Compulsory versus Optional Disaster Insurance

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agenda

• The context
• Goal of European Union
• Timeline EU actions
• Current situation in Europe and abroad
• Comparison between optional and compulsory insurance
• First priority for Member States (MS)
• Green paper, analysis and conclusions
• EP resolution
• Open issues
• Appendices
• References
The context

• Increasing trend of natural catastrophes in the EU, but not equally spread
• A significant portion of losses are uninsured
• Unused insurance capacity does exist
• Various initiatives have been tried in different Member States (MS) and by insurers (see ref. 2)
The context

Natural disasters in EEA States (1980–2011)

The context

Natural disasters in EEA States (1980 to 2011) – overall and insured losses

The context

JRC study "Natural Catastrophes: Risk relevance and Insurance Coverage in the EU"

Flood, Storm, Earthquake — Clusters’ map based on available data. Source: JRC (2012)
Goal of European Union

evaluate the potential for the European Union to:

• facilitate and support increased coverage of appropriate disaster risk insurance and

• financial risk transfer markets,

• as well as regional insurance pooling, in terms of knowledge transfer, cooperation, or seed financing.
Timeline EU actions(1)

• Previous analyses by CEA 2010 & 2011 (see ref. 1 & 2)

• Spring 2011: scientific exercise requested by DG MARKT aimed at drawing the picture of the relevance of various NatCat in the EU MS and of the development of the NatCat insurance markets

• October 2011 DG MARKT organized the conference Prevention and “Insurance of Natural Catastrophes” to bring together stakeholders, experts from the insurance sector and the academia (see ref.3)

• JRC report 2012 (see ref. 4) on different risks (flood, storms, earthquake, drought) assembling a lot of quantitative and qualitative information, focusing on:
  – detecting which NatCat can be considered as relevant in any given MS;
  – for relevant risks, investigating if there exists a market of dedicated insurance products;
  – identifying the main issues and open problems.
Timeline EU actions (2)

- Green Paper on the Insurance of Natural and Man-Made disasters (ref. 5):
  - Adopted by the EC on 16 April 2013
  - Public consultation on the 21 sets of questions
  - Period: until 16 July 2013
  - Response: 73 contributions received (from 17 EU countries, more than 50% from France, Belgium and UK & 3 non-EU countries)

- Summary of responses on Green Paper (January 2014) (ref. 6)

- European Parliament Resolution of 5 February 2014 on the insurance of natural and man-made disasters (213/2174 (INI)) (ref. 7)

- Speech of Kristalina Georgieva, EU commissioner for international cooperation, humanitarian aid and crisis response, on The role of the private sector in developing the EU’s policies on Disaster Risk Management (Rotterdam -10.2.2014) (ref. 8)
Current situation in Europe and abroad

Countries have (and these evolve):

• Different risks:
  – Some countries: more floods, storms or hail
  – Other countries: more earthquake or landslide

• Different insurance schemes for these natural catastrophe risks:
  – Difference in maturity of the local insurance market
  – Some state-controlled systems
  – Direct insurance (sometimes reinsured) or alternative risk transfer
  – Mostly optional, sometimes compulsory
  – Variable penetration rate
  – Mostly no official declaration needed (except in France)
  – Pre-contractual and contractual information

• Different culture and understanding of good safety and security requirements

• More details: see ref. 2

very diverse markets in MS
Compulsory EU insurance

• Compulsory liability insurance for EU-wide transport-based liability (Motor directives):
  All motor vehicles have to be covered by third-party liability insurance (so no cross border checks needed and easy to drive between MS): commonality, frequency and international reach of claims

• Compulsory nuclear liability insurance
  ⇒ Both successful as these sectors share a common feature of cross-border reach (e.g. aviation, maritime, railroad, motor and nuclear)

• Due to great disparity, infrequency and cost of claims not applicable to environmental liability directive (ELD) (see slide p.18)
# Comparison of both approaches: Optional insurance

## Advantages
- Freedom of choice
- Focus more on:
  - risk management and risk mitigation
  - safety & security
  - business continuity
- Fair price based on:
  - quality of
    - risk management and
    - proper audit of the asset
  - statistical data on losses, locations, intensity or frequency, models
- Contract with clear coverage conditions
- Free choice of deductibles, limits appropriate to their exposures
- Possible use of captives to self insure

## Disadvantages
- Is a free choice, some who need to be insured, decide not to be insured
- Is depending on availability of insurance capacity
Comparison of both approaches: Compulsory insurance

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<tr>
<th>Advantages</th>
<th>Disadvantages</th>
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<tr>
<td>• Based on solidarity</td>
<td>• Moral hazard, prevents incentive to build a risk management process to prevent disasters</td>
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<td>• Protection of victim, by providing a means of compensation</td>
<td>• Does not promote risk management culture</td>
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<td>• Often flat rated</td>
<td>• Administrative burden to supervise and a lot of paperwork for insureds</td>
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<td>• Through pooling good coverage based on sufficient claims data</td>
<td>• Time lag for compensation</td>
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<td>• Acceleration of insurance penetration:</td>
<td>• Higher premium often not linked with risk exposure, and considered as a ‘tax’ and not used to improve the exposure to NatCat</td>
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<td>– If good cooperation exists between all economic agents in society (government, homeowners, insurers, media, …)</td>
<td>• Limited contractual flexibility: coverage not transparent and often quite narrow (no clean-up costs, nor business interruption)</td>
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<td>– If an equally adequate reinsurance market exists</td>
<td>• Mandatory is unpopular, therefore not easily imposed by MS, so penetration is low (e.g. Turkey)</td>
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<td>• Stabilise/secure the annual budget of the MS by reducing potential post-disaster emergency relief costs</td>
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<td>• Large pool can help build financial capacity to cover potential future losses and offer lower premiums</td>
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<td>• Constrain adverse selection (see ref. 9)</td>
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First priority for MS

effective disaster risk management:

– to mitigate possible losses in future
  • Use and control of current National Building Code
  • Support research in the area of risk engineering
  • Raise public awareness of natural catastrophe risk (research & media)
  • Establish a crisis aid system (local & international) in case of disaster
  • Implement indirect taxation to raise funds
  • Evt. Issue a compulsory NatCat insurance policy
  • MS can intervene in the market as an insurer of last resort or as a backstop (see appendices)

– instead of focusing on post-disaster rehabilitation
Green paper: consultation

- Poses a number of questions (21) concerning the adequacy and availability of appropriate disaster insurance.
- The objective is to raise awareness and to assess whether or not action at EU level could be appropriate or warranted to improve the market for disaster insurance in the European Union;
- Help to promote insurance as a tool of disaster management and thus contribute to a shift towards a general culture of disaster risk prevention and mitigation, and bring in further data and information.
Analysis Green Paper

- Disasters affect economic stability and growth.
- Strategy focuses on 3 key objectives:
  - Promoting action by Member States
  - ‘Climate proofing’ action at EU level
  - Better informed decision making
- Important to build a more balanced system that also covers preparedness and prevention actions
- Foster a culture of disaster risk reduction and disaster risk management, together with a well-functioning disaster risk insurance system (today only 30% of disaster losses are actually insured)
- Insurance can contribute to a shift towards a culture of risk awareness through:
  - Risk based pricing: lower price for better managed risks
  - Better research and data (better & more transparent mapping of different risks)
  - Contribute to development policy by helping countries, particularly vulnerable to disaster to effectively ‘hedge’ against the risk of disasters
Some conclusions from consultation (1)

Several respondents (Insurance Europe, Ferma, …):
• state support for the prevention of natural catastrophe damage is welcome but
• the private insurance market should be left as the main manager of risk transfer (free market principles)
• mention a need for an EU-wide database on NatCat:
  – with free and equal access;
  – collected and processed by public entities;
  – created as standardised and comparable data on a European scale and
  – shared through cooperation between MS
Some conclusions from consultation (2)

On compulsory financial security scheme for ELD (Environmental Liability Directive):

- CEA ‘has reiterated its stance that an EU-wide compulsory financial security scheme to cover ELD risks should not be introduced because it would not benefit buyers and the free market is working well.’

- Ferma warned against a worrying trend for the creation of mandatory financial security in a number of areas including industrial accidents, offshore marine and environmental liability, as well as natural catastrophes. ‘At this stage a mandatory financial security would destroy the emerging ELD insurance market and impose unfair insurance conditions regarding the huge industrial diversity of operators targeted in the Annex 3 of the ELD’
European Parliament Resolution
(5.2.2014 – 2013/2174 (INI)) (1)

• Focus on prevention and information:
  – Closer cooperation between private and public sector needed
  – MS & public authorities:
    • Need for good crisis management and emergency planning
    • Develop a network for exchange of information cross-border
European Parliament Resolution
(5.2.2014 – 2013/2174 (INI)) (2)

• Insurance market:
  – Natural & man-made disasters need different types of insurance and are covered by 2 different insurance markets
  – Most MS have some insurance-based system for floods and other natural damage, some state funds and may participate by providing reinsurance
  – Risk-based pricing is central approach to disaster insurance
  – Natural catastrophes affect both private households and business activities;
  – Consumers need to be fully informed about all terms and conditions and insurers have to clarify these contracts to consumers
European Parliament Resolution (5.2.2014 – 2013/2174 (INI)) (3)

• Non-mandatory insurance:
  – Regional authorities should recognise the importance of risk prevention and work on this;
  – Individual responsibility to be maintained
  – No market distortion to justify intervention at European level, not one-size-fits-all solution as different types of risks, quantity and quality, culture of prevention, capacity for action, risk monitoring
  – Flexible natural catastrophe insurance market: best way to develop the right products
Some remaining and open issues

- if EU insurance:
  - What event would qualify as a major disaster at EU level?
  - Which criteria to be taken into account?
  - Which body would have the authority to decide on this?

- ‘Resilience certification’: for certain industries and firms that have prepared themselves for disasters (Ms Georgieva)

- Focus needed on good claims management

- Cyber cat risk insurance?
3. Conference on prevention and insurance of natural catastrophes, hosted by the European commission – 18.10.2011
8. Georgieva, Kristalina, (1.4.2014) *the role of the private sector in developing the EU’s policies on Disaster Risk Management (DRM)*, speech on Public Private partnerships and DRM in Rotterdam