INSURANCE PROTECTION GAPS

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The role of insurance supervisors in building societal resilience

Some stark figures underpin the global challenge of addressing insurance protection gaps.

The damage and economic losses caused by natural catastrophe (NatCat) events are increasing, partly driven by growing exposures in high-risk areas. As the impacts of climate change intensify, it is expected that this will result in even greater damages, leading to increased protection gaps that can affect households, businesses as well as other sectors such as agriculture. The Sigma resilience report stated in 2022 that only 45% of global economic NatCat losses of US$ 275 billion were insured – meaning a NatCat protection gap of US$ 150 billion.

While the IAIS has focused on NatCat protection gaps to date, we are acutely aware that protection gaps exist across a spectrum of risks, also including cyber, health, pandemics and pensions. Across these lines, the figures are also rather alarming. The Global Federation of Insurance Associations (GFIA) published a study on global protection gaps and recommendations for bridging them last year and cited the (annual) pension protection gaps at US$1 trillion, cyber at US$0.9 trillion and health at $0.8 trillion.

Protection gaps manifest differently across markets, countries and regions, but disproportionately affect more vulnerable segments of society and are felt more severely by emerging market and developing economies. For example, the Centre for Financial Regulation and Inclusion in Africa, CENFRI, estimate that 94% or $9.4bn of economic losses in 2023 were uninsured, and that insurance penetration across Africa was just 2.5%. These differences are likely to be compounded by climate change.

Beyond physical risk, insurance protection gaps can create spill-over effects to the rest of the financial system and/or real economy. If damages are not covered by insurance, the costs of reconstruction can fall to governments to provide financial support, with budgetary implications. There can also be spill over into the banking sector if uninsured households or businesses are unable to pay back loans or mortgages due to financial pressure from a disaster.

It is against this backdrop that the IAIS published its "Call to action" in November 2023, outlining why addressing NatCat protection gaps is vital to insurance supervisors and presenting a range of supervisory actions to address challenges related to affordability, availability and take-up of insurance coverage against NatCat events.

A key message of the call to action is that addressing protection gaps is relevant to all supervisors, regardless of mandate. In particular the call to action identified five major areas of supervisory action:

- **Assessing insurance protection gaps** – including collecting data and promoting the development of NatCat models, stress testing and scenario analysis as public goods – to better understand the magnitude and drivers of protection gaps. At the global level, the IAIS will be undertaking a deep dive into the potential impact of NatCat protection gaps on financial stability, for publication in 2025.
- **Improving consumer financial literacy and risk awareness** – there is scope for supervisors to collaborate with industry and other elements of government responsible for consumer protection, to emphasis the value of insurance.
- **Incentivising risk prevention and reduction of insured losses** – for example, supervisors can incentivise or require insurers to integrate incentives for risk prevention in their product design as well as underwriting and pricing practices to achieve a positive impact on the level of losses.
- **Creating an enabling regulatory and supervisory environment** to support availability of insurance and uptake of coverage; and
- **Advising government and industry, including on the design and implementation of public-private partnerships or insurance schemes.** This year the IAIS alongside the OECD provided a contribution to the G7 High-Level Framework for Public-Private Insurance Programmes against Natural Hazards", developed under the Italian Presidency. It sets out considerations for developing a high-level framework for PPIPs against natural hazards for countries, particularly targeting policymakers and insurance supervisors who are considering the development of PPIPs.

Addressing protection gaps is relevant to all supervisors, regardless of mandate.

Overall, the imperative to narrow the protection gap for NatCat events requires a collaborative multistakeholder effort, including governments, insurers and supervisors. The combination of their insights, convening power and authority can lead to the development of comprehensive strategies that bolster societies to withstand and recover from these events.

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Insurance natural catastrophe protection gaps – A multidimensional approach

Europe has been warming at about twice the global rate since 1980, making it the continent with the fastest warming trajectory[1]. In recent years, there have been several extreme climate events with severe societal consequences: The 2021 floods in Germany and Belgium caused 44 billion € in damage and resulted in more than 200 deaths. Similarly, the 2023 floods in Slovenia caused damages around 16% of the country's GDP.

However, EIOPA's Dashboard on insurance protection gaps for natural catastrophes[2] shows that historically only a quarter of the total losses caused by extreme weather and climate-related events across Europe were insured, indicating a large insurance protection gap. The dashboard aims to represent the drivers contributing to this gap, as to enable the identification of measures that will enhance society's resilience to natural catastrophes, and to raise awareness and promote a science-based approach. Improved projections provide further evidence that, if no measures are taken, future climate change will escalate extremes such as heavy precipitation, droughts, and floods, thereby widening the gap.

The insurance protection gap for natural catastrophes in the EU poses a risk to economic growth, competitiveness, and potentially national budgets. From a systemic perspective, climate risks threaten to Europe's energy and food security, infrastructure, financial stability and public health.

A lack of insurance to cover losses caused by natural catastrophes lowers the financial resilience of economies, making it more difficult for businesses and people to recover from disasters. This gap also adds pressure on national budgets, which typically assume a substantial portion of the recovery and reconstruction costs for infrastructure, while suffering a loss of revenue due to disruption of economic activities. The absence of insurance can thus have a significant adverse fiscal impact, potentially prolonging recovery.[3] The risk can spread across the financial sector, as the lack of insurance can impact the value of collateral for mortgage lending.

The regulatory framework can facilitate the insurance industry's ability to offer coverage and increase uptake by households and businesses. Regulators and supervisors can incentivise insurers to embed risk reduction and adaptation measures in their product design, recognizing that protection gaps cannot be addressed by increasing insurance penetration alone. Pro-active measures on the vulnerability of buildings, localisation of exposure and optimised insurance coverage will be important for societal resilience. (Re)insurers, as society's risk managers, can contribute to reducing climate change risks. Some insurers are already doing so, by providing advice on adaptation measures to policyholders. EIOPA has introduced the concept of impact underwriting, aiming to incorporate climate change adaptation and mitigation options into pricing and underwriting.

Supervisors can further contribute to addressing natural catastrophe protection gaps by assessing them and supporting initiatives for improving financial literacy and risk awareness, and by advising governments and industry on the design and implementation of public-private partnerships or insurance schemes.

EIOPA performed significant work in identifying and addressing barriers to the demand for nat cat insurance products. One challenge is that consumers may not fully grasp the coverage they purchase, leading to expectation gaps that can undermine consumer trust in the insurance sector. It is therefore important that supervisors, insurers, and society as a whole to collaborate in building trust and developing solutions that increase resilience to nat cat risks.

A deeper understanding of consumer behaviour can help bridge the protection gap. Studies conducted by EIOPA have identified that consumers often perceive the process of taking out insurance as complex and time-consuming. This, combined with a lack of clarity about the conditions, may further disincentivise insurance uptake.

Addressing EU insurance protection gaps requires decisive and coordinated action by all stakeholders.

EIOPA assessed options for reducing the climate insurance protection gap[4], highlighting the role of private insurance markets, while advocating for a multi-ladder approach for sharing losses from natural disasters among various parties at different loss layers. This is deemed necessary due to the expected increase in frequency and severity of extreme events.

Tackling insurance protection gaps and fostering long-term societal resilience to nat cat risks requires decisive and coordinated action from all stakeholders. There is no time for complacency. Insurance supervisors stand ready to further contribute to overcoming the challenges ahead.

1. *European Climate Risk Assessment (EEA)*
2. *Dashboard on insurance protection gap for natural catastrophes - European Union (europa.eu)*
3. *See the ECB FSR Special Feature "Climate change and sovereign risk", May 2023.*
4. *Joint Staff paper with ECB: Policy options to reduce the climate insurance protection gap*

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Challenges for insurability and insurance approaches

Climate change is increasingly affecting our societies and their various processes, including insurance. Mean temperatures are steadily rising, while sudden, drastic changes can occur overnight. Precipitation extremes are becoming more intense, resulting in both excessive rainfall and severe droughts. Additionally, secondary perils such as hail, tornadoes, and wildfires are on the rise. The overwhelming evidence of these changes is compounded by another significant factor: the rise in global population and the increase in exposed assets. More people and properties are now vulnerable to extreme weather conditions, driving the surge in losses.

This has made prevention and protection measures increasingly necessary. Insurance plays a crucial role not only in indemnifying losses from these events but also in reducing risk by enhancing society's capacity to respond. Unfortunately, estimates indicate that only one-third of catastrophic losses are insured globally and in Europe. This insurance protection gap is concerning given the growing potential for catastrophic events to impact societies. Increasing losses also create affordability problems for the insured, leading to a vicious cycle that further widens the protection gap.

There are no magic solutions to this problem, but certain approaches could bring positive changes. These approaches need to be embraced by insurance regulators, the market, public stakeholders, the insured, and ideally, government agencies with competencies in risk reduction.

Broadening Mutualization

A common starting point is to broaden mutualization. This is essential not only to gather resources to indemnify losses but also to prevent adverse selection issues from impacting insurance viability. Countries with high income, a high degree of insurance culture, and proper risk awareness—usually driven by experience—can achieve high insurance penetration rates and thus broad mutualization almost naturally. However, this scenario is uncommon, necessitating the application of market and regulatory measures.

Creation of Pools or (Re)insurance Companies

One option is to create a pool or a (re)insurance company to cope with losses from specific exposures created by certain perils, such as floods, earthquakes, or cyclones. These pools or companies can be private with some degree of public control or funding, or a public (re)insurer can be created to partner with the private sector in covering a list of predetermined hazards.

Climate change and population grow challenge insurance. Solutions to consider.

Compulsory Insurance

Another way to expand mutualization is to make the uptake of insurance compulsory. This can be implemented by legally mandating insurance, by binding extensions of voluntary insurance to cover common property policies for certain hazards, or in their weakest form, by automatically including some covers with the option for insureds to opt out at their own risk. Making insurance compulsory is always controversial, and its adoption often depends on the shared moral values of a given society and the perceived usefulness. Nevertheless, data indicate that in countries with some degree of compulsory insurance, especially where there is a specific program in place to cover certain catastrophic hazards, the protection gap is clearly smaller.

The Consorcio de Compensación de Seguros (CCS) model.

The Consorcio de Compensación de Seguros (CCS) in Spain exemplifies a successful public-private partnership model aimed at providing catastrophic risk coverage—low frequency and high severity—which the private sector alone could hardly offer without significant exclusions and coverage gaps. The uniqueness of the CCS lies in combining geographical compensation and risk compensation. Geographical compensation mutualizes risks manifesting at different severities across Spain, while risk compensation mutualizes various types of events that rarely occur simultaneously.

This, combined with mandatory catastrophic risk coverage when purchasing a damage insurance policy from a private insurer, results in Spain having a 75% insurance rate for extraordinary risks in homes and 100% in motor vehicles. The premium is low—0.07‰ of the insured capital for homes, 0.12‰ for offices, and 0.18‰ for commercial and industrial risks, among others—and affordable for any insured party regardless of risk characteristics; in fact, there are no risk selection criteria.

As a result, about 60% of catastrophic losses in Spain are covered by insurance.

In summary, in a context of growing losses, insurance is more relevant than ever for creating sustainability and resilience in societies. To achieve this, insurance itself must be sustainable and resilient.

The example of the CCS in Spain shows that with the right approach, it is possible to achieve high levels of insurance penetration and protection against catastrophic events, thereby enhancing societal resilience.

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The next European Commission must champion climate resilience

Gaps in insurance protection are at the core of several societal challenges. Climate change is upon us. So is social and political change, reinforced by global trends, from demographics to digitalization. If not addressed, the consequences of those challenges for our communities and society will be significant. Thus, the time to act is now.

Climate-related extreme events and other natural disasters already cause significant economic disruption and hardship for populations experiencing them. Europe is the fastest warming continent in the world, and direct aggregate catastrophe losses in the EU already amounted to approximately €500 billion in the period between 1980 and 2020 (EIOPA, 2023).

From a global perspective, market penetration of natural catastrophe insurance in Europe is comparatively high in aggregate. However, it differs significantly from country to country – from as low as 3% in Italy to as high as 97% in Switzerland. This results nonetheless in high gaps of natural disaster protection, inevitably causing consequences to countries' public finances.

Risk prevention and adaptation are essential to tackle these gaps. As an insurance company we know the distress that comes with the damage caused to homes and businesses by natural catastrophes. Protection against those damages is always better than just providing support in the wake of a severe weather event. Nevertheless, to deliver the changes required to protect Europe from the impact of increasing frequent natural catastrophes in the future, action needs to be taken by governments, companies, and households.

Governments will have a key role in creating the appropriate framework for risk prevention and insurance penetration. Both will need to be prioritized, alongside developing additional financial risk capacity to cover extreme losses and to keep risk pricing at socially acceptable levels. Austria is therefore evaluating the possibility of integrating natural disasters into compulsory fire insurances, following the example of Belgium.

Insurance companies, on the other hand, will have a critical role to play as risk managers, modelling perils, and resilience services providers. Thus, the insurance sector is already expanding its business, providing respective expertise to firms within the European Union. This includes risk assessment and advice on adaptation solutions. At Zurich Insurance, specialized risk engineers support various customers, from companies to cities, to manage a wide range of risks through prevention and mitigation services, going beyond traditional insurance.

Europe needs to explore new measures and bold policy thinking.

The international shipping company Maersk, for example, relies on Zurich Resilience Solutions teams to strengthen the climate resilience of their most critical ports including Rotterdam over the next 30 years, taking advantage of on-site climate assessments, simulating data-driven and science-based climate change scenarios, their impacts (such as sea level rise) as well as risk mitigation recommendations and solutions tailored to each port to protect them from physical damage and business interruption.

The car manufacturer AUDI AG (Volkswagen Group) also partnered up with Zurich Resilience Solutions as a response to various extreme weather scenarios: together, they developed innovative flood resilience measures at a plant in Neckarsulm, Germany, that help keep production afloat.

Initiatives addressing the climate protection gap at EU level can also be a catalyst for Member State action. Increased interest in capacity building and integrated risk management is to be expected, in particular when it comes to prevention measures. We believe that combined efforts, at national and European level, towards establishing a timely and relevant database on natural disaster risk is vital. Most EU Member States currently do not have a mechanism in place to collect, assess or report economic losses due to extreme weather and other natural hazards. The dashboard on insurance protection gaps for natural catastrophes launched by EIOPA in 2023 should be leveraged, supporting a forward view of protection gaps to inform how national and EU-wide public-private partnerships could be designed and evolved. Furthermore, an EU-wide equivalent of the French Barnier fund – dedicated to risk mitigation and property buybacks – could be explored, with the backing of strong and liquid capital markets.

Invigorated European financial markets could also open new opportunities for risk sharing at a European level. Only by exploring new measures and with bold policy thinking, will Europe be able to effectively combine the capabilities and expertise of the private and the public sectors to deliver the resilience that societies require.

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Global protection gaps at record high

In the context of our dedicated macroeconomic and insurance resilience research, Swiss Re models estimates of the global insurance protection gap by projecting expected economic and insurance losses for four key perils: crop, natural catastrophe, health and mortality.

According to our latest sigma Resilience Index research, the global protection gap reached a new record high of USD 1.83 trillion in premium equivalent terms in 2023, with more than 40% of risks remaining unprotected or uninsured across the crop, health, mortality and natural catastrophe perils. This corresponds to a 3.6% annual increase in nominal terms since 2013, slightly above that of global GDP growth. In terms of the geographic distribution of these results, emerging economies are still much less resilient than advanced ones, with protection gaps being significantly higher in those regions.

Zooming in on the global natural catastrophe protection gap, this rose 5.2% yoy to USD 385 billion in premium equivalent in 2023, reflecting economic growth and inflation. Global protection available against natural catastrophes (i.e. exposure covered by insurance) increased by 10.1% yoy in 2023. At the same time, global protection needed (i.e. total exposure) increased by 6.3% yoy. This can be seen as improved resilience and an encouraging underlying trend in risk protection which should ideally continue in the long term.

Effectively reducing protection gaps requires two fundamental strategies. The first consists in structurally narrowing gaps through loss prevention measures that reduce the risk of damage to crops, property or infrastructure. At the limit of loss prevention, the second strategy comes into play: expanding insurance coverage.

Re/insurers have an important role to play on both accounts. They can incentivize loss prevention through pricing signals, client engagement or advice to relevant stakeholders, such as public authorities. And they can expand the scope of insurance to new and under-served risk pools through ongoing innovation around data, analytics, and distribution. Progress has been encouraging, as re/insurers are now able to design covers for risks that used to be viewed as uninsurable.

The ability of re/insurers to incentivize loss prevention and expand the availability of risk transfer solutions also depends on governments and regulators taking appropriate action. Authorities have numerous tools at their disposal, across the spectrum of protection gap areas. Mandatory health and workers' compensation insurance, support for crop insurance through public insurance programs or subsidies, granting tax benefits to encourage life and health insurance and reducing taxes on property insurance premiums are just a few examples. In addition to creating incentives for risk transfer, public measures are of central importance when it comes to promoting behavior to limit damage, for example through fiscal rules, zoning laws or building codes.

Sustainably reducing protection gaps requires a joint effort by public and private stakeholders.

While the re/insurance industry has for a long time investigated and discussed the issue of protection gaps and the link to economic and societal resilience, the topic has understandably also attracted increasing public and regulatory attention in recent years. One such very recent example is the European Commission-convened Climate Resilience Dialogue, which brought together key public and private stakeholders in order to discuss ways to narrow the climate protection gap and increase resilience to the effects of climate change. The resulting report addresses aspects related to both loss prevention and risk transfer, and nicely illustrates that no single actor can do it alone. Rather, joint efforts by public authorities, regulators, supervisors, businesses, citizens and re/insurers are needed. One suggestion put forward in the report, the idea of exploring the potential of public-private partnerships, seems particularly compelling, for example in view of covering hard-to-insure risks that exceed the capacity of private markets (such as future pandemics or cyber catastrophe risks for large, coordinated attacks). We look forward to further engagement with European regulators on this topic and on other proposals made in the CRD report.

One key message which we will continue conveying in this context is that re/insurers' ability to help reduce protection gaps greatly depends on their ability to diversify risks across jurisdictions. By promoting open markets and removing trade barriers, such as the mandatory holding of collateral or the localization of assets, regulators will be able to unlock the full potential of re/insurers on the path to effectively and sustainably reducing protection gaps.