Response to the European Commission's consultation on the evaluation of the EU's strategy on adaptation to climate change

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Introduction

Insurance Europe welcomes the opportunity to respond to the EC public consultation on the EU Strategy on adaptation to climate change. Climate adaptation is a key issue for insurers, who have long campaigned to raise awareness of the need for policymakers to not only take measures to mitigate the effects of climate change, but also to invest in preventing and adapting to its consequences.

Climate change is having an impact on the frequency and severity of natural catastrophes across Europe and this trend is likely to intensify in the coming decades. This state of affairs is of particular concern for insurers, whose job it is to protect households and businesses against natural catastrophes. Enhancing public resilience and placing focus on the implementation of adaptation measures through effective prevention planning is key if the EU is to tackle the consequences of climate change. Be it at government, regional, corporate, company or individual level, thinking in insurance terms fosters a sound attitude to risk management. The EU and member states should be encouraged to invest in strengthening forward-looking risk management principles, focusing on the four standard components of risk: avoidance, mitigation, transfer (insurance) and acceptance.

Insurers are also Europe's largest institutional investor as a consequence of their business model of investing income until liability payments fall due, and a number of insurers across Europe have already increasingly made public commitments to sustainable investment goals. But more needs to be done by policymakers to increase the supply of sustainable assets in which it is possible to invest and to adapt the regulatory framework to be more sensitive to insurers' risk profiles.

Insurance Europe fully supports the Commission's work on exploring ways for Europe to better deal with climate change-related issues. It stresses that focus should be placed on increasing knowledge of member-state risk profiles and exposures as well as on the insurability of natural catastrophe risks. In this respect, Insurance Europe welcomes studies such as that undertaken by consultancy Ramboll on behalf of the Commission, which highlights possible uses of insurance in adaptation to climate change.

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Role of insurance in adaptation

The insurance sector is often regarded solely as a provider of compensation for losses. This buffer function is of great importance to the economy, since it allows insureds to plan with more certainty by covering specific risks that could otherwise threaten business continuity.

Yet the role of insurance goes much further. Insurance is an integral part of the whole risk-management cycle, from risk identification to risk transfer and recovery. The (re)insurance industry:

- contributes to a better understanding of risk through, for example, the development of forward-looking risk models;
- contributes to risk awareness through risk-based terms and conditions and advice to its customers, and offers incentives to increase prevention and other risk management measures;
- helps policymakers to guide society with tools such as risk zoning and mapping, land-use planning and building codes;
- provides victims of weather-related events with compensation for their economic losses faster than *ex post*-financed schemes, such as the European Solidarity Fund.

However, insurance products are neither a substitute for other adaptation measures nor an instrument for the funding of adaptation or mitigation measures. As we outline below, it is up to national, regional and local authorities to spearhead these efforts.

Avoiding moral hazard is key to increasing climate adaptation

Prevention and adaptation measures must be embedded in member states' socio-economic culture. Although governments are already shifting from no action or post-action relief, this is not enough. Risk prevention and risk management are essential for a country's socio-economic wellbeing.

This crucial shift in risk prevention/management practices is often severely hampered by member states' and citizens' overreliance on post-disaster relief, be it through a member state's own funding or that provided for example under the EU Solidarity Fund. The primary function of this type of fund is indeed to help member states recover as quickly as possible from the effects of a major natural catastrophe event. However, when the relief does not come hand in hand with minimum prerequisites in a country's prevention and adaptation measures, a vicious circle of moral hazard occurs that leaves the affected member state unprepared for future catastrophic events.

Moral hazard refers to the tendency to behave in a riskier manner when the affected do not suffer fully from the consequences of their behaviour. When member states and citizens rely on *ex post* funding:

- There are no incentives for member states to implement adequate measures to avoid the consequences of natural catastrophes, especially in the long term — for example, through responsible land-use planning and enforcement of adequate building codes, which help avoid to the extent possible the devastating effects of a natural catastrophe.
- There are no incentives for citizens to purchase insurance to protect themselves. Insurance is a key tool to incentivise the take-up of preventative and adaptation measures — for example, through deductibles and risk-adequate and risk-adjusted premiums.

Recommendation: Insurance Europe strongly advises the Commission to monitor and support where necessary member states that have repeatedly failed to implement preventive and adaptation measures following a natural disaster. This would enable a more responsible use of the EU Solidarity Fund.

Adaptation to climate change requires government action

Though insurers provide valuable expertise at all stages of the risk management cycle (risk assessment, risk awareness, risk prevention and risk transfer), they cannot provide the sole solution for catastrophe losses. Government action is also required to successfully combat the challenges brought about by climate change.

A basic principle of insurability is that insurance products cannot correct for errors in land-use planning. Insurance is a helpful instrument to manage "peak risks", ie unforeseen and volatile risks. However, with more foreseeable risks, for example those associated with a steadily increasing rise in sea levels, there is typically a need for physical protection measures and land-use planning to avoid losses that are 100% certain to occur. This type of risk is precisely the type of area in which government action is needed to support the insurance sector.

Government investment in infrastructure and promotion of research and innovation is important for bolstering the EU's adaptive capacity. By modernising infrastructure, particularly in areas vulnerable to heavy wind storms or regions prone to river or coastal flooding, public authorities can help minimise the growing impact of climate change. Such efforts can take the form of climate-proofing existing buildings or providing incentives (eg through taxation) for climate-resilient development projects. Similarly, government funding must promote research and innovation in the area of adaptation, such as the project between the Italian Insurance Association (ANIA) and the Italian National Research Council (CNR), which aims to better predict earthquakes by measuring hydrogeochemical indicators.

Additionally, national policies for building or zoning plans should avoid development in high-risk areas or otherwise offer the persons residing in these areas more suitable protection against natural catastrophes. For example, requests to build on floodplains should be denied, while flood defences for existing vulnerable areas should be adequately maintained and reinforced as necessary. The absence of a proper planning policy leads directly to increased risk, thereby weakening the effectiveness of natural catastrophe insurance and making it more difficult for insurers to offer cover in the future.

Recommendation: Land-use planning and property development decisions are usually taken at local or regional level, eg as part of urban planning or agricultural and forestry practices. However, the European Commission has a role to play in ensuring that member states take risk prevention and adaptation into account in these decisions, for example by encouraging member states to integrate these aspects in their national adaptation strategies.

Public-private cooperation leads to resilience

Adaptation measures are crucial for increasing sustainability. However, as noted elsewhere in this paper, these measures cannot be promoted by the insurance industry alone. It is in the hands of public authorities to encourage a societal move towards more preventive behaviour and promote adaptation measures.

It is also vital for public authorities to maintain a dialogue with insurers, who can provide specialised knowledge through productive partnerships. Insurers help policymakers identify the appropriate areas in which public-private cooperation can be beneficial by providing research, encouraging prevention measures, delivering financial solutions and applying their expertise to track trends and define problems posed by climate change.

There are many examples of successful cooperation between the public sector and the insurance sector. Please see here for examples from the German, French and Dutch markets.

Recommendation: Insurance Europe encourages the Commission to continue to share and promote good practices in public-private cooperation between member states and other stakeholders. Insurance Europe strongly supports the EC (DG CLIMA, DG ECHO) in its efforts to engage with the private sector and member states through workshops and seminars.

Tackling the protection gap from an EU perspective

The recent increase in weather-related events has highlighted the need to address problems with underinsurance in several regions of the EU. This is an issue that member states must make a priority in order to ensure their citizens are adequately protected in the face of increasing catastrophic events.

The devastating wildfires to hit California in late 2017have shown that high insurance penetration rates lead to little need for intervention by public authorities. This is a sign of nat cat insurance working and having the desired effect of increasing regional resilience to climate change and related disasters. In contrast, for instance, in the French overseas territories, the penetration rate of nat cat insurance is very low — under 50% in some territories (eg Saint-Martin) — so the economic cost of Hurricane Irma in September 2017 will be significant and largely borne by the state.

It is therefore very important to keep in mind that there can be no "one-size-fits-all" approach to natural catastrophe insurance at European level. This is due to the differing risk exposures resulting from regional environments, levels of public awareness about potential risks, the extent of government intervention, liability regimes or adaptation practices. These factors result in a highly diverse insurance market for nat cat across the EU, ranging from optional private market solutions to compulsory insurance pools. Several examples of natural catastrophe insurance schemes across Europe can be found here.

This diversity is the reason why there is no single solution at European level for insuring natural catastrophes. In fact, imposing an EU-wide system could have a severe impact on markets that are already functioning well and where the risk is already insurable.

Member states must therefore assess their own risk profile and exposures and implement the solution that is best for their circumstances. These solutions range from public-private partnerships to the introduction of mandatory insurance for certain types of risks. Other possible solutions to tackle lack of demand for nat cat insurance could be targeted awareness-raising campaigns or even the abolition or reduction of taxes in certain types of insurance (eg crop insurance or, as in the Italian Budget Law of 2018, policies covering nat cat events). Member states should be urged to have a thorough discussion on this with all relevant stakeholders, including local insurers, as a logical first step to achieving acceptable penetration rates. A prioritisation of efforts on pre-event mitigation instead of post-event relief will in itself likely have a positive effect on insurability, the cost of insurance and willingness to take out policies.

Insurance Europe would like to highlight again that Ramboll's study, "Insurance of weather and climate-related disaster risk", contains a number of case studies that could inform member states' decisions when devising their national strategies.

Recommendation: The European Commission already highlights the benefits of insurance, and thus promotes its uptake, through its interactions with member states. However, Insurance Europe believes that the Commission must go further and urge member states to achieve acceptable rates of insurance penetration as soon as possible within their particular national insurance systems.

Insurance and sustainable finance

Insurers' key role is protection and transfer of risk. As a result of this business model, insurers take premiums (in exchange for their transfer of risk), which they need to invest until claims or benefits are due. Investing is therefore not insurers' primary role, but a logical consequence of their business model.[1]

In fact, insurers are Europe's largest institutional investors with more than €10tn of assets under management. These are invested in a wide range of investment classes, such as equity, government and corporate bonds, as well as infrastructure. While insurers' investment decisions are driven by a number of factors, such as the profile and duration of liabilities, and the risk/return profile of assets, sustainability is increasingly also becoming a factor in investment behaviour.

Insurers already invest in a wide range of sustainable projects. These include investments in housing and social infrastructure, such as hospitals and schools. They also include infrastructure projects, such as renewable energy and biodiversity preservation.

While insurers have the capacity to invest further in sustainable projects, certain barriers need to be addressed:

- The supply of sustainable investment assets remains limited and more long-term sustainable assets need to be created. A EU taxonomy on sustainable finance would be welcome.
- Regulatory frameworks, such as Solvency II, are creating barriers to long-term investment and need to be adjusted to reflect the real risks that insurers face when investing in long-term sustainable projects.

Recommendation: Insurance Europe supports a European taxonomy and related standards for sustainable finance. The industry calls for a greater supply of sustainable investment assets. Insurance Europe also highlights that prudential barriers to long-term investment, such as Solvency II, should be addressed.

[1] For further information on Insurance Europe's position on sustainable finance, please consult the following:
Response to European Commission consultation on institutional investors and asset managers' duties regarding sustainability (here); and,
Response to questionnaire by the High-Level Expert Group on sustainable finance interim report (here).