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REPLY FROM FINLAND. GREEN PAPER ON THE INSURANCE OF NATURAL AND MAN-MADE DISASTERS

On 16 April 2013 the European Commission published a Green Paper on the Insurance of Natural and Man-made Disasters (COM[2013] 213 final). The Green Paper, which deals with the adequacy and availability of disaster insurance, states that the Commission's objective is to raise awareness and to assess whether or not action at EU level might be appropriate or warranted in a bid to improve the market for disaster insurance in the European Union. To this end, the European Commission sets out 21 questions in the Green Paper, which it asks the competent authorities to answer by 15 July 2013.

We wish to thank the Commission for the Green Paper, and think that its efforts to improve preparedness for disasters and help deal with the consequences are worthwhile.

We think that optional insurance policies must be seen as the prime method of preparing for specific natural and man-made disasters. We do, however, think that the natural phenomena and natural catastrophes highlighted in the Green Paper are very country-specific, which is why it may be difficult to find a common approach to disaster insurance that takes account of the conditions that obtain in all the Member States. Flexibility of Member State regulation is important to ensure that local conditions and needs are taken into account to a sufficient extent. We thus do not think it necessary, or indeed possible, to create a fully harmonized insurance approach or legislation at European Union level. Instead, efforts should be made to establish transparent and clear principles for the use of EU funds in disaster scenarios.

In general terms, we would say that the clear identification of insurable risks and avoidance of moral hazard are preconditions for the development of the insurance market. We would also point out that the Green Paper does not define what is meant by "disaster". It may, however, prove problematic to draw an exact line between natural phenomena that are considered normal and natural disasters. In addition, it should be borne in mind that, in terms of insurance law, the points of departure for natural and man-made disasters differ in that natural disaster insurance deals

primarily with property insurance, where insurance in the case of man-made catastrophe additionally deals with insurance against civil liability.

Herewith our replies to the questions set out in the Commission's 's Green Paper:

What is your view on the penetration rate of disaster insurance in the European Union?

Please provide details and data to support your arguments. Is more research needed to understand any possible gaps in insurance supply and demand, insurance availability and coverage?

In Finland, the most common forms of natural disaster are storms and floods. In the case of storms, the insurance market has been able to meet risks, and storm damage is sufficiently covered by home, farm and property insurance. Likewise, flood damage is increasingly well covered by these types of insurance. The situation will change when a law comes into force in early 2014 repealing the Act on the compensation of exceptional flood damage, the purpose of which is to update protection based on private indemnity insurance for buildings and their contents in respect of flood damage. Finland has not previously had generally available insurance products that would feature protection to compensate for damage to buildings and their contents caused by flood water. During the preparatory work done jointly by the insurance industry and other stakeholders to reform the indemnification system, the possibilities were also explored of enhancing the availability of flood insurance protection by legislative means. The preparatory work resulted in a minimum level of insurance protection being defined which, once implemented, would allow for State funding to be dispensed with whilst maintaining compensation protection at its current level. Because different types of insurance were available and, according to information received from insurance companies, more were coming onto the market, it was established during the preparatory work for the law that updating these types of insurance products in Finland did not call for specific legislation.

We think that, in addition to research concerning shortcomings in the availability of insurance, the industry also needs research into when particular natural phenomena should be classified as natural disasters. In addition to defining what constitutes a natural disaster, it should also be determined when there is in fact justification for insuring property against the risk of disaster. Definition of disasters also raises the question of the role of the State. In this regard, one crucial matter is to determine when a phenomenon should cause the State to act.

2) What further action could be envisaged in this area? Would mandatory product bundling be appropriate as a way of increasing insurance cover against disaster risks? Are there any less restrictive ways, other than mandatory product bundling, which might be appropriate as a way of increasing insurance coverage against disaster risks?

3) Which compulsory disaster insurance, if any, exists in Member States? Are these insurance products generally combined with compulsory product bundling or obligation for insurers to provide cover? Is compulsory disaster insurance generally accompanied by a right for the customer to opt out of some disaster risks? What are the advantages/possible drawbacks? Would EU action in this area be useful?

Finland is not in favour of mandatory product bundling or compulsory disaster insurance.

Compulsory insurance may have a number of adverse effects, such as a reduction in competitiveness and an increase in the cost of the insurance system. Also, since the risks of natural disaster vary greatly between Member States, harmonised compulsory insurance at EU level or making the

bundling of certain products obligatory cannot be considered expedient ways of proceeding. In our view, insurance coverage against disaster could be increased not by the compulsory bundling of products or compulsory insurance but by organizing a public debate on preparing for disasters and on the role of the various players involved in such preparations. One thing that remains crucial is the division of tasks between insurance companies and the State in preparing for disasters.

The environmental damage insurance in use in Finland is a secondary obligatory insurance. Pursuant to the Environmental Damage Insurance Act (81/1994) compensation is paid for environmental damage within the meaning of the Act on Compensation for Environmental Damage (737/1994) caused in Finland by operations in Finland, and for the costs arising from the prevention of such damage and from reinstating environmental damage. Compensation is payable where it has not been possible to recover such compensation in full from the liable party, i.e. the party who is liable for compensation of damage pursuant to the Environmental Damage Insurance Act and compensation cannot be obtained from the liable party's liability insurance, or where it has not been possible to identify the liable party. Environmental damage insurance must be taken out by all private-law bodies whose operations carry a significant risk of damage to the environment or whose operations generally cause damage to the environment. Compliance with the insurance obligation is monitored by the Centres for economic development, transport and the environment. The Environmental Damage Insurance Act has not in practice proved necessary in view of the very small number of damage compensation cases, nor is it able to cover all problems caused by, for instance, orphan damages. The law needs developing in terms of, for instance, its scope.

4) How can state or state-mandated disaster (re-)insurance programmes be designed and financed to prevent the problem of moral hazard?

We are not in principle in favour of creating new state or state-mandated disaster (re-) insurance programmes.

Should, however, we end up with such state-mandated schemes, the compensation payable under such schemes or any restrictions regarding compensation should be clearly defined in advance. Schemes should also be for a fixed term. The advantage of having fixed-term schemes, and of reviewing them from time to time, would be that the public sector could withdraw from a project if the conditions for public involvement no longer obtained.

Furthermore, the types of insurance offered under these schemes should be priced according to risk. The moral hazard problem could be prevented, for example, by insurance schemes rewarding certain types of precautionary or protective measures to safeguard against damage caused by disasters. Insurance schemes should also feature high excesses.

5) Do you see any difficulties, barriers or limitations in using information to generate parametric insurance? What factors might scale-up the promotion and uptake of such innovative insurance solutions?

We think that parametric, index-based insurance could be a viable option for the compensation of damage caused by exceptional weather conditions. One particular argument in favour of using parametric insurance is that these types of insurance are sector-independent, making it easier to offer insurance on a cross-border basis too. Parametric insurance is also fairly cost-efficient, as no

loss adjustment needs be carried out in the event of damage occurring. On the other hand, the often formalistic nature of parametric insurance can cause problems.

One argument in favour of developing parametric, index-based insurance, is that schemes of this type do not suffer from adverse selection of policyholders as other types of optional insurance schemes do. However, non-symmetric information makes individual pricing almost impossible, which may make insurers less willing to develop index-based insurance products.

6) Could risk-based pricing motivate consumers and insurers to take risk reduction and management measures? Would the impact of risk-based pricing be different if disaster insurance were mandatory? Do insurers in general adequately adjust premiums following the implementation of risk prevention measures?

We think that risk-based pricing encourages consumers and insurers to take steps to reduce and manage risk. The impact of risk-based pricing would be correspondingly different if disaster insurance were obligatory, as consumers would not then be motivated to take steps to reduce damage risks. In Finland, the adjustment of premiums following implementation of risk prevention measures is more common in business insurance than in insurance aimed at consumers.

7) Are there specific disasters for which flat-rate premiums should be suggested? Should flat-rate premiums be accompanied by caps on payouts?

8) What other solutions could be offered to low-income consumers who might otherwise be excluded from disaster insurance products?

We do not think flat-rate premiums a viable alternative for any type of disaster insurance. We would emphasize the importance of product development in securing the availability of disaster insurance products. If insurance product excesses are sufficiently high, the prices of insurance products generally remain reasonable. If need be, governments may also support restoration measures, e.g. by granting low-interest loans to consumers.

The status of low-income consumers in Finland is generally secured by means of social protection and income support, which is last-resort financial support in the field of social assistance. The purpose of means-test income support is to safeguard the income of an individual/family and promote independent living. If need be, emergency housing and other temporary contingency arrangements for disasters protect individuals during disaster situations.

9) Is there a case for promoting long-term disaster contracts? What would be the advantages/drawbacks for insurers and insured persons respectively?

We think it likely that if insurance products for natural disasters work sufficiently well and are sufficiently attractive, there will be market demand for them. In our opinion, there is no need to promote the use of long-term disaster insurance schemes.

10) Do you think there is a need to harmonise pre-contractual and contractual information requirements at EU level? If so, should the approach be full or minimum harmonisation? What requirements concerning the commitment should be included, for instance:

- the nature of the insured risks,
- adaptation and preventive measure to minimise the insured risks,
- features and benefits (such as compensation of full replacement costs, or depreciated, time value of assets),
- exclusions or limitations,
- details for notifying a claim, for instance, if both the loss and its notification must fall within the contract period,
- who and to what extent bears the costs of investigating and establishing the loss,
- contractual effects of a failure to provide relevant information by the insurer,
- the remedies, costs and procedures of exercising the right of withdrawal,
- contract renewals,
- complaints handling?

We have reservations about harmonising pre-contractual and contractual information requirements at EU level. Harmonisation of requirements would be a very demanding process, particularly since disasters and the likelihood of their occurring vary greatly from country to country. If we do, however, end up deciding to proceed with the harmonisation of such information, there could only be a question of minimum harmonisation. We think that national consumer and/or insurance supervisory authorities also have their own role to play in supervising the transparency and clarity of insurance contracts.

11) Do deductibles, excesses, co-insurance and other exclusions effectively prevent moral hazard? What alternative terms and conditions might be appropriate for disaster insurance, given that the insured party may be unable to take effective risk reduction measures against a disaster?

The methods mentioned in the question can effectively prevent moral hazard.

12) How could data on the impacts of past disasters be improved (e.g. by using standard formats, by improving access to and comparability of data from insurers and other organisations)?

13) How could the mapping of current and projected/future disaster risks be improved (e.g., through current EU approaches in flood risk mapping under the Floods Directive 2007/60/EC, civil protection cooperation and promotion of EU risk guidelines)?

14) How could better sharing of data, risk analysis and risk modelling methods be encouraged? Should the available data be made public? Should the EU take action in this area? How can further dialogue between the insurance industry and policy-makers be encouraged in this area?

We think that "soft law" regulation of the exchange of data between operators might help promote the exchange and/or comparability of data. The insurance sector should be encouraged to collect and transmit disaster data that are as accurate and comparable as possible.

Finland already has a number of different databases relating to the subject matter in question, but access from the outside is not possible because of data protection considerations. Likewise, for competition reasons, insurance companies may not necessarily be willing to share the data they hold. The channelling of public resources into data collection and into the operations of research bodies should solve these problems.

15) How can the Union most effectively help developing countries create solutions for financial protection against disasters and shocks, and what should be the priority actions? What types of partnerships with the private sector and international institutions should be pursued for this purpose?

The OECD is currently carrying out similar research into developing countries and climate change (including its Work on Adaptation to Climate Change, April 13th), which it might also be possible to use in EU decision-making. The OECD has analysed, amongst other things, the extent to which the private sector could participate in the development of adaptive activities to prevent climate change and the role the public sector can play in promoting private measures.

16) What are the most important aspects to look at when designing financial security and insurance under the Environmental Liability Directive 2004/35/EC?

17) Are there sufficient data and tools available to perform an integrated analysis of relevant and emerging industrial risks? How can data availability, sharing and tool transparency be ensured? How can co-operation between insurers, business and competent authorities be strengthened to improve the knowledge base of liabilities and losses from industrial accidents?

The Environmental Liability Directive covers environmental restoration, not the indemnification of economic losses caused by environmental degradation by the payment of compensation. In such cases, the government is responsible for deciding on the level of restoration and the amount of funds needed, rather than the terms and conditions of insurance drawn up by private insurance companies. Because each incident is different, a general and rigid system is not appropriate, nor can it resolve practical problems. Account should also be taken of the fact that there are major differences between stakeholders. Again, we are against obligatory insurance in this sector.

Efforts must be made to expand the knowledge base of industrial risks by various means, thus creating the conditions for cooperation between public authorities, insurers and enterprises and for the exchange of data between them.

18) Considering the specificities of the offshore oil and gas industry, what kind of innovative insurance mechanisms might be appropriate? Can the insurance industry reduce uncertainty regarding the assessment of risks and calculation of premiums? What type of information should be publicly available to promote the development of insurance market products to cover major accidents?

19) Should contractual conditions of third-party liability insurance policies be disclosed to third parties in the case of man-made disasters? If so, how?

Under certain circumstances it should, we think, be possible to disclose contractual conditions of third-party liability insurance policies to third parties. What could be more problematic, however, is deciding on what details of contracts generally tailor-made for companies should be disclosed to third parties. Contractual terms and conditions might include, for instance, data that are deemed to constitute business secrets. It should also be noted that the right to compensation is not contingent on an agreement between the company that caused the damage and an insurance company, but is decided on in accordance with national damage indemnification legislation. What therefore would we hope to achieve by making contractual conditions publicly available?

20) Are there specific aspects of loss adjusting which would benefit from more harmonisation? If so, which? Are there practical difficulties for loss adjusters to operate cross-border?

We do not think it appropriate to further harmonize the procedure for loss adjustment.

21) This paper addresses specific aspects relating to the prevention and insurance of natural and man-made disasters. Have any important issues been omitted or under-represented? If so, which?

Terrorism as a possible contributory factor to a man-made disaster has not been taken into account.