

The Turkish Catastrophe Insurance Pool (TCIP) and the Compulsory Earthquake Insurance Scheme

Selamet Yazici

Turkey is just one of many countries historically affected by natural disasters, especially earthquakes and floods. An earthquake map of Turkey shows that 96 percent of the country is susceptible to some degree of earthquake risk. The last two major earthquakes in 1999 (with magnitudes of 7.4 and 7.2) in the Marmara region resulted in the loss of thousands of lives and placed an enormous financial burden on the economy and the government.

Before 2000, earthquake insurance in Turkey was provided mostly as an additional peril insured on fire and engineering policies. The coverage rate was also quite low, especially for residential buildings (5 percent).

Impacts of such disasters and the low level of insurance coverage led the government to initiate studies to promote disaster insurance and establish a widespread and effective earthquake insurance system. Efforts of the Undersecretary of the Treasury intensified following the Adana earthquake in June 1998. As a result, the political momentum created by the Marmara earthquake and recognition by the public and the insurance industry that action is needed, the government introduced a compulsory earthquake insurance scheme in 2000.

The legal framework of the new scheme was established by decree with the power of law. With this decree, earthquake insurance was made compulsory starting September 27, 2000 for all residential buildings that fall within municipal boundaries. The Turkish Catastrophe Insurance Pool (TCIP) was created to offer this insurance. Moreover, the obligation of the government to extend credit and construct dwellings for the public in the event of an earthquake (a requirement of the Disaster Law) was abolished (from March 27, 2001). The new insurance scheme has effectively replaced a significant portion of government obligations under the Disaster Law.

The Turkish Catastrophe Insurance Pool (TCIP) and the Compulsory Earthquake Insurance Scheme

TCIP was established under the supervision of the Undersecretary of the Treasury to offer insurance at reasonable premiums. The compulsory earthquake insurance scheme aims to limit the financial burden earthquakes place on the government budget, ensure risk-sharing by residents, encourage standard building practices, and establish long-term reserves to finance future earthquake losses.

The compulsory earthquake insurance scheme provides compensation to homeowners without reverting to the government budget. This effectively maintains social solidarity and risk-sharing by the payment of affordable insurance premiums. Meanwhile, a significant portion of the risk is ceded to international reinsurance markets until sufficient financial resources are accumulated within TCIP.

Organizational Structure

TCIP is a legal public entity managed through the TCIP Management Board. The board consists of seven members from academia and the public and private sectors.

Although TCIP was originally designed as a multi-peril natural hazard insurer, it provides only compulsory insurance coverage for the time being. New products for other natural disasters such as floods and landslides will be provided in the future.

To minimize costs and create an efficient operational structure, most TCIP functions and operations are outsourced. For example, operational management has been contracted out to Milli Re, a leading reinsurance company in Turkey. Likewise, insurance companies and their agencies are carrying out policy distribution and marketing and independent loss adjusters are conducting loss assessments. Currently, 32 insurance companies are entitled to distribute TCIP policies.

The Undersecretary of the Treasury is responsible for supervising the program and auditing all TCIP operations and accounts. An independent auditing firm audits accounts annually.

TCIP and its revenues are exempt from all taxes, levies, and charges. Accumulated funds are kept in segregated accounts. The operational manager manages the funds and follows TCIP board of directors' investment guidelines to invest funds in diversified financial instruments. An assets manager is retained when funds exceed a specified amount.

Covered Buildings

The compulsory scheme covers only residential buildings that fall within municipal boundaries. Industrial and commercial risks as well as residential buildings in small villages (with no established municipality) can be insured on a voluntary basis. Eligible policyholders are the owners and tenants of dwellings that fall within municipal boundaries.

Covered Risks

Compulsory earthquake insurance is a stand-alone product and it is sold separately from fire (homeowner's) insurance. It covers building damage for the following risks:

- Earthquakes
- Fires following earthquakes
- Explosions following earthquakes
- Landslides following earthquakes.

Insurance companies offer separate coverage for household assets and movables on a voluntary basis.

Limit of Coverage

The aim of TCIP is to provide an adequate level of protection with affordable premiums. Therefore, the maximum coverage of compulsory insurance is currently TL 40 billion (approximately US\$30,000). This limit is adjusted annually according to changes in the construction price index. If the value of a dwelling exceeds this amount, policyholders can buy additional coverage from insurance companies.

Limit of Payment

When assessing claims, TCIP takes into account the replacement cost for each type of building. Any loss payment is limited to the sum insured. In the case of masonry-type buildings or small dwellings, the sum insured is usually below the maximum possible coverage amount.

The sum insured is calculated by multiplying the total square meters of the dwelling by the relevant unit reconstruction cost. There is also a 2 percent deduction applied over the sum insured.

Pricing

TCIP has a simple pricing matrix as shown below. Pricing takes into account seismic risk and construction type. Prices range from 0.4 per mille at the lowest level to 5 per mille at the highest level

Using vulnerability factors, the earthquake map used by TCIP divides Turkey into five risk areas. Tariffs are based on three categories according to building construction type. As a result of these two groupings, fifteen different rates are applicable for buildings, according to location and type of construction.

Type of Construction	Risk Regions				
	I	II	III	IV	V
Steel, concrete	2,00 ‰	1,40 ‰	0,75 ‰	0,50 ‰	0,40 ‰
Masonry	3,50 ‰	2,50 ‰	1,30 ‰	0,50 ‰	0,40 ‰
Other	5,00 ‰	3,20 ‰	1,60 ‰	0,70 ‰	0,50 ‰

Claims Payment

Claims are directly paid by TCIP. Total claims payments have been approximately US\$3.5 million since TCIP was established. TCIP's claims-paying capacity was almost US\$1 billion for 2003.

Insurance Penetration

The compulsory insurance scheme has been in force since September 27, 2000. The number of insurance policies reached 2,430,000 insured dwellings as of October 30, 2001. This number represented approximately 20 percent of total dwellings that fall within the compulsory scheme. However, after reaching 2.4 million insured dwellings, there was a significant drop in the number of policies, mainly caused by low renewal rates. As of July 16, 2003, the total number of policies was about 1,963,000 with a coverage rate of 15 percent.

Among the main reasons for low coverage rates are a lack of public knowledge of the benefits of insurance, the traditional role of the government in compensating for disaster losses, and the difficult economic conditions experienced in recent years.

While this insurance scheme is mandatory, it will take time to achieve deeper market penetration. Although the current penetration is not yet at the

desired level, it is well above the penetration of the homeowners' insurance rate prior to the application of the new scheme. Thus the future is promising.

Enforcement of Compliance

TCIP insurance is mandatory. For the enforcement of insurance, there are two kinds of sanctions currently applicable:

- The government's obligation to extend housing credit and have buildings constructed as per the Disaster Law came into effect March 27, 2001. Those required to carry earthquake insurance and fail to do so are not eligible to receive compensation from the government in the form of housing credits or reconstruction in the event of an earthquake;
- To initiate sales and purchases related to buildings subject to insurance, homeowners must present their insurance policy documents at real estate registration offices.

A recent plan involves extending insurance requirements to other public services and creating new checkpoints. If these new checkpoints are applicable, homeowners will be obliged to present insurance policy documents when opening accounts for gas, water, electricity, and telephone services. These new measures to improve compliance are expected to bring in a large number of new policies each year.