

CLIMATE CHANGE INSURANCE NEEDS



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Policy measures to reduce climate-related insurance protection gaps

Climate-related extreme events can cause significant economic disruption. Direct aggregate catastrophe losses in the EU amounted to approximately €500 billion in the period between 1980 and 2020.[1] It has been estimated that even in a 1.5°C global warming scenario, related losses across the EU will nearly double by 2050, with costs being significantly higher under a 2°C or 3°C average temperature increase.[2]

Catastrophe insurance helps to mitigate the negative macroeconomic effects of disasters. First, it enables the economy to recover faster by promptly providing the necessary funds for reconstruction and limiting the period of lower output. Second, catastrophe insurance can increase resilience by improving the understanding and assessment of climate change risks and promoting risk reduction measures. Third, it allows the

mutualisation of risks and their transfer to private insurance companies, which can provide incentives for resilience.

EIOPA's dashboard shows that in the EU, only one quarter of natural catastrophe losses were insured in the past.[3] The insurability and affordability of climate-related risks is becoming a critical concern for insurers and policymakers, and if no countermeasures are taken, the insurance protection gap is expected to widen.

As a key strategic area of activity, EIOPA aims to address protection gaps by improving risk assessment, risk prevention and adaptation measures, as well as incentivizing appropriate product design and risk transfer for climate change risks. For example, EIOPA developed a dashboard on the insurance protection gap focused on identifying key drivers and improving risk awareness. Access to data and models are essential for this work: to build prevention measures, it is necessary to be able to understand and model the risk. EIOPA therefore released the CLIMADA-app to facilitate the use of an open-source catastrophe model.[4]

We must act now to address extreme weather event insurance gaps to minimise future taxpayer costs.

EIOPA has also been working to identify possible solutions to address protection gaps along three key dimensions. First, the supply side, with a focus on pricing and product design: how can we reduce losses through preventive measures, which are reflected in insurance pricing? This is what we call 'impact underwriting'.

While progress is being made in how insurance undertakings are adapting their non-life underwriting practices to climate change, EIOPA's report on insurers' use of climate-related adaptation measures in non-life underwriting practices[5] shows that the EU insurance market overall appears to be at a relatively early stage. EIOPA sees further room for improvement, especially in terms of standardising the implementation of climate-related

adaptation measures in insurance contracts, for instance through dedicated risk-based certificates and programs.

Second, the demand side: EIOPA published a report on consumers' preferences to understand why they do not purchase insurance coverage.[6] This work, which draws on consumer research and behavioural studies carried out by EIOPA, has revealed several demand-side barriers and drivers that impact the willingness of people and businesses to buy NatCat insurance. These for example include income levels and the perceived unaffordability of coverage, a lack of clarity in terms and conditions, previous negative experiences with insurance claims or the misperception of the risks of a NatCat event. Potential solution could be to increase risk awareness, greater standardization of insurance products or simpler and more consumer-friendly purchasing processes.

Finally, the macro aspect: EIOPA has been studying the macro-economic implications of protection gaps together with the European Central Bank. This macro-related work outlines basic principles to which policy actions should adhere in order to reduce insurance protection gaps. Alignment on risk prevention measures and sharing of costs and responsibilities across the relevant stakeholders is required to ensure "skin in the game" and reduce moral hazard. Ex-ante risk assessment and risk prevention are crucial to the well-functioning of private insurance markets and for lowering the costs for the public sector in the longer run.

1. *Economic losses from climate-related extremes in Europe (8th EAP) (europa.eu).*
2. *Gagliardi, N., Arévalo, P. and Pamies, S. (2022), "The Fiscal Impact of Extreme Weather and Climate Events: Evidence for EU Countries", Discussion Paper, No 168, European Commission, July.*
3. *Dashboard on insurance protection gap for natural catastrophes (europa.eu).*
4. *Open-source tools for the modelling and management of climate change risks (europa.eu).*
5. *Impact underwriting: EIOPA reports on insurers' use of climate-related adaptation measures in non-life underwriting practices (europa.eu).*
6. *EIOPA research sheds light on why households and businesses are reluctant to take out NatCat insurance (europa.eu).*