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Natural catastrophes and insurance: Managing risk and building resilience in EU

Europe is the fastest-warming continent in the world. Extreme heat is becoming more frequent while precipitation patterns are changing. Precipitation extremes are increasing in severity, and recent years have seen catastrophic floods. At the same time, southern Europe can expect more severe droughts¹.

The insurance industry plays a unique role in raising the resilience of society and the real economy. Insurance products protect economic wealth and social welfare by pricing risks accurately and providing compensation after natural catastrophes events. However, as climate change increases physical risk exposures, risk-based premiums are expected to rise over time. This could reduce both the affordability and availability of insurance products covering climate-related hazards in the medium to long term.

Between 1980 and 2023, only around a quarter of the losses caused by natural

catastrophes across Europe were insured, with material differences in the protection gaps across countries and perils. Given the current trajectories of climate change, these insurance protection gaps are expected to become even wider in the future. This is why adaptation and mitigation measures need to go hand in hand. In the short term the insurance sector can shield itself from increasing risks by raising prices and deciding on which risks it can continue to cover. In the longer run, the gap will put into question (re)insurers' role in providing financial resilience. This requires action on different fronts.

Firstly, adaptation measures that are implemented ex-ante to a loss event, such as water-resistant walls in case of flood risks, reduce the policyholder's physical risk exposure. As such, adaptation measures can be a key tool to stabilize risk-based premium levels and to maintain the future availability and affordability of insurance products covering climate-related hazards. In this regard, EIOPA introduced the concept of impact underwriting, which refers to how insurance companies can contribute to the adaptation of society and the real economy to climate change through their underwriting practices in terms of data, risk assessment and expertise, thereby promoting and incentivizing policyholders to take up climate-related adaptation measures.

**The insurance industry
is crucial in raising
climate resilience by
promoting adaptation.**

While the current implementation of adaptation measures in the European insurance market shows progress, a global comparison suggests there is further room for improvement.² Efforts are needed to standardise the implementation of climate-related adaptation measures in insurance contracts, for instance through dedicated risk-based certificates and programs. The risk-based recognition of adaptation measures in premiums, for instance through discounts, merits further analysis. In addition, raising awareness about climate risks and related prevention measures is also needed.³

Finally, further innovation is needed to place adaptation measures at the core of all insurance products. For this, new technologies such as the use of satellite data, open-source data and models⁴ and AI play a significant role.

Secondly, the insurance sector should engage with policymakers to develop national and European approaches for reducing the impact of catastrophes. In a new joint paper, EIOPA and the ECB highlight how individual insurers and consumers often fail to factor in the broader economic benefits of insurance⁵. Combined with the expectation that governments and EU Member States will cover losses after disasters, insufficient insurance coverage slows recovery from disasters, burdens fiscal budgets and misses the essential benefits of ex ante risk management. Analysis shows that national schemes help improve insurance coverage and reduce the insurance protection gap. Examining the design features of such national schemes can inform potential EU solutions to support and supplement national initiatives. Pooling insurance risks of businesses and households across the EU could increase diversification benefits and reduce the cost of capital. Strengthening EU disaster risk management can contribute to national adaptation efforts. It is in the long-term interest of insurers to contribute to the development of such solutions.

1. *European Climate Risk Assessment | European Environment Agency's home page*
2. *Impact underwriting: EIOPA reports on insurers' use of climate-related adaptation measures in non-life underwriting practices - EIOPA*
3. *Consultation on a blueprint for an awareness tool for natural catastrophe risks and prevention measures - EIOPA*
4. *Open-source tools for the modelling and management of climate change risks - EIOPA*
5. *EIOPA and ECB joint paper: Towards a European system for natural catastrophe risk management - EIOPA*