

# FEEDBACK STATEMENT

on comments received on the Discussion Paper  
on non-life underwriting and pricing in light of  
climate change

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**eiopa**

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### **Introduction**

EIOPA conducted a public consultation on the Discussion Paper on non-life underwriting and pricing in light of climate change, which ran from 10 December 2020 to 26 February 2021.

EIOPA received 16 stakeholder responses to the public consultation, of which 14 public and 2 confidential responses.

EIOPA would like to thank all stakeholders for their responses to the public consultation. All comments submitted were given careful consideration by EIOPA and have helped in preparing the final report. Considering the nature of the discussion paper and the concepts addressed, EIOPA took note of the various positions and has integrated many of the examples and comments in the final report in order to improve the understanding of the subject matter and provide a balanced basis for further initiatives. Many of the comments will benefit from further discussion. Hence the importance, for EIOPA, to continue engaging with stakeholders on the matter, following the publication of the final report.

This feedback statement summarises the main responses received and how EIOPA addressed them in the Report. The non-confidential individual responses received and EIOPA's feedback on these responses are published in a separate document.

### **Objective of the final report**

The report aims at engaging with stakeholders on how insurers could address the insurance protection gap in light of climate change. The report illustrates the key role of the (re)insurance sector to contribute, through insurance-based solutions, to climate change mitigation and adaptation. For this purpose, the report provides further clarification on EIOPA's concept of 'impact underwriting'.

### **Main responses received and how EIOPA addressed them**

#### On risks to affordability and availability of insurance in light of climate change

Respondents to the consultation broadly agreed that **climate change will have an impact on the insurance sector** through an increased frequency and severity of extreme weather events resulting in a real risk of increasing premiums that ultimately could lead to affordability issues for policyholders. As potential obstacles to future availability and affordability respondents listed the lack of availability and increasing price of reinsurance, limited access to granular data, the absence of adequate mitigation and adaptation measures and a lack of clarity on public action in response to climate change. Also, some stakeholders expressed concern about the lack of awareness and risk perception amongst potential policyholders, leading to lower demand for insurance coverage, as well as a higher risk of anti-selection due to potential increasing tailoring of contracts. Some stakeholders noted that climate change can put at risk the fundamentals of insurability, such as the need for randomness and independency of events, and the benefits of a mutualisation of risks.

Respondents recognised that **risk-based pricing** is a relevant tool to reflect climate change in insurance solutions, but the majority noted that the effect of climate change is not (yet) taken into account in the pricing of insurance. Respondents stressed that the assessment and pricing of any risk must be exclusively risk-based at all times. For climate change, respondents noted that such risk-based approach is limited by the uncertainty to predict future evolutions; attempts are being undertaken to incorporate climate change through nat cat models, but modelling is at an early stage for many, with often limited data availability. Some stakeholders stated that climate change trends resulting from analysis of past claims experience is gradually taken into account for new business and some also noted that the price of reinsurance as an input factor into pricing reflects recent experience. Others also acknowledged that as part of strategic considerations, long-term aspects are relevant, also in terms of future business planning (e.g. referring to ORSA). Stakeholders referred to open-source models and access to open source data, fed by public and private data, which could help better reflecting climate risks in insurance contracts.

Respondents also pointed out that special consideration should be given to the **role of governments for prevention measures**. Most respondents reaffirmed that while private insurance markets can usefully contribute to the climate transition, they cannot substitute for government action. As such, according to respondents the primary responsibility for incentivizing risk prevention measures would remain with governments and regulators (in order to create a level playing field in the insurance sector), in particular for prevention measures aimed at long-term risks such as climate mitigation. This could include the setting of building standards, building infrastructure for flood defences, as well as public subsidies or fiscal incentives to promote prevention measures by individuals and businesses, reduced tax on premiums for insurance adapting to climate change or covering natural catastrophes (for specific sectors or selected risk, e.g. agricultural insurance for weather-related perils in the Netherlands or residential insurance coverage against earthquake in Italy), or the requirement for mandatory coverage. Respondents also noted that solutions should be developed at national level and take into account the peculiarity of the risks, as countries are not all affected in the same way by climate change. All respondents support public-private partnerships to maintain availability and affordability of insurance covers, based on the argument that when a risk, because of its intensity or frequency, goes beyond the capacities of private insurance, governments can provide a backstop as (re)insurers of last resort. Public-private partnerships could also improve social acceptability of insurance contracts and educate about insurance solutions.

**EIOPA welcomes the fact that stakeholders recognise the impact climate change can have on the insurance sector and on the affordability and availability of insurance solutions. EIOPA took note of stakeholders' support for risk-based solutions and the particular role of public authorities with regard to prevention measures.**

#### On 'impact underwriting'

The majority of respondents supported the **positive role of prevention measures for climate change adaptation and/or mitigation**. 'Impact underwriting' could improve availability and affordability of insurance, through engagement in prevention measures (e.g. through incentives in contracts) or by directly designing products features that have a connection to mitigation and/or adaptation to climate change-related risks. Respondents noted that insurers could intervene in many ways before and after extreme events: through prevention and awareness campaigns among their policyholders to prevent or limit damage; provide data, models and studies to improve the knowledge of the risks for both their policyholders and public authorities; raise public awareness on standards and techniques that

contribute to resilience against climate change, for example for new buildings in light of government-sponsored building codes.

Several respondents questioned however the need for a **new concept of ‘impact underwriting’**, and questioned the objectives EIOPA is pursuing in this area. Some stakeholders stated that it is difficult to assess how ‘impact underwriting’ could affect availability and affordability of insurance as it depends on many other factors. Other respondents argued that the definition for impact underwriting remains too vague to be able to state the extent to which it could impact the availability and affordability of insurance in the context of climate change. Respondents were at opposite ends as to whether the issues and practices mentioned in the paper are at an advanced stage for insurers, or a relevant new practice to consider further. Some respondents noted that impact underwriting can have negative effects were it to lead to a lack of capacity or willingness of insurers to, for example, underwrite risks related to coal-power plants or mining explorations, driving up the premium up and ultimately make such covers no longer be affordable or available.

Respondents highlighted on the one hand that the **bedrock of technical pricing** is and should remain the actuarial assessment of the risk insured. In this context, some respondents argued, taking into account the expected effect of prevention measures for climate adaptation is justified, but for wider considerations of climate mitigation, only the proven secondary effects on the risk insured could be taken into account (e.g. if drivers of eco-vehicles are driving more prudently than the general population). Several answers mentioned a risk of greenwashing if actuarial price signals were unduly distorted in the pursuit of marketing goals. Respondents made a pertinent distinction between a company’s technical pricing and its underwriting policy. In the latter, allowance can be and is routinely being made for wider topics (e.g. commercial, reputation, competition, business model). This can potentially include climate mitigation and longer term sustainability considerations to help promote the insurance sector’s role in the climate transition (as is seen for example in coal underwriting policy already implemented by several companies).

**As part of its mandate to take into account sustainable business models and the integration of ESG-related factors in the areas of its competence, EIOPA supports initiatives to reduce risks and losses in insurers’ underwriting policies, through climate change adaptation and mitigation strategies. Following the comments from respondents, EIOPA aimed to clarify in the report the scope of impact underwriting, making a clearer distinction between the climate adaptation objective (with a direct link to the risk insured, i.e. with the aim to reduce losses upon the occurrence of the event) and the climate mitigation objective (with the aim to reduce the risk of climate change, mainly through the reduction of greenhouse gas emissions)). EIOPA supports the distinction between technical pricing (actuarial-based) and underwriting policy (where wider considerations can apply).**

#### On long-term contracts

The **majority of respondents does not agree that long-term non-life insurance contracts could help insurers maintain availability and affordability of insurance in light of climate change**. Stakeholders mainly stressed the possible disadvantages listed in the discussion paper and only few recognized potential advantages for policyholders (such as more stable coverage over time, reduced search efforts and premium stability) or insurers (reduced acquisition and administrative costs through less renewals and less turnover in personal lines, ability to lock in a price for a longer policy term). According to respondents’ view, a long-term contract would ‘defer the problem’ rather than address the underlying risk.

The main disadvantages listed with reference to insurers were: need for additional risk premium to reflect the increased uncertainty over longer term horizon or the need for holding large reserves, increased risk of mispricing/underpricing, lack of ability to adapt to risks, incalculability of premiums for contracts subject to dynamic claims development, decreased competition between insurers, and in extreme cases, potential impact on the solvency position of the insurance and financial stability of the sector. Reinsurance contracts would also need to match the changes in primary insurance contracts, which may be difficult to achieve for Nat cat risks.

If long-term non-life contracts were to be considered as a potential solution to the affordability and availability concerns, the majority of the respondents agreed that this would require specific regulatory treatment. Measures listed were: adapted treatment of multi-year contracts under IFRS17, adaptation of the Solvency II standard formula to reflect risks beyond a one-year time horizon, and the need to reconsider treatment of cancellation and lapse risk. It was pointed out that long-term contracts would lead to a significant increase of the volume measure for premium risk, consequently, the risk factors of the premium risk would need to be recalibrated. Mispricing could be addressed if the minimum duration of the contract offered to policyholders would match the Nat cat event payback period.

Another potential measure, mentioned by some respondents would be the prudential recognition of the use of equalisation reserves/the accumulation of reserves to factor in long-term increases in claims and costs and to create financial buffers to pay out claims during years presenting higher claim events.

With regard to potential policyholders, respondents noted as main disadvantages of non-life long-term contracts the decreased flexibility and freedom of choice, inability to seek a better deal during the term of the policy, contradiction with national consumer regulation/impact on consumer protection, risk of increase in prices, the potential lack of incentive to invest in climate mitigation or adaption if they rely on favourable terms of multi-year contracts ('false sense of security'), the risk that new emerging risks arising during the coverage period are not reflected in the contract, as well as the risk of higher exclusions. Stakeholders did not offer potential solutions to these obstacles.

**EIOPA took note of the obstacles listed to a long-term approach to non-life contracts. Having regard to the need to address the challenges posed by climate change, EIOPA will further investigate the potential for product innovation, including further analyzing the potential for long-term non-life contracts having regard to the main obstacles and potential solutions.**

#### On the quantification of climate change adaptation and/or mitigation in underwriting and pricing

While respondents agreed that it is necessary to reduce losses upon the occurrence of the event (climate change adaptation objective) or reduce the risk of climate change (climate change mitigation objective), the quantification of the impact of any (incentives for) prevention measures would be difficult or impossible. Such quantification would depend on data that are not readily available and would require a consistent approach within the insurance industry on the definition of preventions measures and methods for measurement of the impact. This would require exchange of data and risk assessment between the insurance sector and other involved institutions (e.g. NGOs, state institutions, data providers) in order to collect information and to properly assess the impact of prevention practices on the risk insured and on GHG emissions.

Stakeholders all agreed that indemnification could promote climate resilience by giving policyholders the opportunity to change their behaviour after a loss. When asked as to ways to promote climate resilience through indemnification, beyond 'like-for-like' replacement of vulnerable property, stakeholders mentioned however that the indemnification should only cover the cost of the loss and should not finance the entire cost of replacement technologies or the cost that results from new public standards. In addition, respondents mentioned that risks attached to sustainable materials (e.g. straw or timber) should be taken into account when indemnifying the losses and promote climate resilience, reflecting also the availability and the quality of sustainable materials that could have an effect on the indemnification decision. Furthermore, instead of indemnification, it was noted that insurers could offer premium discounts for each reparation that the client does with sustainable material in order to cover the cost of additional repair, eventually promoting reparation instead of replacement. Promoting replacement when it is for more resilient a device/material/car was also suggested.

**EIOPA will explore the potential appropriateness for a differentiated Pillar 1 treatment of insurance products promoting measures related to climate change adaptation.**

#### On the availability of products

Stakeholders provided very limited evidence of concrete existing products that integrate prevention measures aimed at climate change adaptation and/or mitigation.

Instead, further generic types of products to support mainly mitigation purposes were mentioned, such as for motor insurance (e.g. free bicycle rental for policyholders after a car accident during car repairs, specific insurance for shared vehicles), for property insurance (e.g. discount on premium after installing green roofs), for corporate insurance (e.g. option in the policy to upgrade the company's fleet to green energy vehicles).

Among insurance services to incentive climate change adaptation and/or mitigation, the following was listed: provide expertise on risk engineering, environmental liability, sustainable building, CO2 reduction, heat isolation, sensor technology, smart meters etc. to help customers understand, mitigate against and properly disclose their climate exposures; advising municipalities and real estate investors on the risk of (pluvial) flood and heat stress, as well as early warning system for extreme weather events; providing advice on natural catastrophe risk in order to guarantee business continuity. Complementary services could include warnings, guidance and support in the case of extreme weather events; combination of insurance and savings to enable the customer to renew and maintain buildings, transportation (especially cars) eco-friendly; internet of things (IoT) for early warning in the case of events (e.g. flooding in commercial buildings); energy-reduction insurance in combination with IoT (optimizing energy-consuming machines, light, etc.)

**EIOPA will further engage with undertakings and stakeholders and collect good practices, to identify how to further materialise impact underwriting from product design perspective.**

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