The opportunity to design real catastrophe insurance is now

Interview conducted by Thomas Carver, for the BINK magazine

The pandemic and subsequent economic recession has highlighted a protection gap in catastrophe insurance. According to the Geneva Association, less than 1% of the estimated $4.5 trillion global pandemic-induced GDP loss for 2020 will be covered by business interruption insurance.

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Set up in 2011, the European Insurance and Occupational Pensions Authority (EIOPA) is the European body responsible for insurance and occupational pensions. The EIOPA's first chairman, Gabriel Bernardino, is retiring next month, and BRINK spoke to him about the need for shared resilience and public-private partnerships to help bridge this gap.

BERNARDINO: I think there is a clear recognition from all parties, that the current situation — when we look at the coverage of business interruption — is far from optimal. It creates risks for the companies and reputational risks for the insurance market.

The Need for a Public-Private Solution

I think we can do better collectively as a society to deal with these risks. There are different views, but I think that there is a high level of support for an approach that would combine public and private engagements in order to maximize the COVID-19 agenda and to have a better management of these risks out there.

There are solutions in the form of insurance and reinsurance mechanisms. What is needed at the end of the day is political willingness and political decision to move ahead.

BRINK: Does the EIOPA have a view as to how to bridge this protection gap?

BERNARDINO: Our role here is to propose solutions, and that's what we have been doing. We published a paper in July with a skeleton outline of what could be these shared resilience solutions, and we have been discussing that with the European Commission.

Better Data Is Needed

Non-damage business interruption is a quasi-systemic risk. It is impossible for these risks to be dealt with by the insurance sector alone. What we propose are three elements for this shared resilience solution to work. One is to really have better risk assessment.

It's clear that the pandemic has shown that the modeling and the data availability in relation to the consequences of pandemics needs to be improved. There needs to be a better risk assessment and better data collection.

Secondly, the role of prevention and mitigation is crucial. And when we're talking about that, it's prevention and mitigation that can, and should, be put out there not only by governments, but also by different companies in the economy and by insurers.

Engage the Insurance Companies for Risk Transfer

For the risk transfer, we propose a four layer solution. Firstly, direct insurers will need to have a role because insurance companies need to have some skin in the game. So there needs to be some coverage done by the insurance sector to participate in its common effort. It's the role of the insurance that should go beyond just the role of conveying money from the public side to the policyholders.

A second layer is for the reinsurance market to have different elements; it can be pools that we have seen that developed in some countries, but also some alternative risk transfer mechanisms.

Thirdly, there will be a role for governments at the national level in excess of the private market capacity.

Finally, a fourth layer should be an EU-level support mechanism that could have different nuances. One possibility could be to have a new reinsurance solution on top of what is insured by the other layers.

BRINK: What’s been the response from the EU at them taking on that sort of role?

BERNARDINO: Well, the EU Commission is now looking at this contribution from our side. It’s also looking at the lessons that can be taken from the crisis in terms of the costs of this business interruption in the different countries.

Without political awareness and support, it’s impossible to move ahead in this area. I think it’s already very positive that the European Commission is looking seriously into this, but I cannot anticipate that political decision.

What we’re seeing right now is reinsurers tightening the wording of the contracts and explicitly excluding this risk. The situation will only be worse if we do nothing, and in the end, governments will pay.

BRINK: Do you think there is a role for kind of alternative risk financing mechanisms and capital markets in this?

BERNARDINO: Of course, alternative risk transfer mechanisms and the capital markets are quite relevant in terms of transferring risks — and we have seen that in different types of situations with other types of risks. Now, is it an easy solution? No..

Engaging the Capital Markets

Usually capital markets prefer to have a role in risks that are completely uncorrelated from an economic perspective or from a financial market perspective. This is not the case with this risk, but if we avoid complexity — if we can reduce the moral hazard in the way that we define the risk in the way that we define the transfer and the coverage — then I think these will all help to have more standardized risk coverage, which is much more suitable to be placed in the capital markets.

We need to have something standardized and simple enough with simple trigger mechanisms in order to make sure that it is sufficiently transparent to be funded on the capital market side.

BRINK: How transferable do you think your work in this area is going to be to applying it to those other types of catastrophe?

BERNARDINO: We recently published a pilot risk dashboard that looked at different perils in European countries. We arrived at the conclusion that if you look at the last 10 years, only 35% of the losses of those natural catastrophes throughout Europe were covered by insurance.

So there is clearly a protection gap in this area and there are solutions: There are already some of the solutions in place, quite similar to what we propose to them, to the shared resilient solutions.

Mitigating Climate Change

BRINK: And presumably at a political level, there would be openness to that idea as a mechanism for handling climate change.

BERNARDINO: As you know now, everything related to climate change is a hugely important and central element of EU politics. The green agenda is one of the main objectives of the European Commission. So I really hope that this can also contribute to having this discussion at the political level and to take decisions going forward.

That’s why we have been looking at the possibilities of having multi-peril approaches because we have come out with this proposal specifically for the pandemic, but these are solutions that can also be applied in other types of risks.

In order to deal with this properly, we need to have a combination of EU and national implementation. If we just have one of the legs, I don’t think that this will change the picture very much.

Our key contribution for this is to try to bring these two elements together in a comprehensive framework that will make this situation in the future managed much better.

If Nothing Is Done, It’ll Be Worse Next Time

I think that if nothing gets done, the consequences for the next pandemic will be even worse. The numbers suggest only around 1% of the costs induced by the pandemic in terms of business interruption have coverage worldwide.

But even that number will not be covered in the next pandemic, because what we’re seeing right now is reinsurers tightening the wording of the contracts and explicitly excluding this risk. The situation will only be worse if we do nothing, and in the end, governments will pay.

These shared resilient solutions could bring a much more efficient and effective way of dealing with these costs and then funding these costs. There could be a step-by-step approach in terms of what kind of liabilities you assume: It could start with some simple trigger mechanisms and parametric insurance, but in the end, all of these will be much better for member states.

That’s the message that I’ve been passing politically, and I hope that this time we can take the right approach. With the recovery, the opportunity is now.

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