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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 trajectory¹. 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 catastrophes² 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 gap⁴, 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*