

FIVE YEARS OF EXPERIENCE IN THE MANAGEMENT OF THE TCIP (TURKISH CATASTROPHE INSURANCE POOL)

My company, Milli Re, has been manager of the Turkish Catastrophe Insurance Pool since the very beginning and has shared all the experience of the Pool during the formation process.

In this presentation, I will give you some brief information about the background, organization, operational aspects, claims management and information technology of the Pool and dwell on the key lessons to be drawn from these 5 years of experience. I believe that, since we are no longer managers of the Pool, my comments will now be more objective and less emotional.

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The TCIP (Turkish Catastrophe Insurance Pool) is a public legal entity set up to implement mainly the compulsory earthquake insurance in Turkey.

The aims of the TCIP may be summarized as follows:

- to cover all the buildings within the scope of the policy against the earthquake risk in return for an affordable technical premium.
- to alleviate the financial strain shouldered by the State by relieving the government from the burden of replacing earthquake-damaged dwellings.
- to secure the spread of the risk through the insurance/reinsurance systems.
- to be able to set up funds against earthquake losses in the long term.
- to make use of the insurance system as a means to contribute to reliable building construction.

Background

Turkey is one of the most earthquake-prone regions of the World. Indeed, existence of the North Anatolian and East Anatolian faults has caused many earthquakes throughout the history of the region. Since 1894, around 120 earthquakes with magnitude over 5.0 took place in the area, causing the loss of life of more than 100.000 people. On the other hand, a

considerable part of the population is currently living in the first and second earthquake zones which are the most susceptible ones to the earthquake threat.

Consequently, following the severe floodings in the Western Black Sea region (May 21-22, 1998) and the Adana-Ceyhan earthquake (June 27, 1998) the Government of Turkey decided to find out methods of compensating the direct costs of natural disasters outside the State Budget. Within the framework of credit secured from the IBRD (International Bank for Reconstruction and Development, i.e. World Bank) a project aiming to develop a Natural Disaster Insurance has been put under way by the Treasury's General Directorate of Insurance.

Under this project, successful models such as CEA (California Earthquake Authority) in the USA and EQC (The Earthquake Commission) in New Zealand have been examined meticulously.

The earthquake which occurred on August 17, 1999 and severely affected the Marmara region has accelerated the process of developing a new protection scheme and preparations culminated in the introduction of a Compulsory Earthquake Insurance system. For the time being, this compulsory insurance does not cover a whole range of natural disasters. Only earthquakes are covered because of the devastating effects experienced so recently and so dramatically. The compulsory nature of the insurance stems from the fact that insurance consciousness is rather low in Turkey. To give an example, in the Marmara region earthquake, insurance penetration rate for civil risks was only around 7%.

Organization

The principles of the Compulsory Earthquake Insurance have been determined by a decree-law issued on December 27, 1999.

According to this decree, the TCIP is a public entity set up in order to implement the Compulsory Earthquake Insurance in Turkey. The operational management of the Pool is to be assigned to an insurance or reinsurance company. Within this context, a contract was signed between the Treasury and Milli Re on August 8, 2000 for a period of 5 years which came to an end on 08.08.2005.

The TCIP is administered by a Board which consists of seven members representing Prime Ministry, Undersecretariat of Treasury, Ministry of Public Works and Settlement, Capital Markets Board, Association of Insurance and Reinsurance Companies of Turkey, Pool Manager and an earthquake expert.

The annual accounts, transactions and expenditures of the TCIP are to be audited by the Undersecretariat of Treasury. The Pool and its income are exempt from any tax, duty and charge. Recently, two portfolio management companies have been engaged so as to manage the funds of the TCIP.

The decree-law also secures the resources of the TCIP by limiting expenditures to be made out of these resources to only specific needs of the Pool.

In this Compulsory Earthquake Insurance system, the insurance sector plays an important role. Since TCIP and the managing company do not sell policies directly to the public, insurance companies (and their agents) have been given the role of intermediaries of TCIP in selling Compulsory Earthquake Insurance policies in exchange for a commission. The number of authorized insurance companies is currently 25 and the rate of the commission they collect for sale of policies is 12,5% for risks located in İstanbul and 17,5% for risks situated outside İstanbul. The higher commission rate outside İstanbul aims at spreading policy sales throughout the country.

Although the system is named as a “compulsory insurance scheme”, under the current legislation, there is no penalty or fine for those who do not buy compulsory earthquake policies. The main enforcement for the implementation of the scheme is the following requirement:

- Homeowners must present their compulsory earthquake insurance policies
 - a) for procedures at the real estate registration offices.
 - b) while signing up an agreement for supply of water and natural gas.

Operational Aspects

Under the TCIP policy, all material damages caused directly by an earthquake (including fire, explosion and landslide following an earthquake) to the insured buildings (including foundations, main walls, joint walls separating independent units, ceilings and floors, stairs, landings / platforms, corridors, roofs and chimneys) are covered up to the sum insured.

On the other hand, the following risks are not covered:

- Costs of debris removal, loss of profit, business interruption, deprivation of rent, alternative residence and office expenses, third party liabilities and any other indirect losses which may be claimed
- All kinds of movables, goods and the like
- All bodily damages including death
- Claims for moral injuries

The buildings subject to the Compulsory Earthquake Insurance are:

- Independent units falling within the scope of Law No: 634 regarding the Flat Ownership
- Buildings constructed as dwellings on lands registered under private ownership
- Independent units situated within these buildings and used as business house, office or for similar purposes
- Dwellings constructed by the State or with credits provided by the state as a result of natural disasters.

On the other hand, the following buildings are not within the scope of the Compulsory Earthquake Insurance:

- Buildings belonging to Public institutions and establishments
- Buildings constructed within the settlement areas of villages
- Buildings entirely used for commercial and industrial purposes
- Buildings constructed after 27.12.1999 without any construction licence.

The Compulsory Earthquake Insurance tariff has three components:

- 1) Type of building
- 2) Earthquake zone
- 3) Sum insured

Buildings are grouped under three classes according to their type of construction:

- A) Steel, Reinforced Concrete Carcass
- B) Amassed Stone and Brick
- C) Others

As for the earthquake zones, we have five different zones in Turkey reflecting the earthquake susceptibility.

The sum insured on the policy is determined by multiplying the squaremetre price of the construction (fixed in accordance with the type) with the squaremetres of the unit to be insured. The squaremetre prices for different types of buildings are to be increased as from January 1, 2005 to: A) YTL 380 (approx. US\$ 280), B) YTL 270 (approx US\$ 200), C) YTL 145 (approx. US\$ 107) respectively. Meanwhile, the maximum amount of cover to be provided for a dwelling under the Compulsory Earthquake Insurance has also been increased accordingly to YTL 85.000 (approx. US\$ 63.000) for all types of buildings. Where the value of the unit exceeds this maximum amount, the exceeding amount can be insured against the earthquake by the insurance companies on a voluntary basis on the condition that the Compulsory Earthquake Insurance policy has already been taken out. It goes without saying that, since the Compulsory Earthquake Insurance policy covers only the dwelling and only the earthquake risk, insurance companies can always issue policies with regard to the same dwelling to cover contents and other risks (such as fire and allied perils).

In order to work out premiums, the following tariff rates are applied to the sum insured amounts:

EARTHQUAKE ZONES

Type of Construction	1 ‰	2 ‰	3 ‰	4 ‰	5 ‰
A-Steel, Reinforced Concrete Carcass	2.20	1.55	0.83	0.55	0.44
B- Amassed Stone and Brick	3.85	2.75	1.43	0.60	0.50
C-Others	5.50	3.53	1.76	0.78	0.58

Numerical example:

- A reinforced concrete carcass dwelling of 100 squaremetres situated in the earthquake zone 2

Sum Insured : 100 sq metres x YTL 380 = YTL 38.000

Premium: 1,55‰ x YTL 38.000 = YTL 58,90 (approx:US\$ 44)

Public Awareness Campaigns:

Between 2002 and 2005 the public awareness campaigns of the Pool were shouldered by a private company with past experience in the insurance sector. Campaigns at national and local levels were carried out in close collaboration with the Pool Manager. During the local campaigns, governors and mayors were visited so as to obtain their support, programs/interviews were broadcast at the local radios/TV's, meetings were held with the local agents of the insurance companies acting as intermediaries of the TCIP. All these activities were corroborated by the circular-letters of the Education and Interior Ministries on the subject. The contract of the mentioned private advertising agency has also expired in 2005.

Claims Management

As to the claims management of the TCIP, the following points and achievements are worth considering:

- Claims were directly paid by the TCIP through the banking system.
- There is a deductible of 2% of the sum insured to be applied for any one loss. For the application of the deductible, each and every 72 hours period is considered as "one" loss.
- There is no co-insurance condition for the Compulsory Earthquake Insurance Policy and the only part of the sum insured shouldered by the insured is the above mentioned 2% deductible.
- There is no "average clause" in the TCIP policy. The policy is on the "first loss" basis.
- Losses concerning dwellings/units damaged by an earthquake were assessed by the surveyors already active in the market.

- A training programme of the loss adjusters helped to standardize TCIP loss assessment and to set up a loss assessors reserve to be employed in case of a big earthquake.
- In case the final settlement tends to be delayed for some reason, the policyholders were provided with advance payments.
- Since the introduction of the Compulsory Earthquake Insurance scheme and until the end of Milli Re's management over 6,8 million US\$ were paid to more than 5700 policyholders.

Information Technology

- The TCIP has a unique IT (information technology) system which allows real time on line policy sales, premium booking, claim advice through the Internet.
- A Call Centre gives service to homeowners for general information, claim advice, policy details and to users (companies/agents selling policies) for IT information.
- A Disaster Recovery Centre in Ankara secures the data of the whole system in case the TCIP headquarters at İstanbul are out of order.

Since the system is a flexible and modular one, it will be possible to mount additional components such as use of SMS within the GSM .

Figures at the Time of Management Transfer (08.08.2005)

No of policies in force : 2.202.251
 Average cover / unit : YTL 37.932 (approx. US\$ 28.863)
 Average premium / unit : YTL 64,11 (approx. US\$ 49)
 Funds accumulated : YTL 255.221.931 (approx. US\$ 195.000.000)

Key Lessons:

The TCIP experience has taught us valuable lessons which could be very helpful for the establishment of similar schemes:

- The TCIP has a special structure within the Turkish public sector and this uncommon design has no corresponding regulation in the Turkish public law. Consequently, all the public law decrees, arrangements etc. making the TCIP subject to the bunch of regulations irrelevant to the operations of the entity make life impossible for the Pool.

For instance, in order to minimize the operation costs the organization of the TCIP is based on the principle of “outsourcing”. Accordingly, the management of the Pool is assigned to an insurance or reinsurance company, the public awareness campaigns are shouldered by a private company, portfolio management companies are engaged for the management of the funds etc. Once you make the TCIP subject to Public Tender Laws, you put a big obstacle to the operation flexibility of the Pool. Therefore, institutions with special purposes like TCIP should always be exempted from the legislation in use for the other establishments of the Public.

- According to the article 17 of the decree-law regulating the TCIP, where the insured loss exceeds the expected level and is greater than the Pool's resources (including reinsurance protection), the loss is paid to the eligible homeowners at the ratio of the aggregate Pool's resources to the total claim amount. This provision was originally taking place in the General Conditions of the Compulsory Earthquake Insurance Policy as well but was subsequently deleted as from 01.01.2003 with the consent of the Treasury.

In view of the reinsurance protection secured from international markets, this pro rata payment of claims was a very remote possibility, but the mentioned stipulation has provoked big confusion in the minds of the people who were already suspicious about the insurance system and has been seen as a pretext to avoid claim payments. Besides, this is not a realistic provision since prompt claim payments are very important in the success of such social schemes and it is not possible to await completion of all the claims so as to evaluate whether the current sources are sufficient or not. In addition to this, in countries with low insurance consciousness, very late claim advice is a common fact. Consequently, the government –already relieved from the big financial burden of reconstructing dwellings

damaged by earthquake- should be the last resort reinsurer of a very remote situation.

- It is very important to obtain the collaboration of the insurance companies and their agents acting as intermediaries of TCIP in selling policies. Certain insurance companies attribute decrease in their household insurance premiums to the introduction of the Compulsory Earthquake Insurance scheme. This attitude can be overcome by inserting the compulsory earthquake insurance premiums into the own production figures of the insurance companies and ceding immediately to the Pool without any retention. This approach could be a satisfactory solution in a production-oriented market and leave the scheme unscathed.
- Despite the above mentioned attitude of certain insurance companies, the problem with the marketing of the TCIP policies is not a “supply” problem, but a “demand” problem. This is partly due to the lack of insurance consciousness. But the main obstacle to increase in sales is the lack of “Political Support”.

Just two examples:

- Since the introduction of the decree-law in December 1999, the Bill concerning the Compulsory Earthquake Insurance scheme has not become Law yet. The point is important, because firstly it will show the seriousness of the Government about the system and secondly under the Turkish legislation it is not possible to insert penalties, fines into a decree, so you need a proper law adopted by the Parliament. And from the people’s mentality point of view, even rumours of a penalty is a very strong incentive to buy a policy.
- At the very beginning, the main enforcement for the implementation of the scheme was that after an earthquake the government would not compensate owners of the damaged dwellings/units under the scope of the compulsory earthquake insurance who failed to buy a policy. But since the introduction of the Compulsory Earthquake Insurance system, after each and every considerable earthquake causing damage in dwellings, governments forgot their commitment and decided to reconstruct earthquake damaged dwellings. Finally, in March 2005 the government reverted to the old system of reconstructing damaged dwellings by public means. You can easily imagine that, such an attitude shakes confidence of the

people -who are already not very familiar with insurance- in the Compulsory Earthquake Insurance system.

Conclusion

To conclude, we may say that despite the drawbacks mentioned above, during the first management period of 5 years, the scheme has overcome all the teething troubles and reached a considerable policy sales level of over 2,2 million (compared to 500.000 policies before the introduction of the TCIP). We only hope that this success trend will further develop under the new management and TCIP will remain a positive example for similar schemes.

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