

EIOPA Discussion Paper: Non-life underwriting and pricing in light of climate change

General Comments

AMICE welcomes EIOPA's initiative to discuss how insurance companies can take into account climate change in underwriting and pricing. As the paper concludes: ***“Impact underwriting is a nascent field, and more new ideas can be expected in the future”***.

In that context, as an overarching issue, we would like to underline that the paper appears to merge two objectives, climate change adaptation and climate change mitigation. These are two distinct issues (clearly separated for instance in EU's taxonomy). **A clear differentiation would be needed in the paper.**

Insurance companies are direct enablers in the context of adaptation to climate change. While underwriting extreme events, the risks related to them are directly related (including reinsurance). Insurers are therefore directly involved, be it by underwriting and preventing the related risks. This is a key stake looking forward.

While, in the context of climate change mitigation, insurance companies are mostly in the position of accompanying policyholders in their choices They may also have to abide by/following government policies or decisions. Insuring in that context needs to be undertaken without undermining sound risk-based underwriting as well as eventually to the final benefits of the policyholders.

In other words, among the actions that may be considered beneficial to limit climate risk, it is crucial to clearly **distinguish between those for which insurers may have a role to play as insurers and those that are not in the direct remit of their activities and responsibilities, but that they can accompany.** Hence the focus of the paper may appear to try to achieve several targets that can be deemed in large respects incompatible to assemble together.

Furthermore, as a general introductory comment, we would like in that respect to underline that:

- Insurers can certainly play a significant role in incentivizing the decisions of policyholders through **adequate communication to raise risk awareness, foster resilient behavior, favor a responsible behavior and eventually, in the context of an accident or disaster event, assist adapted behavior.**
- But overall the instrumental role as regards climate change remains that of **governments (European, national, local) towards setting adequate measures such as aids, subventions, tax reliefs as well as regulatory requirements.**

The full spectrum of the **specificities of non-life insurance activities** needs to be taken into account. This includes:

- **A significant part of non-life insurance is covered on a mandatory basis.** This means that a policyholder (companies or individuals) will solicit an insurance contract regardless of climate change adaptation and mitigation. This cannot be ignored: an insurance company will have to propose a contract to a policyholder eventually. **There is a risk of developing “off-shore” solutions if the selection from “mainstream” companies as a result of public policies based on climate change adaptation or mitigation is too stringent.**
- **Mandatory insurance bears some social accountability.** Underwriting contracts based on climate change and adaptation may imply a selection process that can become soon socially unfair if insurance becomes unaffordable.
- This appears even more true in the context of climate mitigation, **inequalities among policyholders, including from a social standpoint, can become unsustainable** if, for the same risk, the price of a contract is subsidized against the price of another contract, because one is better for climate risk mitigation than the other.
- As a result, **it is absolutely critical to maintain a significant degree of mutualization (limiting thereby the degree of selection).** Otherwise, where the price of risks becomes too stripped down to the cost that each individual policyholder would bear on an individual basis, insurance does not play a role anymore and it becomes down to each individual to face his own cost.

Against this background, we wonder whether the paper sufficiently bears in mind that for insurers the issue at stake remains the adequate pricing of risks. Risk management and pricing should remain risk based in order to be meaningful. Impact underwriting can be important and an impactful way of dealing with risks and pricing, mostly in the factoring of **adaptation and prevention measures** (eg building norms).

With respect to climate change adaptation, it will increasingly be a prerequisite in the future to render risks measurable, manageable and insurable. Prevention and adaptation will be instrumental to inform a workable and competitive pricing of insurance. If adaptation and prevention measures fail to be in place, there is an increasing risk reaching the point of non-insurability (eg policyholders cannot afford the cover or insurers would not even be able to price extreme risks situations through increments).

Overall, the position above **disregards the possible use of discounts or penalties to premiums imposed on insurers by public authorities** to help “incentivize” broad “green” behaviors with no direct relation with risk exposures and hazards. Government policies would need to take into account, however, the consequences of these measures from a social and economic standpoint, especially because, as noted above, being insured is in many cases mandatory (be it for companies and individuals).

The position above includes, however, the need for government intervention as regards risks related to climate change adaptation, where shared solutions such as public-private nat cat schemes are fundamental approaches to major/systemic events. This turns to be critical as mandatory insurance (or widely spread) is an instrumental feature to avoid antiselection and enable adequate risk sharing and mutualization (with a government backstop for capacities beyond the remits of insurers and policyholders).

Q1: Do you agree that climate change could lead to increasing premiums and wider exclusions, potentially negatively impacting the affordability and availability of insurance covers over the long term? Please elaborate

- Yes

Please explain

Yes, but mostly from a climate change adaptation standpoint.

All other things being equal, where risks are deemed to increase it is fair to assume that premiums will follow a similar path.

Moreover, if a limit of affordability and/or premium increase is reached for the subscription to an insurance guarantee, it would mean that solutions for acceptability of prices would have to be found around exclusions, deductibles and other limits or reductions of risk exposure through adaptation and prevention measures.

Climate change projections still remain highly uncertain. But the effects of climate change are already observable on the amount of annual aggregated losses borne by insurers. Climate-related property damages are expected to increase, as the French Insurers Association FFA indicated when it published its White Paper in 2015, with the losses expected to almost double by 2040. This increase in claims could in fact mechanically lead to increasing premiums and/or to the identification of areas that would become uninsurable.

Looking at climate change mitigation, insurers should be cautious in taking the path of underwriting and pricing with that sole objective in mind. **This would lead to wider exclusions and affordability issues, while in many cases insurance is mandatory.** This may derive as such from government interventions and policies, but proper warnings should be raised on their effects and the need for graduation and transition.

That does not preclude insurers to take adequate measures in terms of communications, incentives, ad-hoc discounts...

Q2: Do current underwriting and pricing practices already take into account the expected impact of climate change? If so, please outline in which manner.

- Yes

Please explain

Yes, with respect to climate change adaptation. Evolutions in insured risks due to climate change are already noticeable and to this extent **they are taken into account in underwriting and pricing practices.**

Indeed, for the majority of non-life insurance contracts, the period of cover is one year, which allows insurers to adjust regularly and smoothly.

We disagree with the following statement *"3.1 The fact that non-life insurance contracts are short-term contracts and can be annually re-priced has been presented as one of the main*

reasons to not capture climate change in the actuarial pricing". In reality, insurers are already capturing climate change in their pricing.

Indeed, insurers' pricing processes are based in particular on past claims history. This makes it possible to observe long-term averages and trends (around 10 - 15 years) but also possible accelerations in trends (e.g. over the last 3-5 years). Changes in pace can thus be integrated into the pricing process on top of a long-term trend via hypotheses of anticipated claims development.

As regards climate change mitigation, the impact of the premium can be on the opposite side (reduction), as a result for instance from discounting, sales or targeted policies. As an example, premium discounts are offered to low-emission vehicles although those reductions are not technically justified. Another example is the premium discount applicable to private houses with the highest energy performance levels, which is not justified through lower frequencies or severities.

Q3: What are in your opinion the main obstacles to maintaining insurability and affordability in the context of climate change?

- Yes

Please explain

As regards climate change adaptation and mitigation, **insufficient mutualization and diversification, selection of risks are major obstacles that will generate uninsurability and unaffordability.**

On the side of climate change adaptation, this will be emphasized by **lack of risk awareness, deficient adaptation and prevention measures**. The lack of mutualization appears already as an issue in certain areas very exposed to climatic and natural risks such as tropical islands, where the insurance offer is already lacking (as a result of risk selection) (e.g. Guadeloupe and Martinique after hurricane IRMA in the context of the French market).

One of the most paramount obstacles though remains the hazard and mutualization aspect. Beyond adaptation and prevention, it is key to maintain a significant degree of mutualization. Otherwise, if and when insurance premiums are stripped down to an individual insured own cost, insurance is not effective anymore and it becomes down to each individual to face his own cost.

The insurability of risks can only be maintained if the occurrence of the risk remains random and the risk itself is diversifiable. Climate change raises fears of both disappearance of this random dimension because the risk could occur systematically each year and of its diversifiable nature because it would affect a very large proportion of insurance contracts simultaneously. The overall insurance model is not designed to respond to this type of risk. The consequences would be the impossibility for insurers to price insurance coverage at an affordable level or to offer insurance covers at all.

Q4: Do you see a role for coordinated industry solutions or Public-Private Partnerships to maintain availability and affordability of insurance covers? Please elaborate on the pros and cons of such mechanisms in your view.

- Yes

Please explain

Yes, as regards climate change adaptation, **public/private coordination is indispensable.**

Firstly, from a regulatory standpoint, it appears that **mandatory insurance (or widely spread) is an instrumental feature to avoid antiselection.** It enables adequate risk sharing and mutualization as well as affordability.

Secondly, **shared solutions such as public-private natural catastrophe schemes appear adequate approaches to major/systemic events and risks.** While a coordinated private industry solution (co-insurance, reinsurance, etc.) may be considered in the case of coverage of a single risk, it occurs rarely and only when the risk is of such magnitude that it cannot be provided by a single insurer. Such mechanisms already exist (for instance co-insurance for large industrial risks).

But in the case of risks related to climate change, such solutions do not seem conceivable. For example, the Caribbean Islands are very exposed to the risks of hurricanes, volcanoes and earthquakes. In some cases (e.g. Guadeloupe and Martinique as regards the French market), the withdrawal of some insurance companies is explained by the fact that the risk is very high (high intensities and frequencies). Yet, maintaining an insurance offer is essential and is indeed possible thanks to a public-private partnership whereby the reinsurance system is public and it shows its effectiveness. The latter is particularly facilitated by a state backstop beyond the remits of insurers and policyholder's capacity.

Based on our experience to date, it is also very important to note that **such private-public partnerships foster alignment of action and interest.**

Finally, **such a system is fair from a social standpoint.** Social acceptability and recognition is crucial in the context of climate change and the multiplication of extreme events.

Overall, public-private partnerships are to be favored in order to maintain a resilient insurance sector. The French mechanism that governs natural catastrophes regime is an example of this.

Thirdly, upstream of a public-private partnership, possible new rules on equalization provisions could be implemented with a smoothing mechanism over ten years for example (to be calibrated). This type of solution should then be developed at national level through the local GAAP rules because each country is not affected in the same way by climate change (drought in some, flooding in others).

As regards climate change mitigation, from a regulatory standpoint, **all attempts from the public authorities to send a signal (taxes, subsidies, bans...) should take into account, as discussed above, possible consequences (selection of risks, mutualization...) on pricing and underwriting**, including fairness on the social front. Risks pricing needs to remain the cornerstone of insurance policies. That does not preclude cooperation as regards communication and prevention (the example of such partnership already exists in France for road prevention).

Q5: Do you think that insurers developing impact underwriting would impact positively or negatively the availability and affordability of insurance? Please elaborate.

- No

Please explain

As regards climate change adaptation, we think that impact underwriting is already well under way.

Insurers already play a positive role in ensuring that the insurance market remains available and affordable.

Insurers already intervene in many ways before and after extreme events. Here are some concrete and effective examples:

- They carry out **prevention and awareness campaigns** among their policyholders to prevent damage from occurring or to limit the damage once it occurred. In the case of commercial lines business insurance, on site risk control visits are a privileged moment for this type of action.
- In the event of a total loss, they provide **advice on reconstruction to make buildings more resilient**. Insurers are very present in the organizations defining the building regulations.
- They actively **contribute to the knowledge of risks and provide data, models and studies** to improve the knowledge of the risks, for both their policyholders and public authorities.
- They are facilitators for their policyholders to take the necessary steps to demand help from national mechanisms or **initiatives to finance preventive work on their homes** (eg the Barnier Fund in France). For example, areas at risk of flooding can benefit from subsidies to carry out prevention work and make houses resilient. The role of the insurer is to support policyholders in the process to benefit from these funds and better protect themselves against risks.
- Finally, insurers raise **public awareness of the new construction standards and techniques that contribute to the resilience of new buildings**, through communication or advertising actions notably in favor of organizations specialized in these new standards. This type of action fosters risk awareness and propagates a risk culture that will lead to enhanced resilience of future insurable material.

On the other hand, it is noteworthy that there are some limits to impact underwriting:

- Insurers **cannot indemnify the costs of repair/construction at these new standards**. This would lead to those additional costs being taken into account in the pricing and would lead to an explosion in premium levels.
- **A compensation that takes into account the new standards would risk doubling the cost of the premium**. Doubling the premium would make access to insurance products difficult for certain territories and certain populations now covered by a contract.

More could be done obviously as regards impact underwriting. For instance, in some extreme situations, the threat of exclusions could be an educative tool to foster adaptation and prevention. Coverage by insurers, for instance, cannot be blindly provided in situations where the risk is certain (for instance grounds declared unbuildable).

This issue appears to be quite different as regards climate change mitigation. As already mentioned, the consequences of impact underwriting have to be carefully reviewed. **What may seem to be true for an individual policyholder may be at the expense of other policyholders** (see answers to the questions above).

Q6: Are you aware of other measures such as tax rules or local GAAP which could improve the availability of insurance cover for climate risks? If so, please list the countries and if possible, the relevant references to national law.

- No

Please explain

Equalization reserves may provide a mean to factor longer term increases in claims and costs, hence contributing to climate change adaptation.

In addition, in countries where premiums are subject to insurance taxes, the tax rate on premiums exposed to climate risk could be dramatically decreased or suppressed.

As noted above, equalization provisions can play an interesting role in maintaining an affordable and available insurance market. With regard to tax rules, it may be appropriate to explicitly redirect the amounts collected towards actions that promote the resilience of the insured risks.

Q7: Should underwriting and pricing practices make allowance for wider climate change considerations that go beyond direct impacts on the insured risks? Please provide examples in your answer and indicate what are the challenges to including such considerations, in particular how to comply with risk-based actuarial principles.

- No

Please explain

Long term climate change issues (multi decennial time horizons) and considerations are beyond insurers' reach under standard business strategic planning and pricing and underwriting processes. This does not mean that insurers do not consider climate issues.

On the contrary, insurers are well aware of climate issues but to the extent that the impacts are in the remit of their business models in terms of risk profile, granularity and time horizons. **To a significant extent, claims data already capture climate change impacts from which trends can be derived and pricing can be adapted in time** (see answer to Q2).

In that context, we want to make a comment on the first bullet point of article 3.5. It states that in France premiums for Nat Cat coverage are restricted by legislation, since they are a flat 12% surcharge on property insurance. It is to be noted that the flat percentage is set on an actuarial basis and notably since it is applied to insurance premiums that are themselves determined on a strong actuarial basis. For instance, for risks in a flood zone, the insurer can increase the underlying property insurance premium, hence mechanically also increasing the nat cat premium of 12%.

As indicated in the consultation, modulating insurance premiums to favor policyholders who have invested in so-called "green" houses, in construction techniques that are more resilient in the face of various natural perils or in vehicles with low GHG emissions is:

- On the one hand little incentive because the reduction that can be granted on the premium in relation to the underlying investment is **too small**; we don't believe it will make policyholders change their behaviors;
- On the other hand, **potentially too remote from the actuarial considerations necessary for a good measure of risk** (since premium discounts are not related to reduced risks);
- While in the meantime there is a risk of greenwashing, consisting in using those price reductions as **a marketing tool** while their impact on the climate is limited. Proposing premium reductions based on green criteria associated with the insurable matter may appear to be a commercial argument in line with the insurer's strategy, while being a marginal measure favoring adaptation to climate change.

We would instead support the prevention measures outlined above can be a real lever in the hand of insurers to participate in climate change adaptation.

Q8: What role do you see for direct risk prevention measures (at policy level) in insurance underwriting within the context of climate change?

Please explain

Please see Q5

Q9: Do you think that considering long-term insurance contracts (similarly to what is done for life insurance) could help insurers maintain availability and affordability of insurance in light of climate change? Please elaborate on the main pros and the cons for developing multi-year non-life insurance covers.

- No

Please explain

We stand against a proposal to increase the term of non-life insurance contracts. We think **this would deprive insurers from a critical ability to continuously adapt to risks and exposures in a sound, meaningful and safe manner**. Without the possibility to annually review the premiums, mispricing becomes more probable and could even lead to insolvency.

If the terms of contracts were to increase, insurers would in turn incorporate an additional risk premium to make up for increased uncertainty. This would translate in higher costs for policyholders.

It is also likely that the prudential costs through capital requirements would increase, which in turn would be passed onto insurance premiums costs.

Reinsurance would also pursue on an annual risk endorsement term that would not fit the multi-year stance of ceding insurance undertakings, hence requiring an additional risk premium.

Q10: Do you think that the development of long-term insurance contracts to deal with climate change would require specific regulatory treatment, for example for future premiums?

- No

Please explain

See Q9. All other things being equal, a longer term means increased uncertainty towards climate risks, so higher risk calibration and associated requirements.

Q11: Do you see potential solutions to the lower flexibility for the insurer and less efficient use of capital as a consequence of long-term non-life insurance contracts?

See Q9 & Q10

Q12: In your view, what would be the pros and cons for policyholders if they were offered multi-year contracts?

Policyholders would be linked to their insurers for a long period of time. It will reduce awareness to risk change and adaptation. Most prevention efforts would hereby be undermined.

One should note that renewal processes in France for motor and household insurance are legally defined and changed a few years ago: **policy holders are now allowed to cancel policies any time after the first year of insurance**. Resistance to change this rule would by all means come from a large area of stakeholders, including consumers. In order to increase competition in the insurance sector, consumer associations have been asking the right to change insurer at any time, eve during the first year for some type of contracts (motor insurance, home insurance, health insurance).

Q13: How could insurers quantify in their underwriting and pricing practices the incentives on the risks insured, and any wider incentives to reduce greenhouse gas emissions?

Impact underwriting is an important and impactful way of dealing with risks, but **pricing and more generally risk management should remain “risk based” in order to be meaningful**. In that context, one has to be careful therefore in the quantification process.

For instance, pricing discounts as such could fail to compensate the costs of new technology and adaptation and prevention measures, but could rather develop premium add-ons where such adaptations fail.

Yet, the way we see the factoring of adaptation and prevention measures (eg building norms) is that a competitive pricing would lead to a standard base price that would then be increased where adaptation and prevention measures fail to be in place up to the point of non-insurability.

Premium discounts for low mileage policies, for clients holding an annual public transportation pass, for drivers having an eco-responsible driving style, etc are useful, as long as the level of the reduction is in line with the claims behavior of the policies.

Insurance of new technology in favor of the climate (photovoltaic energy facilities, geothermal installations,...) should be clearly covered in the insurance policies.

Besides underwriting and pricing, **non-life insurers contribute to a higher awareness of climate risks through their claims handling process**. For instance, by proposing repair solutions instead of replacement solutions in case of a claim, by proposing eco-friendly car paints, by contracting with glass breakage repairers that respect green charts, by proposing car wreck disposal solutions respecting the strict ecological norms, etc

Q14: In which ways could indemnification promote climate resilience by going beyond simple ‘like-for-like’ replacement of vulnerable properties? Please provide examples (either from real experience or as potential product ideas) and elaborate on the pros and cons to going in this direction.

Compensation for loss needs to remain based on loss effectively encountered and cannot finance the entire costs under new technologies or building norms, since this would again induce considerable price increases. Yet the compensation can be used by the policyholders to partially finance reconstruction under new norms, the remaining gap being borne by the policyholder and or state aids/subsidies.

Q15: Are you aware of other insurance products not mentioned in this paper and which would fit with the definition of impact underwriting?

- No

Please explain

N/A

Q16: Are you aware of other insurance services not mentioned in this paper and which could contribute to climate change adaptation or mitigation?

- No

Please explain

N/A

Q17: Do you have any other comments on the draft Opinion?

- No

Please explain

N/A