

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

Fields marked with \* are mandatory.

## Responding to the paper

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EIOPA welcomes comments on the discussion paper: Non-life underwriting and pricing in light of climate change.

Comments are most helpful if they:

- respond to the question stated, where applicable;
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA using the EU Survey tool **by Friday, 26 February 2021, 23:59 CET** by responding to the questions below.

Contributions not provided using the EU Survey tool or submitted after the deadline will not be processed.

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[1] Regulation (EC) No 1049/2001 of the European Parliament and of the Council of 30 May 2001 regarding public access to European Parliament, Council and Commission documents (OJ L 145, 31.5.2001, p. 43).

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[3] Regulation (EU) 2018/1725 of the European Parliament and of the Council of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45 /2001 and Decision No 1247/2002/EC (OJ L 295, 21.11.2018, p. 39).

## About the respondent

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\* Please indicate the desired disclosure level of the responses you are submitting.

- Public  
 Confidential

\* Stakeholder name

Actuarial Association of Europe

\* Contact person (name and surname)

Monique Schuilenburg

\* Contact person email

moniques@actuary.eu

Contact person phone number

003222016021

## Questions to Stakeholders

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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?

- Yes  
 No

Please explain.

The effects of climate change can have an impact on the affordability and availability of insurance cover in the long term. This applies both to changes in the actuarial expected value of the insured risks and to the frequency and severity of accumulative events and large losses. Ultimately the situation depends also on the availability of capacity in the global reinsurance market.

Actuarial calculations of premium increases and exclusions will not necessarily happen gradually, but could instead come in the form of a series of abrupt step changes, particularly in the availability and cost of reinsurance, following very severe weather events. We can already see this effect in the USA.

Some locations that are currently lower risk may be expected to experience an increase in weather events. It is possible that such areas could face similar issues with the availability and affordability of insurance as areas that are currently high risk. It is likely that demand for insurance coverage would increase in such areas.

Even if climate goals are achieved, further preventive measures will be necessary to reduce risks in order to ensure permanent insurability. We doubt whether this will be possible and sensible due to regional differences, at least as long as no further preventive measures are taken, such as for example technical flood protection.

However, the decision as to whether a customer makes use of the insurance cover offered is always an individual economic decision. The insurance gap mentioned is therefore not only a question of supply. In Germany, for example, the insurability against flood is significantly higher than the insurance density.

While Insurers can play a role in identifying preventive measures in order to ensure availability of insurance cover, wider Societal efforts will be required to mitigate the risk resulting from climate change.

One point we missed from the discussion paper is the ability for building planning laws to influence the future exposure to climate change risks. Planning restrictions should be put in place to reduce the risk of buildings being built in areas that are likely to become higher risk areas in future. Additionally, construction of defences should be studied to mitigate against future increased risks, Poor planning could lead to an unnecessary increase the insurability gap.

Q2: Do current underwriting and pricing practices already take into account the expected impact of climate change?

- Yes
- No

Please explain. If yes, please outline in which manner.

The impact of climate change is already taken into account, to the extent that insurance covers perils where climate change is already causing changes in the underlying risks, especially tail risks. As most P&C Insurance contracts are short term, underwriting practices primarily focus on the current risk profile, with less regard for future expected effects materially beyond a 1-year time horizon. This means underwriting and pricing consider expected climate change risk to a degree possible and visible at this point of time. The cost of extreme events is allowed for as part of the cost of reinsurance. In turn, reinsurers use Nat Cat Models which are continuously updated to allow for emerging climate trends.

With views changing over time on the likelihood and magnitude of certain insured events driven by climate change, insurance prices will change. The level of change will likely be higher in some parts of the business (e.g. Agriculture, Reinsurance on Tropical Cyclones, Motor Hull, etc.) and lower on others (e.g. Personal Liability insurance). One-year contracts allow insurers to take these effects into account gradually and in a controlled way. However, for some risks, in particular transitional risks, it is very likely that their expected impact is not fully taken into account yet, or even cannot be taken into account properly due to their nature.

Commercially it is for each insurer to decide if it makes sense to avoid writing business or to charge higher premiums in areas that are expected to be higher risk in the future. Setting plans and strategies for the evolution of risks and portfolio exposures is within the scope of the ORSA and wider strategy setting.

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

The main obstacles are

- Actuarial Insurability and Economic Insurability as defined in sections 2.10 and 2.11 of the discussion paper.
- the inherent uncertainty (and the lack of data) about breadth and magnitude of climate change in the medium term.
- the interaction of each (re)insurer's underwriting risk appetite with more frequent and/ or more severe loss events and uncertainty about whether, or by how much, the underlying risk has changed because of climate change. It may not be possible to maintain insurability (for high probability of correlated events) or desirable to maintain affordability (construction in floodplains).
- the inability to diversify and cede risk. The nature of private sector capital flows into the reinsurance industry means that price of the risk, and the capital available to support it, fluctuates substantially over time. Reinsurance capital provided by the public sector in addition to the private sector would be one way to stabilise reinsurance pricing. In Spain, for example, there is a public entity called "Consortio de Compensación de Seguros" [Insurance Compensation Consortium] that provides reinsurance capacity and reinsurance capital and that stabilizes reinsurance prices and insurance prices.)

EIOPA has noted "The willingness of consumers to pay for an insurance policy should exceed the premium level for which insurers are willing to accept the risk transfer." This is the basic premise of insurance which is founded on risk aversion and allows for a system where risk transfer is provided and rewarded. This near-term risk aversion should not be conflated with longer-term risk aversion especially where the risks are uncertain or unclear. A case in point is the provision gap in pensions where there is no lack of ambiguity over the need for future provision but there remains a clear unwillingness to fund for the same today. Similarly, in non-life underwriting there was limited demand to purchase explicit pandemic business interruption cover, but once the need became obvious the demand for cover increased significantly.

Climate change risk is similar and unless demand is stimulated through a legislative requirement with appropriate framework it might not be commercially viable to provide it.

On the whole, measures beyond the influence of the insurance industry are necessary to ensure the affordability and availability of insurance cover in the long term (see answer to Q1).

Risk-minimising measures are needed to minimise impacts. It is necessary in the private as well as the public sector that such measures are taken proactively and not only after damage has occurred. The risk remains that sufficient risk capital may not be available to cover the increasing amount of large and accumulation losses. Private-public partnerships could be considered to overcome this obstacle.

Climate change can lead in the future to regional or local adverse situations, e.g. buildings and factories have to face a significant claims probability or even significant claims expectation. In this situation, risk-based pricing will have an impact and can support climate change adaption: insurance will become expensive, non-affordable or even unavailable.

The problem of uninsurable risks is exacerbated in the context of a competitive market where insurers naturally seek to select the best risks and avoid the worst risks.

Also, the more sophisticated that insurers pricing models become, the less attractive the poorer risks are from an insurer's perspective, thus further increasing the problem of uninsurability.

Q4: Do you see a role for coordinated industry solutions or Public-Private Partnerships to maintain availability and affordability of insurance covers?

Yes

Please elaborate on the pros and cons of such mechanisms in your view.

We see basically two ways to maintain affordability:

- (i) reduce the underlying risk or
- (ii) subsidise the higher risks by charging more to lower risk customers to compensate.
- (i) Reduce the underlying risk: This option is clearly preferable. The risk can be reduced via two mechanisms
  - (a) halt or stem the drivers of climate change and
  - (b) discourage further investment in risks likely to prove uninsurable.

Approach (a): This clearly requires a wider societal response. The question is how insurers can play their part. We can already observe various “green” initiatives by insurers to support environmentally friendly solutions (e.g. not-supporting coal-based energy plants, incentivizing energy efficient houses or low-emission cars).

Insurers have the ability to react to new trends very quickly and can adapt their portfolio to stop supporting traditional/less environmentally friendly risks due to the fact that majority of non-life policies are underwritten on annual basis.

It is a societal responsibility to ensure that there is enough capacity, insurance-based solutions for traditional sources to smooth the transition to new options and offerings. Any changes in available insurance capacity should be closely monitored to provide enough time for reaction, which could lead to some public solution. Such PPPs do work, for example Flood Re in the UK, and as such, they can help monitor changes in risk over time and inform governments on mitigation strategies to reduce insurance gaps caused by climate change.

Approach (b) is clearly possible for insurers.

New uninsurable risk will be discouraged by higher premiums and tighter terms and conditions. In fact, if premium rates did not increase, or if policy terms and conditions were not tightened, insurers could be blamed for not passing the correct price signals in response to climate change.

To be considered: There are many already existing risks which will in time become uninsurable. Individual insurers in a competitive market cannot solve the problem of uninsurability for these risks. Some form of state /government led pooling of risks becomes necessary.

- (ii) Subsidise higher risks: This approach diverges from risk-based pricing and is problematic in a competitive market. State/governmental oversight needed to form a pooling arrangement. It would be important with such a pooling scheme, not to unintentionally encourage inappropriate investment in new risks, which would be uninsurable in the absence of the pool. Risk and reward are potentially misaligned, e.g. charging lower risks a higher premium than actuarially justified could discourage investment in risk mitigations by policyholders.

A well-crafted pooling system could buy society some time and offer price stability while wider society addresses climate change. We have identified 4 areas to maintain availability and affordability of insurance covers:

#### 1) Raising transparency and understanding the risk

To achieve this, data and models are indispensable. To have a complete data set, a coordinated industry solution and/or public private partnership is favourable. Many shareholders have data which may contribute to understand the impact of climate change, the risk exposure of single risks and the impact on potential claims. A better understanding of a risk can result in a lower margin for uncertainty and support affordability and availability.

Publicly available data and models can also support local governments (e.g. in developing building zones, maintaining pipe system, ...) as well as individual private and commercial customers in avoiding and preventing risks.

## 2) Support for heavy tail

There is a big and growing uncertainty regarding the frequency and severity of extreme weather events. These events can cause tremendous losses, which cannot be covered by the insurance industry solely. Governmental guarantees, pool solutions for events leading to losses which exceed a threshold, could help to maintain affordability and availability of insurance covers.

## 3) Subsidizing premiums

The effect of climate change can increase the risk in specific locations, e.g. especially exposed to river flooding or to avalanches. These locations face strong increases of their premium. Some owners of private or commercial premises may not be able to afford the cover. A systematic cross-subsidising among policyholders towards these more exposed risks is not fair and risk adequate. Other possibilities beyond insurance could be considered.

Indian crop insurance may be an example how to organize such a system in case of a specific market niche.

## 4) Risk prevention

Intensified risk prevention will be key in the future. The ability to cope with effects resulting from climate change can be improved by appropriate investments in infrastructure. Public private-partnerships with the insurance industry can help to accelerate this. Protection and risk prevention lower the risk and can reduce the price.

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

- Yes
- No

Please explain.

Insurance and availability of insurance plays an important part in our decision-making process. Impact underwriting as such can have both positive and negative impacts on availability and affordability of insurance.

Fundamentally, price and availability of insurance is driven by two main components: risk and capacity. Impact underwriting as such might have some effect on risk, but more importantly it will have significant effect of capacity and product offerings. We can already see some significant shifts by many insurers, which no longer provide protection for coal-power plants, various mining explorations or provide incentives for ecological and sustainable alternatives (e.g. electric car / internal combustion engine (ICE) cars). As such the lack of capacity/willingness of insurers to write such business will drive the price up and ultimately such cover might no longer be affordable.

There are unquestionably many positive effects of impact underwriting from societal standpoint in respect of education, sustainability, and overall higher environmental awareness of the policyholders.

However, we need to ensure that the effects of impact underwriting are gradual and supported by some hard evidence of risk mitigation and that there is still a competitive market and capacity for traditional solutions. (e.g. we still need cover for nuclear / coal power plants as they are balancing out variable energy output from renewable sources of energy, such as wind and solar. Ultimately a reduction in the availability of insurance cover for traditional solutions could lead to market distortions in some areas where (re)insurance capacity becomes limited and/ or expensive for activities deemed to promote the climate change and be detrimental to society).

We must consider the question of whether insurance is the right medium to drive the positive change via impact underwriting. One of the main principles of insurance is provide stability to the businesses, where risk is analysed, and any findings are supported by evidence and data. It will remain risk-based, i.e. based on the expected claims amount and also based on the volatility of the risk insured. Thus underwriting must always avoid uninsurable risk and must reliably price risk, which may inevitably have a negative impact on the availability and affordability of insurance. The main challenge of impact underwriting is to apply then the right degree of robustness, which is not easily swayed by social media and current moods within a society.

A further issue to consider regarding impact underwriting, in a competitive market, is that insurers are not permitted to work in concert as this would breach competition law. However, if they apply impact underwriting in isolation, they may risk losing business. In the extreme this could lead to less availability of insurance rather than more.

Each undertaking will need to take its own decision on business strategy when it comes to impact underwriting. While some undertakings will not see much relevance, others might need to manage their sustainable-oriented shareholders. Hence, we can only name possible examples:

- No underwriting of coal / fossil fuel-based power plants
- Premium reduction for the prevention of claims caused by climate change (e.g. flood)
- Insurance of buildings: Allow for reconstruction of damaged buildings at a place more suitable w.r.t. climate change
- Foster repair/replacements by more sustainable parts/items.
- Liability insurance: Premium differentiation based on carbon footprint (cf. litigation risk)
- Non-life insurance based on green assets: as sustainable assets contribute to ESG objectives, a reduction could be offered for long-tail business
- Non-financial report / Taxonomy: Insurance undertakings could have the objective to reach a certain quota of sustainable products – and therefore offer a reduction for the insurance of sustainable items.



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[1]?

[1] In particular, some authors have suggested that governments could incentivise the building up of equalisation provisions to improve the availability of insurance cover for climate risks (Paudel, 2012 "A Comparative Study of Public—Private Catastrophe Insurance Systems: Lessons from Current Practices. ")

- Yes
- No

If so, please list the countries and if possible the relevant references to national law.

We note the reference to equalization reserves which could serve to improve the availability of insurance. We note that while these would apply for tax or GAAP rules, they are not currently a feature of the Solvency II regime.

Q7: Should underwriting and pricing practices make allowance for wider climate change considerations that go beyond direct impacts on the insured risk[1]?

[1] Direct and indirect impact of insurer's contribution to climate change adaptation or mitigation on the insured risk: (a) direct - insurers contribute to climate change adaptation and mitigation and the insured risk is directly decreased (for example incentivise policyholder to take prevention measures against flood risk contributes to climate change adaptation and also directly reduces the insured risk) (b) indirect - insurers contribute to climate change adaptation and mitigation but it does not directly decrease the insured risk; it is expected to have an impact at long-medium term on the overall climate related risks exposure of the insurer (for example offering insurance coverage for photovoltaic panels does contribute to climate change mitigation but the insured risk is not directly impacted. The impact on the insured risk could be materialised in the future as GHG emissions are reduced on a longer term).

- Yes
- No

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.

There is a slight difference between underwriting and pricing practices.

From the pricing perspective we cannot see any reason why there should be wider consideration beyond direct impact on the risk as, based on the actuarial principles, the pricing should be purely based on the view of the risk, evidence, data and any other effects such as rewarding good behaviours should not be considered if they do not directly impact the risk.

However underwriting principles can, and often do, take other indirect effects into consideration. We can already see many companies to change their underwriting strategy in order to support and promote socially responsible behaviour. A shortage of insurance offers for coal plants can already be observed. Such underwriting initiatives are driven by management/investors to be considered as good corporate citizen and avoid bad press. They are not directly linked to actuarial considerations. Such withdrawal of insurance protection may have a strong impact.

Principally, every business should look after its market and ensure long term sustainability and profitability. In other words, there might be an incentive to provide benefits to sustainable solutions in one line of business as it might have long-term positive effect of another line of business. E.g. Provide benefit to electric cars over internal combustion engine cars insurance as it might have positive effects on emissions/climate change and long-term impact on property market (floods, droughts etc.). However, this long-term cross-impact view is not widely considered, and any potential cross-segment subsidy should be considered very carefully to ensure smooth transition and minimize potential distraction due to sudden changes in availability and affordability of cover.

If climate change is a systemic risk to the financial system and an existential risk to society then there is an argument that underwriting and pricing practices should make allowance for wider climate change considerations that go beyond direct impacts on the insured risk. While there is a desire amongst underwriters to “do the right thing” in managing their reputation risk, problems arise where such a wish conflicts with their need to achieve target profitability.

If underwriting and pricing is based on something that is not directly related to the risk, it does not conform to risk based actuarial principles. However, as seen with something like the gender directive in motor insurance pricing, insurers can adapt pricing structures if there is a legal requirement to do so. Pricing which is not based on the underlying risk could lead to distortions in the market.

Insurance could have a role to play in accelerating the transition to lower carbon technologies where the behaviour of the insured can be influenced (e.g. offering a discount for electric vehicles where that discount is subsidised by petrol vehicles). Insurers could consider the impact of climate change on every product and check if there is room to integrate aspects of climate change considerations into the underwriting guidelines. However, competitive forces may limit the extent to which this is possible.

Disruption is an additional risk linked to non-eco-friendly activities or products. Transition to a carbon-neutral economy may include sudden bans of certain products, production processes, transportation. A default of certain industries or corporates could be the consequence.

Such risks need appropriate consideration in underwriting and pricing decisions. This will have an impact on the availability and pricing of insurance covers potentially affected by such bans.

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

There are numerous examples in the paper in respect of the direct risk prevention measures at policyholder level. The main challenge in respect of prevention measures is education and the link between the prevention measure and some financial gain. As noted in the paper many policyholders may underestimate the level of risk or not be aware of certain risks, which makes them vulnerable and at disadvantage. Another issue is that many insurance pricing practices do not consider all the risk specifics (limited amount of risk factors) and by adopting some risk prevention measures policyholder may not see the financial gain (reduction of insurance premium).

There are two types of risk prevention measures:

- Retrospective. There are prevention measures to deal with the effect of climate change, such as higher frequency/severity of flood. It is critical that these prevention measures are taken into consideration by the insurer in their risk-based pricing and that there is significant amount of education of policyholders in respect of the risk they are facing and potential sources of mitigation.
- Prospective. These are prevention measures to ensure that the speed of climate change is reduced (e.g. energy efficient houses, using low emission cars). These do not directly impact the risk (from the short-term horizon – 1 year) and as such are not considered in the risk-based pricing, but insurance companies can offer policyholders some level of incentive. These prospective risk prevention measures are often supported by governments via financial incentives / subsidies. There could be higher cooperation between governments and insurers in respect of forward-looking views of the risk and potential sources of mitigation to ensure stability of the market and continuous availability of commercial insurance solutions.

Concerning prevention:

We realise that the role of insurance is limited to cases where there is alignment between climate change behaviours and reduced insurance risk. As such, risk prevention measures at a policy level are unlikely on their own to achieve a significant impact on the wider mitigation issues relating to climate change. Such measures need to be applied at the widest possible level to have an impact.

Nevertheless such measures are highly important to avoid uninsurability in some areas, for example in highly climate-change risk-exposed industrial insurance.

The insurance industry is experienced in the development and implementation of risk prevention measures. There is a long-established proceeding in several lines of insurance business.

Example: Activities of the insurance industry have led to the establishment and broad usage of many technical risk prevention measures in the past e.g. sprinkler systems in fire insurance; immobiliser systems in motor car insurance.

Prevention or lowering the impact of climate related risks could be supported by similar processes.

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?

- Yes  
 No

Please elaborate on the main pros and the cons for developing multi-year non-life insurance covers.

Long term contracts will not of themselves address changes in the underlying risk or the relatively high levels of associated uncertainty. Long term policies increase risk for insurance companies significantly and are not consistent with the prudential management of risk.

We do not believe that, in isolation, multi-year contracts can serve to reduce the underlying risk or the insurability of higher risks. In addition, it could materially impact the solvency of insurers. A key issue for primary insurers would be the need for corresponding multi-year reinsurance cover.

Using multi-year contracts in the face of growing climate risks could result in large step-changes in premium at the end of each multi-year contract or following a major climate related event. Insurers would need to set higher premiums in order to compensate for greater uncertainty over long term of multi-year contract and to allow for the risk of anti-selective cancellations by lower-risk policyholders. The inability to adjust the price if it is too low from the insurer's perspective or too high from the policyholder's point of view make such policies unattractive to insurers and policyholders. Additionally, given that the cost of insurance is likely to increase over time, a multiyear premium will be higher, at the outset, than a stream of annual policies. This is likely to make the product unattractive to policyholders.

There is also a question about how such multi-year contracts would be promoted / encouraged.

Multi-year cover could introduce moral hazard by disincentising policyholders from investing in climate mitigation solutions in a timely manner, because they could rely on cover provided on favourable terms over a multi-year period. New customers could end up subsidizing existing customers because insurers could not increase premiums to match the risk for those existing customers.

Long-term insurance contracts seem to guarantee stable premiums and thus ensure enduring insurability during the evolving climate change. But insurance companies have to consider a number of factors for such contracts and include them in the premiums (if possible at all).

1.) The insurance companies themselves face the uncertainty of the consequences of climate change, which at present can hardly be calculated on a long-term basis. Through long-term contracts, unseen developments resulting from climate change could put an excessive burden on the insurance companies. An example, in life insurance the burden of long-term high-yield contracts can currently be seen quite frequently.

2.) Uncertainty also exists with regard to political decisions on climate protection measures, which have a significant impact on claims requirements and thus on premiums.

3.) The capital requirements according to Solvency II are based on the one-year underwriting risk, including in particular the premium and catastrophe risk. Within the one-year period considered in Solvency II, these capital requirements quantify the risk of error, change and random fluctuations. Due to possible dynamic development of climate change, long-term contracts would imply a significantly higher risks of error and change, and thus lead to an increasing capital requirement and associated capital costs.

4.) For primary insurance companies, the underwriting risks are usually only bearable if corresponding reinsurance cover for (natural) catastrophes can be obtained. Reinsurance contracts are usually only offered for a one-year period, and the reinsurance premium depends significantly on catastrophe events having recently occurred. For long-term primary insurance contracts, either long-term reinsurance contracts would have to be agreed or the reinsurance premiums would no longer be calculable as a cost component.

To summarize, long term contracts would lead to higher risks and therefore higher premiums (if calculable at all) and so to less affordability for the majority of the policy holders. In addition, it could provide little incentive for the policyholder to reduce risk.

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?

- Yes  
 No

Please explain.

Long term policies are not consistent with the prudential management of risk in insurance companies and it is not clear that there would be a benefit of investigating this avenue. In Germany, multi-year-contracts were even banned a few years ago for customer protection reasons.

Multi-year contracts are generally the exception in non-life insurance. Although the current regulatory treatment can allow for some multi-year contracts, we believe that if they were to become the norm that this would require a thorough review of regulations.

For example, capital requirements for non-life business are generally calculated using the Solvency II Standard Formula. The Standard Formula is designed for one-year risks with multi-year risks being the exception. The current approaches around cancellation, lapse risks etc would need to be reconsidered.

Another example is IFRS accounting, in particular the new IFRS17 standard for technical provisions. Many more insurers would be required to adopt the more complex Building Block Approach, instead of the simpler PAA approach which can be used for one-year business. This would introduce additional costs for insurance industry which would inevitably be passed on to policyholders

Other problems to be addressed would be

- the correlation over time in climate exposed risks
- the need for reinsurance contracts to be overhauled to match the changes in primary insurance contracts.

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? Please explain.

Please see also our answer to Q9 above.  
We do not see such a solution.

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

Sections 3.17-3.22 of the discussion paper cover these pros and cons very well.

In addition, we would add the following additional considerations:

Over the course of, say, a 5-year policy new risks or coverages could emerge, which become market standard, but existing multi-year policyholders would not be covered. Similarly, new exclusions or restrictions in cover could also emerge over time. Such changes could affect the propensity for policyholder to selectively cancel their contracts, further increasing the premium required for multi-year contracts.

Normally intermediaries would receive commission at the beginning of multi-year contract. There is then a risk that, after the first year has expired, intermediaries would incentivize cancellations if there are not effective commission clawback arrangements.

In general, we do not believe that majority of policyholders would opt for long-term cover for climate risk, although some segments could be encouraged by appropriate marketing and promotion. There is a risk that those opting for longer term cover would be self-selecting

Introducing multi-year insurance would not solve the problems of climate change or of the affordability of insurance. Instead, multi-year contracts could simply prolong the problems and postpone insurers and insureds from addressing them.

Advantages:

- Transfer very significant risk in insurance companies
- Certainty over the future price of insurance regardless of any claims. If it formed part of an insurance contract taken out at the same time as a mortgage it would just form part of the underlying cost of purchasing a house and regular mortgage repayments.

Disadvantages:

- High cost
- Reduced competition, depending on the nature of the market
- Insurance company providing the guarantee may be insolvent when you need to claim
- Unable to change insurer if the service is poor, or if a better price becomes available on the market (depending on the nature of the market)

Actually, section 3 of the discussion paper notes a number of advantages and disadvantages for policyholders quite well.

In fact, a multi-year contract as such does not change any of the annual expected claims cost compared to shorter term contracts and therefore does not resolve any climate change related risks or affordability of insurance.

Potential administration cost savings within a multi-year contract are likely negligible compared to increased risk premiums required for multiyear contracts. These have to be charged due to increased uncertainty loadings, due to likely self- or anti-selection of policyholders.

Moreover, policyholders may be excluded from any (necessary) adjustments in coverage due to new risks evolving over time or due to transitional risks emerging in the course of climate change mitigation.

Multi-year contracts may “fix a risk situation as is” and therefore even prevent from timely implementing risk mitigation measures.

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?

We expect that insurance undertakings will continue with their risk-based pricing and therefore apply usual actuarial pricing techniques to quantify also the incentives used in impact underwriting. Any insurance incentives aiming to reduce greenhouse gases need to be very carefully designed so as not to have unintended consequences on the existing insurance market.

As each insurer could design its own version of impact underwriting and could design ways to measure its effectiveness, an aggregate quantification of impact underwriting is difficult and would require a common approach to defining, and measuring the extent and effectiveness of impact underwriting across the market. Significant judgement would be required. Consistent incentives across insurers would likely be very difficult.

In some cases, incentives will be based on strategic decisions (reputation, need to manage shareholder expectations, CSR, ...). In this situation, pricing will be rather individual.

A reduction in premium is not the only way to offer incentives. Other options are reduced/no deductibles under certain conditions (e.g. new fossil-free heating) or support in transition to carbon-reduction like offering consultancy on measures or financing.

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.

We see this as a key area where insurers are already active e.g. buildings destroyed by fire are replaced with buildings using green technologies.

Indemnification beyond 'like-for-like' replacement could promote climate resilience.

We name a few examples:

- Allow for or foster CO<sub>2</sub>-neutral indemnification and claims adjustments;
- A replacement by environmental-friendly, climate protective materials/items/machines, could be supported through e.g.
  - o prefer repair over replacement with new item (if the new item would have a similar carbon footprint than the old item);
  - o prefer replacement with carbon-free new item over repair of fossil-driven old item;where 'prefer' can mean specific conditions (obligation, allowance) in insurance contracts and/or financial incentives during loss adjustment;
- Buildings: allow rebuilding at other, more resilient locations, etc...

Pros:

- This could have a considerable positive impact on climate change risks and resilience
- Insurance undertakings could promote itself as being supportive to sustainability
- Depending on circumstances, the premiums could even decrease as new sustainable items may have lower claims expectation as old ones

Cons:

- Depending on circumstances, 'green' incentives might come with additional costs which either need to be priced in or subsidized by other means.

See also our remarks on Q5 and Q15/16

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

Yes

No

Please describe the products.

e.g. For third party liability a “pollution” clause / exclusion (litigation as a consequence of activities linked to the carbon-footprint) could lower the risk for insurance companies and raise awareness as well as stipulate change.

We recommend a survey of insurance companies to identify current products and those currently in development.

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

Yes

No

Please describe the services.

We recommend a survey of insurance companies to identify the full range of insurance services currently provided or in development.

Some possible services below:

- For business interruption and transportation, a global understanding of the Nat Cat risk is more and more important. An analysis of the value chain to support the non-retail customer in its own risk assessment may be helpful (tools available in the market)
- Risk management is a key capability of the insurance industry and could be offered as a fee-based service.
- Warnings, guidance and support in the case of extreme weather events (e.g. public insurers, Germany).
- Claims settling with a carbon footprint optimization (reuse, repair, local craftsmen), Relocation of buildings, premises, etc. away from risky locations in collaboration with local governments.
- Combination of insurance and savings. Savings to enable the customer to renew and maintain buildings, transportation (especially cars) eco-friendly.
- IOT (Internet of things) for early warning in the case of events (e.g. flooding in commercial buildings)
- Energy-reduction insurance in combination with IOT (optimizing energy-consuming machines, light, etc.).

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

Yes

No

## Contact

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