Insurance protection gaps

1. The natural catastrophes trend and economic affordability

1.1 Growth in losses due to extreme events

An industry representative referred to the Swiss Re sigma publications concerning natural catastrophe (nat cat) protection issues, nat cat protection gaps and nat cat losses. A new record was broken in the previous year in the global protection gap for nat cats at 385 billion. 74% of exposures were not covered. Looking at the total losses from natural catastrophes in 2023, a note particularly eventful year, only 40% were covered by insurance. In terms of resilience, positive changes have been made between 2013 and 2023. However, they are not enough to catch up with other developments in terms of losses.

Looking across regions, Europe, Middle East and Africa (EMEA) is best placed in terms of resilience, followed by North America and then Asia Pacific. The top 10 countries in terms of resilience include a few European countries, though Italy and Greece are comparatively low in the rankings. Even within EMEA and within the EU, the situation is mixed.

In terms of affordability and the evolution of losses, losses have always been higher than GDP growth in the past 30 years, which creates a challenge for the industry. The Swiss Re Institute forecasted that insured losses will increase by 5-7% in the foreseeable future, beating any GDP forecasts. There is an increase in the frequency of medium severity events. In the previous year there were more than 108 billion losses, of which around 70% were related to convective storms in the US, which is a very new phenomenon.

In the United States, the UK and Australia, the increase in premia for property insurance last year was higher than both inflation and the increase in disposable income. If the path of insured losses continues, low penetration affordability may become an issue and challenge the progress made in terms of penetration and resilience.

Annual record high protection gaps, changing weather patterns and increasingly high losses mean that for the current model to be sustainable there has to be consideration of ways to decrease exposure impacts. That can only be achieved through prevention, mitigation and adaptation, which needs everyone working together.

1.2 Frequency, severity and new regions impacted

An industry representative reported that nat cat frequency and severity in Europe are increasing. Additionally, nat cats happen in regions where they typically were not observed previously, so those regions are not prepared and have not invested in protection. These elements lead to an increasing trend in losses.

The WEF Global Risks Report provides the opinion of 1,500 experts. According to that risk report, climate risks dominate. In only 10 years' time, the top four global risks will be environmental risks like extreme weather, the collapse of ecosystems and critical changes to earth systems. This is an urgent topic.

1.3 Limits on the speed of recovery

A regulator emphasised that the exponential growth of the protection gap presents a financial stability risk. The European Insurance and Occupational Pensions Authority (ElOPA) and the European Central Bank (ECB) produced a paper that showed the impact of nat cats on GDP. When there is no insurance cover, GDP recovery takes much longer and falls far lower. Actual insurance coverage enables immediate intervention and starting the recovery. When there is no coverage, though state help may come it might be much later.

The Chair added that there is work happening at Financial Stability Board (FSB) level around the financial stability impact of nat cat insurance protection gaps, including recognition of the spillover effects of uncovered losses in the real estate sector and what that might mean for the banking sector.

1.4 The challenge of raising awareness about the challenges posed by insurance gaps

The Chair highlighted that the global community of insurance supervisors is acutely aware of the challenges posed by insurance protection gaps and the fact that a coordinated response is needed. In November, the International Association of Insurance Supervisors (IAIS) published a report making it clear that addressing protection gaps is vital for insurance supervisors, regardless of their mandate. The IAIS presented a range of supervisory actions covering five areas: assessing insurance protection gaps, improving consumer financial literacy and risk awareness, incentivising risk prevention and the reduction of insured losses, creating an enabling environment to reduce protection gaps, and public-private partnerships. A coordinated approach is required.

An industry representative noted that the EIOPA/ECB paper was very useful for the public debate. Many in the industry have been talking about protection gaps for years, but it is something different when EIOPA, as an institution, launches something, as it leads to recommendations. There is a partnership in explaining to the public and to policymakers what is at stake.

An official sought risk awareness from the population. In Spain, cover is connected to the policies that are known by the population. Some people do not know the importance of having a private insurance policy in order to be covered.

2. Climate related threats require addressing varied challenges including prevention

2.1 Moral hazard, poor education, perfectible product design and coverage are part of root causes

A regulator stated that one reason there is not much appetite to take up insurance coverage is that there are expectations that the state will intervene. However, that expectation is sometimes not very well grounded. Even when there are state interventions, they are slow, and they impact GDP recovery.

Another reason is that the price is perceived to be unaffordable. When it is asked how much entities would pay for the coverage, the price they give is not very different from the market price, so an educational effort is needed. The simplicity of the product and clarity of the terms can be improved. Public authorities and the private sector can help, in terms of risk awareness, by making it simpler and more friendly to buy this kind of product. They could even intervene at key moments. For example, when someone buys a new house that is a key moment, as the appetite to cover the risk is higher.

EIOPA produced a nat cat risk dashboard that shows how much exposure there is. Italy and Greece are outliers. There are awareness initiatives that can still be undertaken.

2.2 Common tools and deepening insurance penetration

An official reported that, in the past decade, the frequency of extreme weather events has increased over 40% globally. Additionally, the population and the assets exposed are increasing. The approach to dealing with the challenges varies across countries. It is not easy to adapt markets that have evolved over time, depending on the specific social and economic and environmental issues, and that have different tools. Some countries have advanced early warning systems for natural disasters, while others lack the infrastructure to implement such measures effectively.

In theory the most common solutions tend to broaden the mutualisation base, which is connected with insurance penetration, and applying better models to adjust the policy prices in order to adapt to the risk in play. These prices can also be flexible depending on the risk mitigation measures. For example, some insurers offer discounts on properties that implement flood defences or fire-resistant materials. If too much information is applied to prices or premia at the property level, some properties will be uninsurable. Very large mutualisation is needed in countries. The Consorcio de Compensación de Seguros (CCS) in Spain is an example of successfully covering such losses.

2.3 Adequate insurance design requires public-private partnerships (PPPs)

A regulator indicated that to make the system more resilient in general through PPPs, each player must have the right role, starting from the primary insurer and the people who need to put measures in place to mitigate the risk. There should be a product offer that takes account of the mitigation measures taken by the individual, then the system can be built up such that each player plays its role in mitigating. The means primary insurance, the reinsurance market, the capital market and then a last resort measure in terms of the government, because things could become unaffordable otherwise.

2.4 Risk prevention

An industry representative emphasised that risk prevention is key. There is a collective responsibility beyond just insurance, so it requires cooperation. The obvious role of insurance is to insure the risk, but, with the dynamics of climate change unfolding across Europe, the capacity of the insurance industry will be challenged at some point. Furthermore, paying a loss is only the second line of defence. The first line of defence is prevention. Insurers, reinsurers and brokers play a key role in prevention and building resilience. There are already resilience services combining risk engineering expertise with climate data scientists' expertise, in order to model and assess risks, and calculate the impact. On this basis, clients can be advised on risk improvement actions to help build resilience.

For example, Audi had a flood event that affected production. Following this event, it asked for support in building flood resilience measures. After an on-site assessment, it was decided that several measures would be taken, such as an early warning system for floods, local training with the fire brigade, and building measures. When the next flood came, it did not affect the production.

In big cities, heat is becoming an enormous problem, especially for vulnerable populations like children, the elderly or poorer people who cannot afford air conditioning. The city of Madrid and an insurer developed a blueprint for how to build the climate resilience of a city with respect of heat.

3. Roles of the different stakeholders

The Chair suggested that one consideration at the global level is whether there are things that insurance supervisors can do to either incentivise or even require insurers to include risk prevention and reduction of insured losses in how they approach the business of insurance.

3.1 Multi-stakeholder and holistic frameworks

An industry representative replied that governments can build the framework for insurance penetration and prevention measures. They can build on capital funds to cover extreme events. Policymakers and supervisors can help to enable that.

Insurance protection gaps are increasing, because losses are increasing, and natural hazards are increasing. Insurance premiums will therefore also increase. That means affordability will become an issue. Although globally the insurance industry has significant capacity, there is still a limit, so availability will become an issue. Protection gaps in Europe are very diverse, ranging from 3% to 97%. Addressing availability, affordability and having more harmonised protection requires the collaboration of governments, European institutions, worldwide institutions and insurers.

That starts with data. Many member states do not collect data on nat cat. The EIOPA dashboard is a good starting point. It is not yet a PPP, and that should be the next stage by combining data from reinsurers, insurers and countries. Digital tools are beneficial. Austria has an insurance data base, the Natural Hazard Overview & Risk Assessment Austria (HORA). It is a risk map for natural hazards. Anyone can type in an address and immediately see how it is exposed to natural hazards. It was developed by the Austrian Insurance Association together with the government and is a very successful PPP.

The insurance industry regards the Spanish consortium as a functioning nat cat scheme. Other countries should look at it. An EU-wide solution will not be achieved in one step, but looking at the already existing solutions is worthwhile. Belgium chose the simple solution of combining nat cat insurance with fire insurance and making it mandatory. Switzerland has almost no protection gap. It has solved availability and affordability with a pool solution and aggregate reinsurance cover.

An industry representative noted that there are particular types of schemes in the US and in Europe, and there are reasons why they were set up as they were. PPPs are not needed where the private sector can step in and deliver. PPPs should exist where they are required and should be tailored to the particularities of the regions/countries.

An official emphasised that there is no one-size-fits-all solution. It depends on the market circumstances, which include the social and economic values of the society. PPP approaches vary widely. They might address specific hazards, like floods, earthquakes or terrorism, or target specific sectors like commercial or residential, or cover the entire market. They can be insurance and reinsurance schemes. They could involve private or public insurance companies. Sometimes there are public reinsurers or a concession to a private pool. The regulator's role is crucial. The key to these approaches is having a common goal for all stakeholders. Insurance supervisors should play a central role in implementing the schemes.

3.2 Supervisor contributions at macro and micro levels

A regulator suggested that supervisors can help with design, from a technical point of view, at the political level. When checking the risk management system in different supervised entities, if there is a system that really measures the risk, and there is a mitigated measure, then it is evident. That is also the job of supervisor. If it does not work properly then a better understanding of the real risk exposure of the company is asked for.

From a supervisory angle, both sides of PPPs can help with the design of the system to make it affordable and give the right incentives to each player, as well as in terms of measuring how much risk management there is in the company, what needs to be improved, the mitigation measures, or the pricing policy considering the mitigated measure.

3.3 CCS case study

An official reported that, in Spain, the CCS covers extraordinary risk. It is a state-owned company with its own assets independent of the state. This arrangement is based on PPPs. The consortium is complementary and interacts with the private insurance industry.

In the scheme, insurance companies cover predictable mass risks. However, where wind, for example, exceeds a speed of 120 kilometres per hour, the consortium enters to cover the losses. For some other phenomena, like earthquakes, volcanic eruptions, hurricanes and floods, the consortium covers the losses. The partnership is a cooperative solution to not remove any commercial opportunities from private insurers. The extension of the needed cover can be a selling point for other products.

The private market also bears some burden of natural hazards. They retain the capacity to choose risk and maintain more hazards under control. The goal of the scheme is to be a win-win solution for insurers and the insured, and so for society in general. There is a mutualisation scheme from three points of view: risk, geography and time. The risks do not usually happen at the same time. The same risk with a high probability in one place but not in another is mutualised as well. There is no dividend distribution, and all the assets of the consortium remain for future events.

3.4 Collecting data

An official added that the CCS scheme gathers a great deal of risk data from agencies, administrations and academia, which is used in risk reduction measures and initiatives, such as for where buildings are built in the context of potential floods. However, such actions take time, and then buildings can already be built on locations that could flood.

3.5 National natural catastrophe prevention and mitigation schemes

A regulator stated that the ECB and EIOPA are evaluating 12 existing schemes to extract the key features. The incentive system is key. It must have the purpose of diminishing and mitigating the risk in general. The first step should be mitigating measures at the level of individuals. The public sector can help there, because it provides more credibility to data, though there is need to evolve in terms of depth and granularity.

The system should have, as a natural last resort measure, a form of final reinsurance through the government, because matters can become unaffordable and uninsurable. There can also be help with talking to politicians about making addressing the protection gap more palatable for people, and on how to give returns to people. When people see that they are insured, and there are no events and no catastrophes, the profits can be returned to them. For example, in one initiative a city gave back part of the profits made, year by year, by building up new gardens. There can also be help with linking between people's desires and their needs, with government selling the product. It must be sold, as otherwise it is simply a new form of tax imposed on people.

An industry representative recommended a deeper dive at t European level in already existing and functioning PPPs, to have more transparency on how they function, what does and does not function well, and what could or could not function in other countries.

3.6. Mobilisation in the global and European contexts

An industry representative recommended continuing the conversation with all parties at the table. EIOPA continuing its work is appreciated. A climate resilience dialogue paper was recently published in Brussels. There is also the new Commission.

A regulator stated that the issue is a European and global one, and for the EU it can be tackled at the European level, for which more awareness is needed. It is an issue for every area of Europe, so a European solution has to be sought.

The Chair emphasised the scale and urgency of the problem. A positive message, from the global perspective, is that there has been a perceptible shift from talking about the problem to looking at concerted, collaborative action. There are opportunities to not only go deeper on the nat cat protection gap issue and what is working, but also to bring in other types of protection gaps.

4. Dedicated approaches to address protection gap specificities

An audience member highlighted that there will be gaps in the pension market and other exposures. The experience of Covid demonstrated that there were expectations for the insurance industry to have done more. With nat cats there is also the challenge of business interruption.

An industry representative highlighted that there had been a focus on the nat cat protection gap, because discussing all protection gaps would take a very long time. The protection gap in the pension system is an increasingly important topic. Business interruption is also increasing, and there is also the supply chain problem, not only related to the pandemic but also several other worldwide crises. The problem becomes even greater with business interruption.