Climate protection gap

Why does it matter to intermediaries?

Public authorities are mainly responsible for climate change adaptation. However, insurance intermediaries play a pivotal role in contributing to climate adaptation, as many have expertise in the modelling of climate risk and the development of resilient and sustainable business models. Intermediaries have also a role in raising awareness of climate risks, in covering new risks (especially for SMEs), preventing a possible "protection gap/insurance gap" by developing adapted and innovative insurance solutions.

State of play

Climate Resilience Dialogue

The Climate Resilience Dialogue is a forum set up by the European Commission (its two Directorates-General FISMA and CLIMA) at the end of 2022. The primary task of the Climate Resilience Dialogue is "*to exchange views on how to address the losses incurred from climate-related disasters and to identify how the insurance industry can contribute more to climate adaptation, from actions that increase the penetration of climate risk insurance for industry and all of society, to making the conditions right for more investment in good adaptation solutions*".

The objective of the Climate Resilience Dialogue is to create a forum for discussion that will strengthen the collective understanding of insurers, reinsurers, intermediaries, businesses, consumers and other stakeholders about the climate protection gap. The climate protection gap is the share of non-insured economic losses caused by climate-related disasters. The launch of the Climate Resilience Dialogue was announced in the Commission's 2021 EU Strategy on adaptation to climate change, as well as in its 2021 Strategy for Financing the Transition to a Sustainable Economy.

BIPAR (represented by experts) welcomes the initiative and is a member of the Climate Resilience Dialogue.

EIOPA's and ECB's joint discussion paper

At the end of April 2023, EIOPA and the European Central Bank (ECB) published a joint discussion paper entitled "*Policy options to reduce the climate insurance protection gap*" on how to better insure households and businesses in the European Union against climate-related natural catastrophes such as floods or wildfires. The joint discussion paper is part of the EIOPA's sustainable finance agenda and its work to improve the overall understanding of climate-related risk.

EIOPA and the ECB explain that **catastrophe insurance plays a key role in mitigating the losses arising from extreme weather and climate events.** Only a quarter of such losses are currently covered in Europe - and in several countries this share is below 5% - resulting in burdens on individual households and businesses, and macroeconomic and fiscal costs at the local, regional and national levels. Addressing this insurance protection gap would provide substantial economic benefits. Climate change – which is likely to drive more frequent and more devastating catastrophes – adds greater urgency to the need to reduce the protection gap, particularly given that it may cause the gap to widen further.

EIOPA's and ECB's proposed actions

In their joint paper, EIOPA and the ECB set out 4 possible actions to increase the uptake and efficiency of catastrophe insurance while creating incentives to adapt to and reduce climate risks:

1) **Policies designed with adaptation and mitigation measures**

To foster insurance coverage, EIOPA and the ECB suggest that insurance provision should be carefully designed to ensure that it encourages adaptation and reduces vulnerability to climate-related catastrophes over time. Insurers should provide incentives for risk reduction and adaptation by, for example, promoting risk awareness and providing risk-based incentives linked to premiums. For example, premium reductions could be associated with homes meeting certain standards with respect to flood-proofing in flood-prone areas or protection against storms, and with the use of real-time weather data and alert systems in relation to crop insurance. The cost of implementing the risk reduction measure could be compensated by a lower premium.

2) **Catastrophe bonds**

To support the overall supply of insurance, the use of catastrophe bonds could be increased to pass on part of the risk to capital market investors.

EIOPA and the ECB explain that policy measures could be undertaken at both national and EU level to foster greater and more effective use of cat bond markets in both the private and public sector, thereby helping to reduce the climate insurance protection gap.

3) **Public-private partnerships (PPP)**

It is recalled that PPPs are insurance schemes which provide government financial support that supplements the losses insured by the private sector. They can support the overall functioning of the insurance market by providing additional coverage either via direct insurance or by indemnifying a private (re)insurer against extraordinary events. PPPs are already in place in some European countries to manage particular disaster risks (for example, in France and in Spain). EIOPA and the ECB explain that governments could set up public-private partnerships and backstops to partly cover the costs that insurers may incur in the event of major disasters. To protect themselves and ensure that public funds are used efficiently, governments should also provide strong incentives to reduce risks.

The design of PPPs should consider the four elements of a shared resilience solution: (i) risk assessment, (ii) risk prevention, (iii) product design and (iv) risk transfer.

4) **An EU-wide scheme**

Finally, national level insurance schemes could be complemented by an EU-wide public scheme that ensures sufficient funds are made available to European countries for reconstruction following rare, large-scale climate-related catastrophes.

The ECB and EIOPA also recall that the policy options set out in the joint discussion paper to address the climate insurance protection gap also intersect with and complement some wider policy initiatives. These include the EU strategy on adaptation to climate change, and initiatives relating to the EU's CMU.

EIOPA's dashboard on insurance protection gap for natural catastrophes

On 6 December 2022, EIOPA launched its dashboard on insurance protection gap for natural catastrophes. It is particularly concerned about the affordability and insurability of natural catastrophes insurance coverage in light of climate change. EIOPA identified an insurance protection gap, owing to the fact that only a quarter of the total losses caused by extreme weather and climate-related events across Europe are insured. EIOPA aims at monitoring the risks related to the insurance protection gap on the dashboard by consolidating data on economic and insured losses, risk estimations as well as insurance coverage from EEA Member States.

Next steps

- **Climate Resilience Dialogue:** the conclusions of the Dialogue will be published in a report mid 2024. The report will contain practical good practices and recommendations, with a view to accelerating Europe's adaptation to climate change.
- **EIOPA's and ECB's joint discussion paper:** this discussion paper does not reach firm conclusions on specific policies that need to be implemented to tackle the climate insurance protection gap. The paper aims to foster discussion and solicit feedback on the principles, framework and possible policy actions.

Links

- EIOPA's and ECB's joint discussion paper
- EIOPA's sustainable finance agenda
- EIOPA's dashboard on insurance protection gap for natural catastrophes