The UK Government has proposed changes to the way Pool Re is to be funded.

Initial reports indicated that the proposed changes might have a significant impact on the provision of terrorism insurance in the UK.

At an extraordinary general meeting held on the 21st November 2014, motions to accept a revised funding proposal from HM Treasury and to allow Pool Re executives powers to agree 'modernisation' plans with the Treasury were carried. Although the changes are significant, a review of the detail indicates that there may not be any notable difference for policyholders.

**BACKGROUND: POOL RE**

Pool Re provides property damage and business interruption terrorism reinsurance for its insurer members.

Because of the scale of potential losses from a terrorist attack, the UK Government, via HM Treasury, acts as reinsurer of last resort (via what is termed a ‘retrocession agreement’ – the practice of one reinsurance company insuring another reinsurance company) in the event that Pool Re has insufficient funds, making Pool Re’s security gilt edged.

Since it was established in 1993 Pool Re has accumulated circa £5.5 billion in reserves. Although the insurer member is free to charge its policyholders whatever premium it wishes, it is obliged to pay Pool Re for the reinsurance at tariff rates (set by Pool Re, but agreed by HM Treasury). In practice, insurers charge the policyholder the tariff rates, plus a small loading to fund the amount of risk the insurer member has to retain across its whole account.

For many years HM Treasury has made a charge of 10% of Pool Re’s total premium income for agreeing to act as reinsurer of last resort.

**NEW HM TREASURY PROPOSALS**

HM Treasury has increased the charge from 10% to 50%.

In addition, HM Treasury will receive payment of an annual dividend in the event that Pool Re accrues a surplus. This dividend represents 50% of any surplus, half of which will be paid to HM Treasury and half of which will be paid to insurer members (subject to various terms and conditions).

The remaining 50% will be held in reserve by Pool Re.

Subject to regulatory approval these changes will be effective from 1st January 2015.
WHAT DOES THIS MEAN FOR POLICYHOLDERS?

Pool Re has already stated that these HM Treasury changes will not result in any amendment to tariff rates, nor will the amount that a member is required to retain increase (meaning the amount insurers load the tariff rates by should not alter).

This means the premiums payable by policyholders will not increase as a result of HM Treasury’s changes.

There are separate discussions being held with HM Treasury that could have some impact on the way the premium is calculated (see ‘Other Potential Changes’ below) but these are not directly related to HM Treasury’s changes.

If there were to be significant terrorism losses in the future, the changes would reduce the future ability of Pool Re to fund from its own reserves. This might then lead to tariff rates increasing more than they would have done had the changes not been made, however the current Pool Re reserves are so significant that the risk of this happening is low. It should also be noted that if reserves fall below £1 billion, Pool Re is allowed to retain 100% of its premium.

OTHER POTENTIAL CHANGES

In addition to the proposed changes from HM Treasury, Pool Re has informed its members that it has some modernisation proposals of its own. HM Treasury has agreed to consider these separately, subject to member and regulatory agreement, in 2015.

Exact details of the modernisation proposals are not known to us, except that they include ‘the purchase of commercial retrocession cover’ and a revised basis of pricing, reflecting the risk that Pool Re assumes, which would be ‘financially neutral’. This presumably means keeping the overall premium that Pool Re collects the same, but altering the way the premium is calculated.

So, while not directly linked to the changes, it could be that the basis of calculating the premiums may alter in the next 12 months or so.

There is always the potential for this to happen as Pool Re can change its rates for risks incepting at any time, subject always to HM Treasury approval.

ALTERNATIVES TO POOL RE

Policyholders should note that there is an alternative option to Pool Re and the Willis International Terrorism Team will be able to offer this alternative, or review its suitability for Willis clients on request (including for real estate and construction risks).
THE REAL ESTATE SECTOR

The effect of any significant change in the availability and/or cost of terrorism would have a disproportionate effect on the real estate sector. Modern lease forms and finance agreements stipulate that the property owner must buy 'full value' terrorism cover for their buildings. Consequently, property companies have much less room to manoeuvre when making decisions around terrorism insurance procurement than companies operating in other sectors.

It is reassuring that the changes will not have any impact on the availability of cover. However, any changes to the way premiums are calculated arising from the 'modernisation' plans need to be monitored carefully to determine whether some tenants could be penalised while others in different localities benefit.

On a positive note, one of the areas under discussion is the concept of allowing some form of 'risk management credit'. This opens up the possibility of property companies seeing a direct correlation between the implementation of effective risk management measures and a reduction in terrorism insurance costs.

ABOUT US

Willis retains one of the largest teams dedicated to serving the insurance and risk management needs of the property sector in the UK. We arrange insurance for property values exceeding £100 billion and place £100 million of premium into the market.

Willis’s reputation is built on delivering excellence at all stages of a project or placement with a strong focus on quality, compliance and insurer financial security.

Our depth of understanding and insight into how organisations in the property sector create and maintain value allows us to provide innovative solutions in the following specialist areas:

- Construction
- Legal Indemnities
- Environmental liabilities
- Transactional liabilities
- Delivery of service across Europe
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