

Climate change insurance needs

1. Rapidly rising climate change risk impacts citizens as well as non-life insurance and reinsurance companies

1.1 The occurrence of natural disasters is increasing significantly

The Chair introduced the session on the role of insurance when dealing with natural catastrophe and how society risk can be managed. These are happening more frequently, are more intensive and damages are going up.

An industry representative noted that catastrophe impact depends on the business an entity does. For life business, there has been limited impact in Europe. Weather events and heatwaves can claim a lot of lives, but it does not show in premiums. On the other hand, there is a major impact on property and casualty lines. In France, droughts that happened every five years now have a 95% chance of happening every year, according to the Intergovernmental Panel on Climate Change (IPCC). Yet with European storms, there is not any visible change so far in the pattern. Then there are events that have not been seen before, such as hailstorms so severe than they trigger business interruption. Weather events previously cost to Groupama 7% of its property and casualty (P&C) premiums. Last year they cost us 14% of our P&C premiums. The impact on reinsurance is also stark. Reinsurers will not pay those claims in future. Insurers will keep more of the tail risk, but in any case he public bears the brunt of it, which is going to change the economics of the P&C business.

1.2 Increasing natural disasters lead insurance companies to address the issues of possible moral hazards and insurability of certain physical exposures, beyond the necessary adaptation advice to their customers and insurance policy repricing

An industry representative explained that underwriting is where the insurer assesses the risk and has dialogue with the client regarding the risk exposure. Insurers tell clients that risks will be twice as frequent and severe in the future. The challenge of pricing is about not only an increasing risk but also insurability, mutualisation, and responsibility. Some assets may become uninsurable. Insurers have to reconsider the question of the balance between mutualisation and responsibility. It is the responsibility of individuals to pay for the real risk. Pooling is the solidarity between high exposed risk and low exposed risk. The price signal of the risk is also crucial for the education of the system.

Crop insurance in agriculture is facing another challenge. There is a lack of symmetry in terms of information.

Farmers do have a better understanding of their real risk in comparison to an insurer. There needs a better-balanced knowledge of the risk. Technologies like satellite imagery and crop modelling will be instrumental.

1.3 Fast evolving nature-related risks impose further forward-looking risk assessment approaches leveraging shared swiftly-updated data

An industry representative advised that there is a need to share some risk data, though some is at the core of companies' strategy and may impede the competitiveness. Data on losses is very difficult to share. Model building is important. The European Insurance and Occupational Pensions Authority (EIOPA) has standardised some measures to adapt to climate change in contracts. The framework is the same to analyse the potential of the dedicated prudential treatment of those risks and impact on the solvency requirement. It is very important to have common rules.

The Chair stated that EIOPA receives a lot of data and tries to share it, recently publishing the climate change dashboard. Some data does become less available, because it becomes a commodity.

An official reported that the International Association of Insurance Supervisors (IAIS) is turning attention to the liability side to collect data.

1.4 Insurers' assets are also significantly exposed to climate related changes

An official stated that IAIS has been looking at the impact of climate change for insurers at the global level. A pilot exercise was conducted in 2021 looking at insurers' exposure from the asset side to transition risk. Within the sample, 33% to 40% of investments were exposed to climate-related assets. Depending on scenarios on transition, it was clear that there could be a wide range of impacts. There was no scenario where the impact would lead to insolvency, but in the too little too late scenario the impact were significant.

2. Challenges posed to insurance companies by non-insurable natural disaster risks

2.1 Main points of concern: transition and adaptation costs, and lack of skills

An industry representative stated that things no longer being insurable depends on the clients' markets. Those who are most educated about climate change and what they need to do to be insurable are farmers. At the other end are governments and public partnerships. In the middle are the retail markets, but there is an issue that

is not just for insurance. Homeowners can save energy by insulating their homes, but that is costly and will take years for the cost of insulation to be recouped through lower energy costs. People will not spend to proof their homes just to capture lower insurance premiums. A few customers may be convinced by the economics of proofing, but most people do not spend time with insurance intermediaries; they simply compare insurance prices over the internet.

The Chair noted that 75% of the natural catastrophe risks in the EU that EIOPA and the European Central Bank (ECB) identify are not insured.

2.2 Key success factors: risk awareness, premium reductions and updated insurance products encompassing support services

An industry representative stated there are three main levers to make consumers buy insurance. One is risk awareness. The second is improving the terms and conditions and any things that have an impact on the product. The last is renewing the insurance offering.

On the first lever, loss preventions can be done through loss prevention activities. It is important to also activate services such as alarming. Through the usage of artificial intelligence, there can be campaigns to inform people of what is going on and how it could be better. On the second point, it is easier to understand how to adapt with the increasing understanding of the risks. The insurance industry has to better reflect the terms and conditions, and the impacts of adaptation and mitigation measures, making the product more affordable. On the third lever, one example is parametric insurance. If insurers think about the ability to connect the service around the adaptation, they can service clients, explain the risk and offer services that helps to reduce losses.

These pieces depend on different dimensions of retail versus small and medium-sized enterprise (SME), versus corporate, or emerging market versus developed market, or even a different line of business. Two points are crucial. One is the financial education. The second is, if a good natural-based solution is implemented at the government level, the cost of adaptation and the cost of product for insuring will be lower.

2.3 In the challenging context of rising natural catastrophes, the sustainability of insurance schemes requires combining a wide insurance coverage, systematic prevention approaches, state-managed solidarity mechanisms, and compulsory deductibles reducing moral hazard

The Chair raised that claims going up are already causing a problem. Insurers can incentivise adaptation and mitigation, without which there will be a bigger issue. In natural catastrophe risk, preventions should be taken in order to capture damage. Public-private partnerships need to be considered.

An official stated the long-term resilience of an insurance scheme requires dramatic promotion of climate-related prevention and adaptation measures to reduce risk and limit moral hazard. The first step to promote prevention is to offer a wide insurance coverage

of climate-related risks. France is offering a compensation scheme based on a public-private partnership with private insurance and a non-mandatory state-guaranteed public reinsurance through Caisse Centrale de Réassurance (CCR). The system is based on solidarity through an additional premium set by the government at a mandatory uniform rate on P&C contracts and responsibility, with a minimum compulsory deductible. In the framework of the natural catastrophe scheme, local public authorities which set up adaptation measures are charged with a lower premium and can avoid a higher deductible. In 2019 the CCR introduced incentives for insurance companies expanding prevention actions.

3. EU and global policy priorities in the context of rising climate related natural events: achieving the insurance sector soundness and economies transition without overregulating

3.1 European and national policy makers have an important role to play in triggering and sustaining the virtuous circle necessary to achieve an effective reduction of insurance gaps

An industry representative stated that there are four elements in the EU agenda on protection gaps. One is financial and risk education. The second one is the pooling and layering of risk: insured have to participate to reduce moral hazard, then risk can be pooled at insurers level and diversified at EU level, which will be the most cost effective at government level. Insurers have to be able to measure the protection gap and ensure that any solution can be equally measured in terms of benefits attached. Otherwise, it is speculation on something that it cannot be monitorable. Two important aspects have to be kept on the associated protection gap. First is thinking of the mitigation. The second is to support the transition. Adaptation and mitigation can be done at the same time. It is important to have EU-orchestrating ambitions with more robust fiscal stimulus on top of the Net Zero Industry Act. In order to scale up, what has been seen in the US with the Inflation Reduction Act is a game changer. In fact, is already visible the move of industrial companies to US.

3.2 Fostering both adaptation and economic development proves difficult including on the re-insurance area. This deserves further political coordination and structured cooperation regionally and globally

An expert stated that the problem globally is enormous. In Southeast Asia, the production of rice is falling and population is growing. Rice is the biggest producer of toxic carbon and methane. There is a contradiction with incentivising growth in the manufacturing industry and agriculture. The rules Europe has are principles in the West but are difficult to impose on countries which need

industry development. They need electricity, produced by power plants, which function with coal and fuel. They have no renewables, no nuclear and cannot invest in those. Europe has certain models, but the system relies on a good reinsurance system. Some local insurance companies cannot find reinsurance, because environmental, social and governance (ESG) is fashionable and big reinsurers do not have the capacity nor the willingness to accept risk coming from the local insurers. There is a problem of coordination with Europe tacking in account the future of the flows of population.

There should be transition plans for the long-term set up where local companies could present to reinsurers a portfolio where, for instance, the classical production of electricity would be reduced and a growing share of renewables, so those local companies would be accepted by reinsurers. This requires probably a dedicated fund at the level of the United Nations, with the help of the advanced countries to facilitate the creation of a reinsurance mechanism or incentives, with the United Nations Industrial Development Organisation (UNIDO) and probably the Food and Agriculture Organisation (FAO).

An industry representative mentioned two sources of inspiration for the role of public-private partnerships. In agriculture, Spain is the model source of inspiration for the French system. It is a public, private and producers' partnership in force since 1978. A second source of inspiration comes from Africa, with the African Risk Capacity (ARC), which is a sovereign fund launched by the Africa Union to help countries manage their risk at a continental level. They think at a continental level and have pooled the means, the risk and the knowhow. They use cutting-edge technologies and pay quickly just after the claim (one dollar paid by insurance immediately after disaster is the equivalent of four dollars paid by ex-post aids 6 month later).

3.3 Identifying and addressing emerging insurance gaps and achieving an appropriate insurance sector tool kit with regard to climate related rising risks, are key priorities globally

An official highlighted that addressing climate-related risk is and should remain a top priority for the US Treasury Department, the Federal Insurance Office, the insurance sector and public policy conversations. There is growing evidence indicating that climate change is associated with a decline in the availability of insurance coverage in certain parts of the country. Carriers are rising rates or pulling out of markets. That has significant consequences, particularly for homeowners and property values, and can spill over to other parts of the interconnected financial system. Traditionally underserved communities are having an increasingly hard time finding affordable insurance coverage. President Biden's Executive Order in May 2021 tasked the Federal Insurance Office with assessing issues or gaps in the regulation and supervision of insurers in this important area, and assessing where there is potential for major coverage disruptions in areas that are particularly vulnerable to climate change impacts.

The Federal Insurance Office is preparing a report looking at issues regarding regulation and supervision. It is also focusing on the need for granular and decision-

useful information. Quantitative work will assess the physical risk of underwriting liabilities from P&C insurers' current and historic exposures. FIO issues a proposed data collection at the ZIP code level on homeowners' insurance, tied to a specific subset of insurers, to help develop a nationwide understanding and assessment of how the US is being affected by climate-related events. Public-private partnerships can be useful in addressing climate related impacts, especially around issues like mitigation and resilience.

An official added that the ability to get informed, evidence-based information is very important. IAIS needs to consider the outward risk of climate in the insurance sector towards the rest of the economy. There will be an important statement on protection gaps, showing which direction should be worked on.

The Chair commented that in the US interesting public private initiatives are happening at the municipality level, but the world is bigger than the EU and US. There are entities that come from being insured but then lose insurance because risks become too large. But there are also parts of the world where entities never had an insurance, while more damage is caused by climate change.

3.4 Climate risk is considered as an amplifier of usual risks. The challenge is thus to effectively embed these new amplifiers in existing insurance risk frameworks and practices. In addition, however, running stress scenarios will help to address the forward-looking nature of these amplifiers and attention will be paid to greenwashing risk

An official stated that the IAIS sees climate risk as a driver or an amplifier of current risks. It does not see the need for major change to global standards, because they are risk-based and there are plenty of tools to aid dealing with risk. IAIS needs to help the supervisors and the industry to make the best use of the global standard, developing guidance and supporting material. Everyone should look at the open consultation on what to do in terms of policy work. The first step in the public consultation is on where climate risk is positioned within the introduction of the global standard. There are also changes being made to the supporting material, using the supervisory toolkit to address this risk and stakeholders are being asked about the IAIS overall agenda in terms of climate and whether things need to be added.

At the end of this year, IAIS will look at scenario analyses, stress testing for climate to propose more guidance and look at issues related to market conduct and the risk of greenwashing. In 2024, IAIS will consult on potential issues related to valuation and disclosure. There is also a lot of capacity building.

3.5 Over-regulation would play against transition

A public representative stated that the European Parliament represents more than 400 million European citizens and thus its role as a legislator must reflect their priorities. Climate change impacts everyone. An immediate concrete and collective European response is needed. The role of insurers is crucial in the green transition, but they are only one piece of the puzzle. As

long-term investors they need to be drivers of the transition. Moreover, they need to set the example and better embed climate risk in their practices. This is the aim of the Solvency II review being conducted at the European Parliament. The addition of climate scenario analysis is a push to better embed stress tests and best practices in the text.

The EU is leading the way globally with an ambitious, sustainable finance framework and regulators need to let insurers play their role. The European Parliament is pushing for an upgrade of the current rules with the Solvency II review, but there is still a margin to improve. Sustainable finance started with nothing and is now ending up compiling a mountain of legislation (taxonomy regulation, Sustainable Financial Disclosure Regulation (SFDR), Corporate Sustainability Reporting Directive (CSRD) and so on).

Currently the main worry of insurers is overregulation and regulatory coherence. If those concerns are not addressed, there will be a risk to see companies depart from the green transition. Regulation should not condemn insurers and companies but help them. Ambitious rules need to be fit for purpose and coherent. Inconsistencies can be prevented with better stakeholder consultation for example.