CLIMATE CHANGE INSURANCE NEEDS

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The role of insurers in tackling climate change: challenges and opportunities

Climate change is a global challenge posing material risks to society and the economy. Its consequences are becoming more and more apparent particularly on physical risk exposures, for instance in terms of increasing frequency and severity of natural disasters, such as floods, droughts or wildfires. Regarding Europe, EIOPA's dashboard on the insurance protection gap for natural catastrophes shows that currently only around a quarter of the total economic losses caused by extreme weather and climate-related events are insured, leading to a substantial insurance protection gap. The insurability and pricing of climate-related risks become increasingly critical concerns for insurers and policymakers, and if no countermeasures are taken, the protection gap is expected to widen.

The expected growth in physical risk exposures and insurance claims due to climate change will increase risk-based premium levels over time, potentially impairing the mid- to long-term affordability and availability of insurance products with coverage against climate-related hazards. Moreover, the increased frequency and severity of natural disasters associated with climate change can make it more difficult for insurers to predict the likelihood of future losses accurately and to price insurance products appropriately. In this context, EIOPA will regularly re-assess the appropriateness of the requirements of the standard formula regarding natural catastrophe risk, and if necessary, provide suggestions for potential changes in Solvency II.

The insurance industry has a unique role to play in addressing climate change by making society and the economy more climate resilient. Insurers can develop innovative insurance products that incentivize climate-related risk prevention, for instance through offering lower premiums to policyholders implementing climate-related adaptation measures. Such measures, like anti-flood doors or early warning systems, can reduce the policyholder's physical risk exposures and insured losses. Adaptation measures can therefore be a key tool to maintain the future supply of insurance products with coverage against climate-related hazards and help reduce the climate-related insurance protection gap in Europe.

> **Insurers play a critical role through innovative products incentivising climate risk prevention.**

With its concept of impact underwriting, EIOPA aims to foster the development and discussion about insurance products implementing climate-related adaptation measures in Europe. To better understand the industry's current underwriting practices regarding climate change adaptation, EIOPA conducted a pilot exercise with volunteering insurance undertakings in 2022. EIOPA found that progress is being made to increase policyholder resilience against climate change by implementing dedicated adaptation measures in insurance products and offering premium-related incentives, but the overall EU insurance market still appears to be at a relatively early stage.

EIOPA sees further room for improvement especially regarding standardising the implementation of climate-related adaptation measures in insurance contracts, for instance through dedicated risk-based certificates and programs. In its discussion paper on the prudential treatment of sustainability risks, EIOPA outlines regarding underwriting activities the framework to analyse the potential for a dedicated prudential treatment of climate-related adaptation measures in the solvency capital requirements for non-life underwriting risk.

While climate change is a growing risk for the insurance industry, it also creates opportunities. By taking a proactive approach to risk management, insurers can not only protect policyholders from losses but also ensure the long-term availability of insurance products and reduce the overall cost of insurance. It is however important to highlight that reaching the objective of adapting the society and economy appropriately to climate change requires further accompanying actions beyond the scope of the insurance industry, for instance in terms of developing and enforcing public building codes reflecting the dynamics of climate change appropriately. Besides considering Public-Private-Partnerships, public actors can also engage in improving the collection and sharing of climate-related loss data and raising awareness about climate change, thereby encouraging insurers and policyholders to adapt to climate change.

By working together, public and private actors can improve the overall understanding of climate-related risks and promote a more sustainable and resilient future. To foster climate change adaptation in the EU, EIOPA will continue its work on impact underwriting, including to raise the public awareness about climate risks and related prevention measures as well as promoting the use of open-source modelling and data.

ROMAIN PASEROT
Deputy Secretary General and Head of Capital and Solvency - International Association of Insurance Supervisors (IAIS)

Resilience to climate change: the role for insurance supervisors

Last month the Intergovernmental Panel on Climate Change (IPCC) published its latest scientific assessment of climate risks. It makes for grim reading and, for insurance supervisors, reminds us that risks from climate change are very real for the insurance sector. The report shows the global temperature has already risen 1.1 degrees Celsius above pre-industrial levels and is expected to reach the 1.5-degree threshold sometime in the first half of the 2030s. This will not only have social impacts, it will also materially change our economic life. Indeed, the IPCC reports that "human-caused climate change is already affecting many weather and climate extremes in every region across the globe."

As the global insurance standard setter, the International Association of Insurance Supervisors (IAIS) is focused on how the insurance sector assesses and mitigates these risks. Climate change will drive, and amplify, existing risk factors which will in turn impact insurers' assets and liabilities. As supervisors, we are concerned with both the prudential and market conduct impacts as these risks crystallise.

Given the economy-wide nature of climate change impacts and the significant efforts needed to reach net zero, we expect risks to emerge across all insurer business lines. The lack of progress on implementing net zero policies means the risks for insurers are growing. A "too-little-too-late" scenario is the worst of all worlds for insurers; it means transition risks which will bite notably on the asset side, will be more rapid when they come. Also, it increases the physical risks for both the assets and liabilities of insurers. For instance, the IPCC report notes that adaptation, a risk mitigant for insurers, becomes more difficult the longer it takes for substantive action towards net zero. Additionally, the IPCC has highlighted an increased likelihood of compound and cascading risks that are more complex and difficult to manage. This will also present additional risks for insurers as they seek to assess their exposure.

The IPCC report comes as the IAIS is currently consulting on the first of three consultations to embed climate risk within its supervisory material. The consultation, which builds on Application and Issues Papers we have published over the last few years, closes on 16 May. It proposes changes to the Introduction to the Insurance Core Principles--the global standards for insurance supervision--which positions climate risk within the international framework for insurance supervision.

The lack of progress on implementing net zero policies means the risks for insurers are growing.

Additionally, the IAIS is consulting on whether to make changes to our supporting material on governance, risk management and internal controls. Finally, the consultation includes questions seeking stakeholder feedback on our overall climate-related work as we seek to develop a globally consistent supervisory response to climate change within the insurance sector.

At the end of the year, we will publish a further consultation to provide guidance for supervisors on conducting climate scenario analysis and will consider the risks of greenwashing and market conduct issues related to climate risk. In 2024, we will close with a third and final consultation that deals with issues such as valuation, disclosures and enterprise risk management. Last month, working with the Financial Stability Institute, we also launched training for insurance supervisors on conducting climate scenario analysis which will be a key tool for understanding the risks insurers face. This work has highlighted the benefits of global cooperation between insurance supervisors to share and learn from each other on these critical issues.

According to the UN, almost half of the world's population live in regions that are highly vulnerable to climate change. Insurance can be used to support such vulnerable groups to address the economic hardship of unexpected losses. However, the Global Federation of Insurance Associations recently estimated the natural catastrophe protection gap at US$139bn annually. This is expected to grow as climate change increases the frequency and severity of natural catastrophes, exacerbated by the continued economic development in high risk areas. As the impact of climate change are felt, this will result in a significantly higher exposure and it is also possible it will lead to an increased protection gap.

With this in mind, the IAIS recently formed a task force, which will publish a report later this year, to consider the role supervisors could play in addressing protection gaps. Faced with increased climate risk, it is possible some insurers will increase premiums and reduce coverage. For supervisors it is essential to understand and address risks to ensure insurance markets work effectively and that they facilitate good consumer outcomes.

To conclude, climate change will be a significant risk driver for insurers in the coming years. As the insurance standard setter, we are playing our role ensuring a global response to address the growing risks from climate change.

MARTIN LANDAIS

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Insurability of climate risks: perspectives from the French compensation scheme

To address the considerable challenges related to climate change, the expected contribution of the insurance sector is crucial. Natural catastrophe losses at an unprecedented scale are set to make 2022 one of the costliest years on record. In France, according to the French insurance federation France Assureurs, total weather-related claims amounted to EUR 10 billion last year.

The risks associated with the increasing frequency and cost of extreme weather events will have a direct impact on the offer and pricing of insurance policies. As a consequence, a key challenge for governments and regulators is to avoid a widening of the protection gap for natural catastrophes. A recent EIOPA study concludes that only 23% of total losses are currently insured in Europe. Alongside market options aiming to increase insurance and reinsurance capacity for climate risks, including Cat bonds, risk pooling or sidecars, public-private catastrophe risk management frameworks can work efficiently, in particular when the scale of risks requires a public backstop.

Such a public-private partnership was created in 1982 in France through Caisse centrale de réassurance - CCR, a State-owned reinsurer. France is indeed one of the very few countries with a system that guarantees all its citizens adequate compensation in the event of loss or damage caused by a natural disaster such as floods, mudslides, tidal waves, drought and landslides. This unique compensation scheme, known as the “régime CatNat”, is based on a public-private partnership, which combines private insurance with a non-mandatory state-guaranteed public reinsurance that provides cedants operating in France with coverage against natural catastrophes and extreme risks.

This system combines two principles: i) solidarity, based on an additional premium set by the government at a mandatory uniform rate on every P&C’s insurance contract and ii) responsibility with a minimum compulsory deductible also set by the French government. In order to solve the risk of insurers’ insolvency in participating in the Nat Cat system, the government provides private insurers the option of being reinsured against these risks by a public reinsurer which benefits from a non-limited guarantee of the French State, acting as a lender of last resort.

A key challenge for governments is to reduce the protection gap for natural catastrophes.

This compensation scheme has been working well until now: the guarantee of the French State was called only once in 40 years, in 2000, for a very limited amount of public money. Nevertheless, the intensity and frequency of extreme events is bringing new challenges.

First, the definition of what constitutes an insurable risk is evolving. The French national meteorological service and the public reinsurer CCR published a study a few years ago concluding that the loss ratio for insurers would increase at a different pace depending on the natural phenomenon and the region. The loss ratio for floods would increase by 38%, against 23% for droughts and 82% for sea flooding. Regional disparities in the evolution of the claims rate raise the problem of the affordability and availability of insurance products for certain territories: in France, the areas located on the Atlantic coast are particularly exposed with a loss ratio ranging between +60% and +120%.

Second, there is a need to adapt the regulation to existing gaps in the current insurance coverage. Among those gaps, the cost and modalities for insuring risks associated with drought and subsidence is the most dynamic climate risk in terms of cost for the French compensation scheme, with a total amount of one billion euros each year on average. The objective is to avoid placing an excessive financial burden on the natural disaster compensation system and to strike a balance between the financial resilience of the system and the improvement of the coverage of victims.

Third, the long-term resilience of the insurance scheme requires to dramatically promote prevention in the context of increased climate risk exposure. At the international level, many works have been engaged on disaster risk finance and adaptation, in particular by the OECD and in the context of the G7 and G20. Those works suggest that the financial management of catastrophe risks presents an important public policy challenge for governments across the world. In this context, the French government decided in 2022 to set up an ecological planning process. It includes a multiannual plan for adaptation with measures to limit the negative effects of climate change on socio-economic activities.

Part of the current work at the French Treasury is hence to address prevention gaps and to strengthen the role of the insurance system to tackle them. Our central goal is to uphold the core principles of the NatCat scheme based on solidarity and responsibility, at a sustainable cost for policyholders.

STÉPHANIE YON-COURTIN
MEP, Committee on Economic and Monetary Affairs, European Parliament

How to best tackle the environmental transition for the insurance sector?

The latest IPCC report reminds us again about the urgency to act against climate change. Global greenhouse gas emissions have continued to increase. We are already witnessing the effect of climate change on our citizens and our economies, with climate risks materialising in adverse impacts, losses and damages to nature and people.

This is precisely where insurers come into play. As insurers face increasing climate risk exposure, they need to be prepared and to protect the insured against materialising environmental risks. Climate change is one of the most prominent worries of European citizens, which have been calling the European Union (EU) and national governments for ambitious actions.

The European Union has been a pioneer in tackling climate change with the adoption of its groundbreaking Green Deal legislation. EU regulators continue to further address climate risks in the entire EU law framework, following a cross sectorial approach. Achieving a sustainable economy has been additionally enshrined in the establishment of a strong sustainable finance framework, where new legislation has been adopted (e.g., Taxonomy regulation), and current legislation has been amended (e.g., the banking framework, the sustainability reporting framework).

Today's Solvency II Directive already enables insurers to take into account environmental risks but this could be done more efficiently. The revision of this framework is vital to ensure better inclusion of the prudential treatment regarding sustainability risks.

Climate risks are to be assessed in the long term, but short termism in market behaviour still remains too often the norm. Insurers already have possibilities to take into account and assess climate related risks in their activities. Nevertheless, this is still insufficiently enshrined in some insurance practices. EIOPA revealed in a 2021 report that climate risk assessments using scenario analysis are only done by few insurers in their Own Risk and Solvency Assessment and mainly on short time rather than long time horizons.

The revision of the Solvency II Directive aims therefore to promote a risk based and forward looking approach, were investors are incentivised to take into account long-term risks but also to pursue long-term investments. The European Commission's proposal goes into that direction, but the EU should be more ambitious.

We as regulators need to be ambitious and pragmatic in our approaches.

In my view, a renewed and effective framework implies clarity, workability, coherence and ambition.

Firstly, simple, clear and workable rules are key to ensure their smooth application by insurers and supervisors. An important feature to maintain this, is learning from past experiences to better manage climate risks in the future. Many companies are already leading the way in enhancing the use of their existing tools through retroactive analysis. This is why I am the view that those generalised practices should be enshrined in law.

Secondly, ensuring a coherent framework is a prerequisite for ensuring legal certainty to those that will apply the sustainable finance framework. This is why I support the inclusion of transition plans in the Solvency II Directive, in compliance and coherence with other relevant legislation (i.e., the Corporate Sustainability Reporting Directive and the currently negotiated Corporate Sustainability Due Diligence Directive).

Thirdly, the new framework needs to be ambitious. We need to incentivise market operators to change their habits in a durable way and cannot ignore certain issues, notably the treatment of non-taxonomy compliant activities in insurance practices.

An ambitious renewed Solvency II framework means setting up ESG stress testing, better integration of climate risks in corporate governance policies, strengthening the analysis of climate scenarios and the mandate of the European Insurance and Occupational Pensions Authority on the evaluation of sustainability related risks.

Very importantly, an ambitious framework does not mean overburdening our companies. We want companies to embrace the green transition and not run the other way. Ambitious means, that we as legislator are required to ensure coherence, consistency and usability between all the different incoming legislation. The need to avoid unnecessary and additional red tape is for me the key to making this review a success.

Both the private and public sectors need to be positive drivers for change in the European Union. Insurers will play a pivotal role in insuring those increasing climate related events. We as regulators need to be ambitious and pragmatic in our approaches. Ambitious, to fight climate change, and pragmatic, to avoid protection gaps. Although it is a complex exercise, finding a balance between ambition, workability and clarity is key.

CYRIL ROUX

Deputy Chief Executive Officer - Groupama

Climate change isn't easily embedded in insurance products

Don't look up! This American movie, viewed from Europe, can lull us into believing that climate change denialism is the preserve of nitwits, conspiracy nuts or some US (ill-named) conservatives. But I contend that even our polite company fails to grasp fully the extent and speed of climate change. The human psyche struggles against such a reckoning; even the GIEC has consistently been behind the curve over the past two decades.

A case can be made that reinsurers are the financial businesses with the most at stake here, as they bear the brunt of the insured weather related losses. Their cumulative losses on natural disasters over the past decade show however that they have been behind the curve as well. It should be no surprise then that direct insurers, so far, have also failed to convey the pace and scope of climate change to their policyholders via insurance pricing or via denial of cover. This is in part due to the effectiveness and underpricing of reinsurance that they have benefitted from until last year. It is also due to the way insurance operates. By mutualizing the policyholders worst exposed to weather events with those less exposed, insurance undertakings blur the stark reality of physical exposure that the unvarnished price of risk would convey.

We insurers do so because mutualisation is the name of our game. But that means the price transmission mechanism is blunted. It cannot be very effective in any case because insurance policies cover a lot more than weather-related risks. Even when the latter shoot up, the former increase more modestly in prices. Furthermore, even a fast pace of climate change is still a multi year process, when insurance policies are annual. Add broad-based inflation to the mix, and policyholders can be forgiven for not extracting from their yearly insurance renewal notices proper information about their ever increasing exposure to climate change.

Denial of insurance cover would give a welcome jolt to the worst exposed. But this is exceedingly rare because insurers have internalized their role as public interest entities and also because public authorities would not countenance denial of cover to significant swathes of the citizenry or industry. The experience of compulsory motor third party liability insurance is telling : public authorities will not allow insurers not to cover bad drivers, or even allow insurers to price their policies for their actual risk; on the contrary, they force mutualisation through a number of public mandated schemes. Likewise, uninsured industries will be indemnified whether or not they are insured for the risk that befalls them, if that is seen as a public good, either through after the fact public subsidies (e.g. for crops) or through tilted judicial decisions (business interruption cover during the Covid epidemic).

Insurers cannot deny cover not price in full the risks worst exposed to climate change.

No doubt denial of cover would be an effective way to convey the reality of physical or liability exposure to climate change. Nice try if you can get it but alas, as the song doesn't go, you can't make it, even if you try.

To change tack, insurance regulators and insurers can find some way to embed climate change in their calculations within the solvency 2 paradigm. Solvency 2 works with best estimates of future claims arising from policies underwritten. Trends of increasingly costly and more frequent weather events need to be embedded in these best estimates. These increased estimates lead to higher solvency capital requirements and ultimately to higher premiums. Serious caveats apply however. Trends are hard to discern for a number of risks, such as European storms; while data is severely lacking for other risks, such as fires. Modeling of the future path of weather events is tentative at best. And solvency 2 has a one year horizon; this is fitting for a business which can reprice risks annually, but, accordingly, little deviation in solvency capital requirements will show from one year to the next. A doubling of risk by 2050 computes to a yearly rate of increase well below current yearly inflation rates.

As institutional investors insurers are well placed to account for climate change. This is neither virtue signaling nor wokism, but hard-nosed common sense. Better not to invest in what will become stranded assets in the foreseeable future. Double materiality isn't do-goodism either: when a business doesn't account for the detrimental effect it may have on climate, it lets others in society, such as NGOs, or public authorities acting on behalf of their citizens, to reduce or stop its activities.

When the US Congress acts on TikTok for what it sees as legitimate social concerns, it may one day act on energy, construction or transport companies for other legitimate concerns, such as avoiding the climate spiraling out of control. This is ESG investing 101.

In the end, climate change will upend our previous ways of doing business after all.

GERARDO DI FILIPPO

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Measurability: an indispensable approach to address sustainability initiatives

Sustainability is defining every facet of society and the economy. Environmental disasters, social divides and new vulnerabilities that are perceived in a post-pandemic and increasingly militarized world, have led to a prioritization of sustainability topics on policymakers' agenda and the way of doing business.

In past years, climate-related events alone have caused losses of around 0.3% of GDP per year globally, and a two-digit loss is forecasted until 2050. Economic losses due to extreme weather events have also almost doubled from 1,678tn$ to 2483tn$ in the first two decades of the century and Eurostat has estimated a loss of 145b€ in a decade in Europe.

Behind these numbers, an even sharper economic and social divide has emerged between regions that are more affected and those that appear to be less, but also between wealthier and more fragile parts of the population. The IPCC estimates that between 3.3 billion to 3.6 billion people as being among the most vulnerable, with people in the developing world hit hardest.

People's lives will not only be affected by environmental topics, but also by other phenomena that will have the potential to add new threats. Among these is demographic, with increased longevity observed over time, but with low birth rates in more advanced economies. The need to care for healthy aging, maintain a sufficient and wealthy working population, and support family-friendly policies is hence a societal priority.

Management of sustainability topics should focus also broadly on natural ecosystems, which are massively at risk in several regions with outcomes like disruptions in animal habits, species extinctions and food and freshwater scarcity (for instance, in Italy the salinification of the Po river due to reduced water flows is one recent example of a lack of freshwater for agricultural needs) as well as on social aspects, where for example migration flows are expected to increase due to climate change, resources scarcity and geopolitical tensions.

In this evolving, complex and still not fully understood context, the role of insurers remains unchanged; providing protection to people and society. However, the way this role is played will require changes. Starting from the climate change risk, that is the most urgent today, if on one side insurers should contribute to the global effort to reduce GHG emissions to reach the Paris Agreement targets, on the other hand they cannot limit their activities in paying losses from climate events ex-post, as this will result to be financially unsustainable. And very likely not sufficient.

Through measurability, sustainability management generate economic value for business and society.

Instead, insurers can play an active role in contributing to loss prevention and adaptive initiatives related to climate disasters, to avoid that the level of economic impacts become unaffordable for private industry as well as for governments, with ultimate repercussions on citizens.

The insurance industry is well placed to support short-term initiatives, such as information and alert systems for populations affected by climate perils, as well as more comprehensive and long-term initiatives, involving coordinated approaches on the population, ecosystem and technological evolution, that must be coupled with proper regulations, incentives and education.

This requires that plans definition and execution with the contribution of policymakers, public institutions, financial institutions and other public and private companies.

For example, the following burden-sharing scheme can be considered:

1. Primary insurers provide a policy
2. Reinsurance market increases capacity
3. Risks are further mutualized on capital markets through CAT bonds
4. National bodies is involved
5. Top-up intervention through EU funds is added

Moreover, joint investments allows to pursue the highest value combining the right risk return profile for private business, whilst reducing part of investments and risks carried out by the public sectors.

This virtuous cycle allows to render coverage affordable, through deeper penetration of insurance and sensible reduction of risks.

But all of the above is still not sufficient per se: the effectiveness of such initiatives must be measurable, by comparing the benefits in terms of expected loss reduction with the costs needed to implement them, and evaluating ex-post the real benefits obtained to adjust the approach where necessary. This step is essential to prioritize the initiatives to be taken, making them more concrete and ensure that the right set of actors are involved in their implementation.

Moreover, the measurability of the initiatives will ensure that they will be selected and prioritized through a proper business case, exploiting the opportunities, and not only the risks, related to sustainability adaptation, attracting and facilitating private and public investments.

In this way, sustainability management will be truly become a game-changer to be nurtured over time in order to generate economic value for the business and society.

BRUNO LEPOIVRE

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Saveguarding French farming through a public-private partnership

There is no longer any region or agricultural sector in the world spared by the consequences of climate change, not even in a mild climate country such as France. In its 2020 study on the impact of climate change, the insurers' association France Assureurs predicted a doubling of the frequency and intensity of climate-related losses by 2040. As a banker and insurer in the agricultural world, we are at the forefront of observing that, unfortunately, these forecasts are already coming true and are having a major impact on crop production and on farmers' income. Since 2016, each year has seen an extreme weather event. There events have even occurred in parts of the country and in crops thought to be immune from such phenomena.

The stakes are high because the assets involved are considerable: 28 million hectares of cultivated land for a total of €37 billion of exposed capital.

The history of France's model is a peculiar case, having gone from a fully state-funded model to an all-insurance one and finally to a Public-Private Partnership. For 50 years, exceptional crop losses were covered solely by the state (except in the case of hail), via an Agricultural Disaster Fund. This fund was an imprecise and complex protective mechanism that had no budgetary visibility. The increase in risks and the occurrence of extreme events such as the dramatic 2003 heat wave have highlighted its drawbacks and limitations.

Insurers were thus invited to create crop insurance in 2005, which guaranteed a level of yield against a decreased yield level caused by climatic events. This type of insurance in individualised and efficient but is distributed to less than one hectare out of three for several reasons: financial (farmers' ability to pay), administrative (subsidised contracts but considered complex) or even psychological (poor understanding of the risk). In addition, some sectors remained eligible for the Agricultural Disaster Fund, which excluded insurance from this sector.

Moreover, as the system had never found its financial equilibrium (over 12 years, the loss ratio for the companies was more than 105%), reinsurers threatened to leave it. Insurers thus found themselves exposed to increasing volatility, with a risk of accumulation, while not being able to recognise equalisation reserves in IFRS accounting norms. A reform had become necessary.

The Common Agricultural Policy devotes less than 1% of its budget to risk management.

Since January 1, 2023, a new system is in place. Its principles are based on risk sharing and complementarity between the farmer, the insurer and the State. Common risks are assumed by the farmers. Significant hazards are covered by crop insurance, for farmers who have chosen to subscribe. Finally, exceptional hazards trigger state intervention, via national solidarity, including for uninsured farmers. It is doubled for insured farmers. What is new is that in both cases, the loss assessment methods, the compensation principle and the historical reference are the same, which was not the case before. The world of insurance and the world of state intervention now operate according to the same principles. Moreover, as of 2024, insurers will be the sole managers of both public and private systems.

We need to go further through innovation and pooling of resources. With the surface area covered increasing from 30% to 100%, the industrialisation of contract and claims management becomes an objective. Technologies such as satellite imagery, crop modelling and big data processing could be used to create and exploit very local references, in order to adjust offers, rates and expertise to various situations.

The adjustment of the technical results of this business line is also necessary. Basically, it is a matter of shifting from information asymmetry in favour of the insured, who knows much better his land and his practices than the insurer can, to a more balanced knowledge of risk. Data platforms and associated digital services, Artificial Intelligence and image recognition make this detailed knowledge of risk possible. Like Research&Development on risks and prevention measures, they could be shared between public and private players, within the framework of the co-reinsurance pool provided for by the law. These possibilities can be extended to the European level, where the «crisis management fund» could be reactivated and articulated with national risk management systems, or even transformed into a Special Purpose Vehicle (SPV).

The Common Agricultural Policy devotes less than 1% of its budget to risk management. Is it fine-tuned enough for the challenges of climate change?

JEAN-JACQUES BONNAUD
Treasurer - EUROFI

Climate related insurance affordability: think global, act local

Climate related risks are growing in Europe - flood, disease, storms, coastal submersion, wildfires etc. They have severely impacted the claim capacities of insurance and reinsurance companies despite meaningful rises in premiums, which have been estimated to an average of 40% at the last Monte Carlo Reinsurance negotiations in January 2023. Claim capacity reductions are not only hampering the affordability of insurance contracts for households, but also for some big municipalities too, which are all struggling to find adequate coverage for property casualty risks for instance in France.

The reaction of the insurance world, in addition to premium increases, has been to transfer part of the risk by reducing the reach of contracts and related time limits for reporting a claim. They also resort to reinsurance mechanisms to absorb extreme losses.

But the problem is deeper. What is at stake is not a temporary increase of natural disasters but the repetition of the disasters and the increase of their magnitude. The ever-increasing replication and amplification of natural events, challenge the availability of risk anticipation data, and accentuate the insurance unaffordability for both underwriters and insurers.

In addition, the territorial concentration of these events and related damages, limits the possibility to mutualise the risks which usually enables insurers to diversify insured portfolios. Insurability is questioned twofold. We can add that since those risks do not recognise national borders, competitiveness issues emerge in the EU, resulting from the differences in the provision of national solutions, and from national consumers and household's cultures and behaviours regarding insurance.

Now, the situation now calls in all countries for developing various types of public authorities' involvement. The challenge is to maintain a reasonable level of premia notably by extending the mutualisation benefits stemming from reinsurance, while avoiding any unbearable rise of related costs. Some countries have hence favoured reinsurance cost sharing and subsidisation mechanisms.

An example of such a public private cooperation can be found in the French "Cat Nat" system initiated in 1982. A public financial vehicle called "Caisse centrale de réassurance" contributes to further mutualising risk while a portion of the mandatory tax bearing on all the property insurance policies, and more recently on car insurance contracts, is dedicated to alleviating these reinsurance costs.

The objective is to extend climate related insurance coverage while leveraging the insurance sector knowledge of its clients, its local-risk expertise, and its capability to incentivise prevention actions among underwriters and local authorities.

However, non-mandatory insurance schemes, like the one for agriculture in France, suffer from a too weak number of voluntary underwriters. In this context the Government is combining incentivising underwriting by farmers, while providing state assistance for the most poorly insured ones. In the same vein the French parliament proposed to impede French insurers to exclude from their contracts the impact on houses of geological consequences of drought, although their frequency increase is alarming.

Interesting examples could be drawn from the US or Japanese experiences. Many governments in Europe have similar systems involving the public sector through varied forms of cooperation. But it is not the case in all Members States.

Furthermore, in addition to normal but heavy duties of States in security matters regarding floods or big fires which already require massive cooperation, national or local authorities should play in Europe a growing role regarding prevention policies by devising incentive schemes, imposing preventive technical study standards preliminary to building in risky locations, as well as financial support for adaptation of public works where required.

At the same time, it is worth noting that even in the context of public private reinsurance schemes most often claim management remains on insurers' side. The objective is to leverage the insurance sector knowledge of its clients, its local-risk expertise, and its capability to incentivise prevention actions among underwriters and local authorities.

In this context a new role should be given to European authorities in order to favour cooperation and foster information sharing regarding reinsurance schemes, adaptation, as well as meteorology or geology forecasts, since many risks are cross border. Similarly in the context of the EU free provision of service principle, a systematic sharing of the geocoding of risky territories should contribute to maintaining fair competition across the EU. Finally, it should also be envisaged building a common fund to address exceptionally expensive reinsurance costs and coordinating enhanced cooperation with neighbouring countries.

Similarly, globally, the UN should accompany emerging countries in these areas, bearing in mind migration flows which are likely to be impacted by climate change. In a situation comparable to a Tower of Babel, these are prerequisites for the insurance industry to contribute to an ambitious international strategy to damp climate change impacts.