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Highlights

CATASTROPHE INSURANCE RISKS
The Role of Risk-Linked Securities

Highlights of GAO-03-195T, a testimony for the Subcommittee on Oversight and Investigations, House Committee on Financial Services

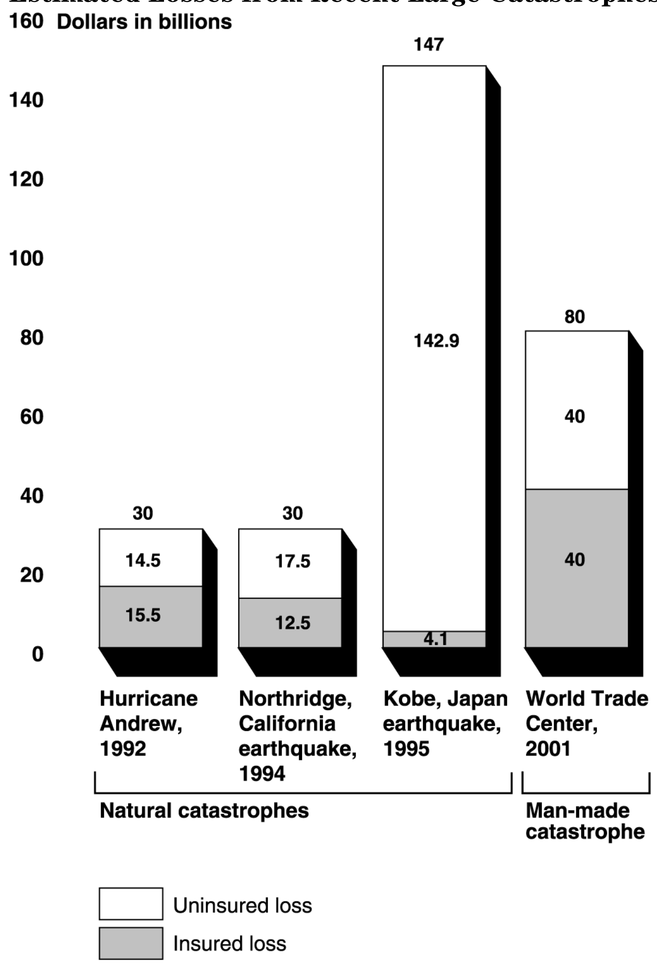
Why GAO Did This Study

Because of population growth, resulting real estate development, and rising real estate values in hazard-prone areas, our nation is increasingly exposed to higher property casualty losses—both insured and uninsured—from natural catastrophes than in the past. In the 1990s, a series of natural disasters, including Hurricane Andrew and the Northridge earthquake, raised questions about the adequacy of the insurance industry's financial capacity to cover large catastrophes without limiting coverage or raising premiums. Recognizing this greater exposure and responding to concerns about insurance market capacity, participants in the insurance industry and capital markets have developed new capital market instruments as an alternative to traditional property-casualty reinsurance, or insurance for insurers. GAO's objectives were to (1) describe catastrophe risk and how the insurance and capital markets provide coverage against such risks; (2) describe how risk-linked securities, particularly catastrophe bonds, are structured; and (3) analyze how key regulatory, accounting, tax, and investor issues might affect the use of risk-linked securities.

What GAO Found

Natural catastrophes are infrequent events that cause severe losses. More than 68 million Americans live in hurricane-vulnerable coastal areas, and 80 percent of Californians live near active earthquake faults. Insurance companies who write property-casualty policies in these high-risk areas try to spread the risks, traditionally through reinsurance. When reinsurance prices or availability became problematic in the 1990s, insurers turned to risk-linked securities as an alternative means to spread catastrophe risk. Most risk-linked securities are catastrophe bonds, which (1) have complicated structures, (2) are created offshore through special purpose entities, and (3) generally receive noninvestment-grade ratings. Key regulatory, accounting, tax, and investor issues pose challenges to expanding the use of risk-linked securities, and GAO discusses the advantages and disadvantages of potential changes.

Estimated Losses from Recent Large Catastrophes



Sources: Insurance Information Institute and other insurance industry sources.

The full testimony is available at www.gao.gov/cgi-bin/getrpt?GAO-03-195T. For additional information about the testimony, contact Davi D'Agostino (202-512-8678; dagostinod@gao.gov).