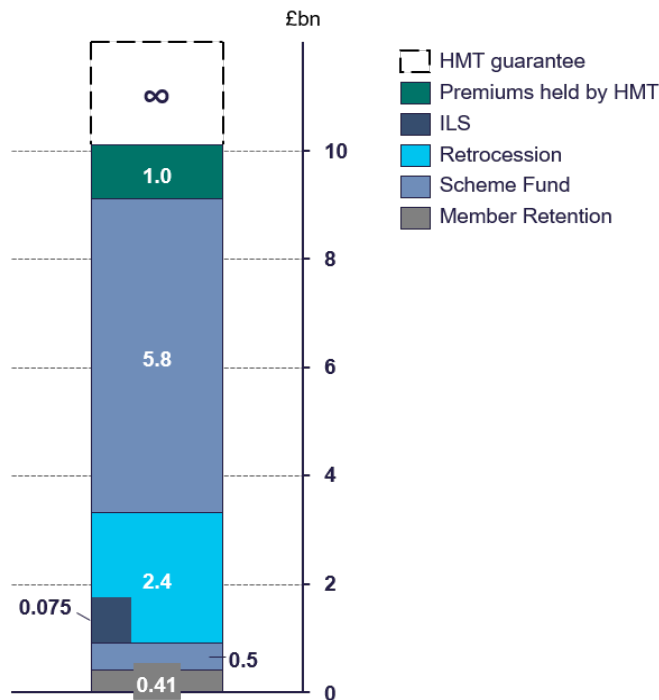
Chapter 4

Background- how Pool Re operates

- 4.1 Pool Re is a mutual company owned by its c.150 members, who represent in excess of 95% of the UK commercial property insurance market.
- 4.2 Insurance companies and captives who are members of Pool Re (members) may offer terrorism cover as part of their commercial property policies, usually arranged as an add-on to their main property insurance policy. In return for paying a premium to Pool Re, members receive reinsurance that will pay the cost of eligible claims that their policyholders make following a terrorist incident minus a loss retention limit which the member must pay themselves (member retentions).
- 4.3 Following a suspected terror attack in Great Britain, businesses may make a claim to their insurer for any losses they are insured against (this may include physical damage and non-damage business interruption (NDBI) costs). If the insurer is a member of Pool Re, then Pool Re will ask HMT to certify the attack as an act of terrorism as defined by The Reinsurance (Acts of Terrorism) Act 1993 (the 1993 Act) (<https://www.legislation.gov.uk/ukpga/1993/18/contents>).
- 4.4 If HMT considers that the incident falls within the definition and is covered by the 1993 Act then, within 21 days of the request from Pool Re, HMT will certify it as an Act of Terrorism. If HM Treasury determines that the incident is not covered by the 1993 Act, then it will decline to certify it. Any dispute over certification is subject to a dispute resolution mechanism.
- 4.5 If the incident is certified, the member will pay its insured policyholders' claims and subsequently invoke the claims process to recover its losses under its reinsurance policy with Pool Re, minus member retentions.
- 4.6 The scheme is subject to two rules which were put in place to protect the scheme, and by extension the taxpayer, from adverse selection whereby only high risk or very large properties are (re)insured. These have ensured that the benefits of diversification and geographical spread are shared amongst all scheme stakeholders, in the absence of which the basis for pricing would need to be reconsidered.
- 4.7 The first rule is that an insurer who reinsures through Pool Re must cede to Pool Re all terrorism risks within its company portfolio (the 'Cede all Business' requirement). Moreover, it must not compete against Pool Re's cover, although members can develop products that "wrap around" Pool Re, e.g. by offering extended business interruption cover.

- 4.8 The second rule is the 'All or Nothing' rule, which means that a policyholder buying terrorism cover from a Pool Re member must do so for all its eligible property and may not select certain properties or locations.
- 4.9 By merit of the guarantee provided by HMT, Pool Re is exempt from Solvency II capital requirements that apply to most reinsurers.
- 4.10 Since being established in 1993, Pool Re has been investing reserves from member premiums. To note, Pool Re pays part of its premium and profits to HMT in return for its guarantee (details in chapter 5).
- 4.11 The scheme fund (also known as the reserves) currently stand in excess of £6 billion. In addition to these reserves Pool Re has bought its own reinsurance (retrocession) and issued insurance linked securities (ILS). These, along with member retentions, serve to distance the taxpayer from potential costs. Pool Re could now absorb losses of up to £10 billion before the HMT guarantee is engaged. To put these figures in context, Pool Re currently underwrites over £2 trillion of exposure in commercial property to terrorism risk across the UK mainland.
- 4.12 Figure 1 below illustrates the hierarchy of obligations, should a claim be made.¹ To note, an initial £0.5 billion of the reserves sits directly above the member retentions, followed by the retrocession (and the ILS, which is at an equal level to the bottom of the retrocession) before the wider reserves and finally HMT support.

Pool Re funding layers - 2020



¹ Pool Re website (2018): <https://www.poolre.co.uk/who-we-are/about-pool-re/>

Chapter 5

Background- HMT's relationship with Pool Re

- 5.1 Since Pool Re's inception, the Government has been committed to step in and provide an unlimited loan to Pool Re should its existing reserves be exhausted by claims that follow a terrorist attack. This loan would ensure that Pool Re can pay claims through its insurer-members, and ultimately enable insured businesses to receive the compensation that they are due from their insurers
- 5.2 The relationship between HMT and Pool Re is governed by the retrocession agreement (<https://www.gov.uk/government/publications/agreement-between-hm-treasury-and-pool-reinsurance-company-limited>)¹ and is enabled by the 1993 Act. This agreement sets out the terms of the relationship between HMT and Pool Re, including, amongst other things, terms of the premium paid to HMT by Pool Re, matters which require HMT's prior written consent, and grounds for termination.
- 5.3 Any changes to the scheme must be updated in the retrocession agreement. There have been a number of changes to the retrocession agreement since 1993, most notably:
- Expanding Pool Re cover to CBRN (Chemical, Biological, Radiological and Nuclear), following the 9/11 attacks (2003);
 - Expanding Pool Re cover to include physical damage arising from a terror attack that uses a cyber trigger (April 2018);
 - Expanding Pool Re cover, via an Act of Parliament, to include NDBI (Non-Damage Business Interruption) (February 2019)
- 5.4 In return for its unlimited guarantee, Pool Re pays HMT an annual share of the premiums it receives from its members, in addition to a share of its profits on its investments.
- 5.5 A renegotiation of the retrocession agreement between Pool Re and HMT in 2014 saw increases to the amount of premium income that is paid to HMT. This increase was designed to reflect the nature of the contingent liability that HMT takes on in backing-up Pool Re. Currently, this payment comprises 50% of all premiums received annually, plus 25% of any profit that is generated in that year.
- 5.6 To date Pool Re has paid £1bn worth of premiums to HMT. This money is held by HMT to the credit of Pool Re, such that if Pool Re's own reserves are

¹ To note, the latest published version of the retrocession agreement does not contain amendments made since 2015.

exhausted by a terror incident, it can draw upon this before borrowing from HMT under the guarantee. To date, the guarantee has never been called on.

Chapter 6

HMT's guarantee of Pool Re

6.1 As set out above, the Government's intervention in the terrorism (re)insurance market was intended to be a temporary measure, to be withdrawn once reinsurers were offering terrorism cover for commercial property again.

6.2 We are keen to understand if the UK market is now willing and capable of providing (re)insurance cover for all or some of the terrorism risk currently managed by Pool Re.

Q1: What factors need to be assessed in deciding whether the HMT guarantee of Pool Re remains necessary to ensure the ongoing availability and affordability of terrorism (re)insurance cover to all market participants who seek it?

6.3 Since 1993 the purely private market for terrorism (re)insurance has significantly grown. We are seeking to understand if there is any distinction in the type of cover the private market is capable of providing, in particular along the lines of 'conventional' terrorism risk versus less conventional risks. Less conventional risks include terrorism with a cyber trigger and extreme tail-end risks such as Chemical, Biological, Radiological and Nuclear (CBRN).

Q2: Would the HMT guarantee of Pool Re remain necessary to ensure the ongoing availability and affordability of terrorism (re)insurance cover for purely conventional terrorism risk if a guarantee remained in place for CBRN and cyber triggered terrorism risks? In your answer please be specific about what (if any) form of terrorism risk the market could handle without Government intervention and detail any barriers you foresee to splitting the market in such a way.

6.4 To date, the HMT guarantee of Pool Re has been unlimited. The unlimited nature of the guarantee means that Pool Re is not required to meet the same Solvency II requirements as other reinsurers. It is possible that capping the HMT guarantee could help to facilitate the return of further risk to the private market. We are keen to understand what the impact would be of introducing a cap on the guarantee.

Q3: If the HMT guarantee of Pool Re was capped, what would be the expected impact on the availability or affordability of terrorism insurance cover? Do you expect that (re)insurers may have to adapt their products to reflect this? For illustrative purposes, we ask that respondents consider the impact of a cap at two different levels £30bn and £100bn, and the possibility of a cap being per event or an annual limit.

Q4: If a cap on the HMT guarantee was introduced and depending on the nature of the cap, it could result in Pool Re being required to meet a Solvency II

capital requirement. How would this impact on the availability and affordability of terrorism insurance?

6.5 We are aware that there may be other potential ways to manage the guarantee HMT extends to Pool Re which have not been explicitly mentioned here.

Q5: Would you like to flag or propose a change to the HMT's guarantee of Pool Re? How would your proposal be effective in transferring some or all of the risk currently held by Pool Re back to the market?

Chapter 7

Increasing reliance on the private market

7.1 This chapter addresses additional ways that risks can be returned to the private market through increasing the capacity of the market to absorb losses from an insurable terrorist event before the HMT guarantee comes into force.

7.2 Since 2014, Pool Re has been increasing members' annual retention, which now sits at £410 million in the aggregate and £250 million per event, up from £100 million and £200 million respectively in 2014. This means that the private market is holding an increasing share of the insured losses from terror attacks, whilst still being reinsured by Pool Re.

Q6: What would be the impact on the availability and affordability of terrorism insurance of increasing members' retentions? In your response it would be helpful if you could be as specific as possible.

Q7: What are the factors affecting members ability to retain more terrorism risk? How could Government and/or Pool Re enable further retention of this risk by private insurers?

7.3 Pool Re has done pioneering work to return risks to the private market. As shown in the diagram in figure 1, they were successful in placing the first ever terrorism only Insurance Linked Security (ILS) product. Additionally, in 2020 Pool Re had £2.4 billion of retrocession protection (excess of £500 million), up from £1.8 billion in 2015.

Q8: Do you think that there is a market for additional insurance linked securities (ILS) in excess of what has already been issued? What do you expect would be the impact on the market appetite for such products following a major terrorist event?

Q9: Do you think there is a market for further retrocession in addition to that which has already been bought by Pool Re? What do you expect would be the impact on the market appetite for such products following a major terrorist event?

7.4 In addition to deliberate efforts by Pool Re to build and return risk to private markets, we are keen to understand if there is anything further that Pool Re could do to support the market whether Pool Re may inadvertently hinder its growth.

Q10: Please set out any proposals by which further risk could be returned to the market that are not currently part of Pool Re's working practices.

Q11: Please set out any ways by which Pool Re may inadvertently be prohibiting the emergence of a larger private market for terrorism reinsurance. We would welcome comments on pricing practices compared to other market reinsurers. (Please note that questions on the scheme rules that govern Pool Re are set out in chapter 8.)

Chapter 8

The scheme rules and structure of Pool Re

- 8.1 This chapter considers if the scheme rules that govern Pool Re remain appropriate, and if amending these or changing the way Pool Re operates would facilitate better outcomes for the market and taxpayer.
- 8.2 Currently, any terrorism risk written by Pool Re's members is reinsured through the scheme under a single retention for any type of terrorism claim. This means that there is no scope in this structure for members to retain more or less risk based on their ability to manage different types of risk.

Q12: Would a revised structure for Pool Re which enables members to differentiate the treatment of different types of risk they reinsure with Pool Re allow for higher member retentions on some types of risk?

Q13: If such a system were to be introduced, how could terrorism insurance risks best be segmented? Please specify where (and to what extent) insurers could retain additional risk under such a model.

- 8.3 As set out in chapter 4, the 'Cede all Business' and 'All or Nothing' rules have underpinned Pool Re since its establishment in 1993.

Q14: Could the 'Cede all Business' requirement be amended to continue to avoid significant adverse selection yet be compatible with the risk differentiation set out in Q12?

Q15: What would you expect the impact on the availability and affordability of terrorism (re)insurance to be of significantly amending the 'Cede all Business' requirement to allow differentiation between risk types? Would this impact the balance of policies being written by Pool Re and other market reinsurers?

Q16: Could the 'All or Nothing' rule be amended to continue to avoid significant adverse selection yet facilitate the return of further risk to the market and be compatible with the risk differentiation set out in Q12?

Q17: Would it be beneficial for members and/or the wider terrorism (re)insurance market to allow policy holders to select in such a way?

- 8.4 We recognise that the questions above may not be exhaustive.

Q18: What changes could the UK's regulatory authorities make to enable an environment more conducive to increasing private market participation in terrorism risk, and promote economic resilience to terrorism risk?

Chapter 9

Small business access to terrorism insurance

- 9.1 Insuring themselves against a terrorist attack is the responsibility of each business, yet the insurance sector estimates suggest that only a very small proportion of small and medium sized enterprises (SMEs) have this cover. We are keen to better understand the reasons behind this, and how uptake can be increased.

Q19: What percentage of SMEs do you estimate to have cover for a terrorist attack?

Q20: What are the incentives or disincentives insurers and brokers face in the sale of terrorism cover to SMEs? Please draw comparisons to other insurance products, for example conventional commercial property insurance.

Q21: What do you think drives the uptake of terrorism insurance by SMEs, and what measures could be taken by the insurance industry to encourage this further?

- 9.2 Since 1993 terrorism insurance has been sold as a separate (or add on) product to standard commercial property insurance (which generally covers against fire, theft and some weather damage).

Q22: What changes could the UK's regulatory authorities make to enable an environment more conducive to the uptake of terrorism cover by SMEs? Please include if you think it would be positive for insurers to be able to offer the cover in different ways (such as included in standard commercial property cover).

Q23: What changes could Pool Re make to its model to make it easier for insurers to offer terrorism insurance? Would a system that allows for more risk-reflective pricing including differentiation between different types of terrorism risk support this?

Chapter 10

Summary of questions

1. What factors need to be assessed in deciding whether the HMT guarantee of Pool Re remains necessary to ensure the ongoing availability and affordability of terrorism (re)insurance cover to all market participants who seek it?
2. Would the HMT guarantee of Pool Re remain necessary to ensure the ongoing availability and affordability of terrorism (re)insurance cover for purely conventional terrorism risk if a guarantee remained in place for CBRN and cyber triggered terrorism risks? In your answer please be specific about what (if any) form of terrorism risk the market could handle without Government intervention and detail any barriers you foresee to splitting the market in such a way.
3. If the HMT guarantee of Pool Re was capped, what would be the expected impact on the availability or affordability of terrorism insurance cover? Do you expect that (re)insurers may have to adapt their products to reflect this? For illustrative purposes, we ask that respondents consider the impact of a cap at two different levels £30bn and £100bn, and the possibility of a cap being per event or an annual limit.
4. If a cap on the HMT guarantee was introduced and depending on the nature of the cap, it could result in Pool Re being required to meet a Solvency II capital requirement. How would this impact on the availability and affordability of terrorism insurance?
5. Would you like to flag or propose a change to the HMT's guarantee of Pool Re? How would your proposal be effective in transferring some or all of the risk currently held by Pool Re back to the market?
6. What would be the impact on the availability and affordability of terrorism insurance of increasing members' retentions? In your response it would be helpful if you could be as specific as possible.
7. What are the factors affecting members ability to retain more terrorism risk? How could Government and/or Pool Re enable further retention of this risk by private insurers?
8. Do you think that there is a market for additional insurance linked securities (ILS) in excess of what has already been issued? What do you expect would be the impact on the market appetite for such products following a major terrorist event?
9. Do you think there is a market for further retrocession in addition to that which has already been bought by Pool Re? What do you expect would be the impact on the market appetite for such products following a major terrorist event?

10. Please set out any proposals by which further risk could be returned to the market that are not currently part of Pool Re's working practices.
11. Please set out any ways by which Pool Re may inadvertently be prohibiting the emergence of a larger private market for terrorism reinsurance. We would welcome comments on pricing practices compared to other market reinsurers. (Please note that question on the scheme rules that govern Pool Re are set out in questions 14-17).
12. Would a revised structure for Pool Re which enables members to differentiate the treatment of different types of risk they reinsure with Pool Re allow for higher member retentions on some types of risk?
13. If such a system were to be introduced, how could terrorism insurance risks best be segmented? Please specify where (and to what extent) insurers could retain additional risk under such a model.
14. Could the 'Cede all Business' requirement be amended to continue to avoid significant adverse selection yet be compatible with the risk differentiation set out in Q12?
15. What would you expect the impact on the availability and affordability of terrorism (re)insurance to be of significantly amending the 'Cede all Business' requirement to allow differentiation between risk types? Would this impact the balance of policies being written by Pool Re and other market reinsurers?
16. Could the 'All or Nothing' rule be amended to continue to avoid significant adverse selection yet facilitate the return of further risk to the market and be compatible with the risk differentiation set out in Q12?
17. Would it be beneficial for members and/or the wider terrorism (re)insurance market to allow policy holders to select in such a way?
18. What changes could the UK's regulatory authorities make to enable an environment more conducive to increasing private market participation in terrorism risk, and promote economic resilience to terrorism risk?
19. What percentage of SMEs do you estimate to have cover for a terrorist attack?
20. What are the incentives or disincentives insurers and brokers face in the sale of terrorism cover to SMEs? Please draw comparisons to other insurance products, for example conventional commercial property insurance.
21. What do you think drives the uptake of terrorism insurance by SMEs, and what measures could be taken by the insurance industry to encourage this further?
22. What changes could the UK's regulatory authorities make to enable an environment more conducive to the uptake of terrorism cover by SMEs? Please include if you think it would be positive for insurers to be able to offer the cover in different ways (such as included in standard commercial property cover).
23. What changes could Pool Re make to its model to make it easier for insurers to offer terrorism insurance? Would a system that allows for more risk-

reflective pricing including differentiation between different types of terrorism risk support this?

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