



ABI response to the European Commission Green Paper on the insurance of natural and man-made disasters

The UK Insurance Industry

The UK insurance industry is the third largest in the world and the largest in Europe. It is a vital part of the UK economy, managing investments amounting to 26% of the UK's total net worth and contributing £10.4 billion in taxes to the Government. Employing over 290,000 people in the UK alone, the insurance industry is also one of this country's major exporters, with 28% of its net premium income coming from overseas business.

The ABI

The ABI is the voice of insurance, representing the general insurance, protection, investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK.

The ABI's role is to:

- Be the voice of the UK insurance industry, leading debate and speaking up for insurers.
- Represent the UK insurance industry to government, regulators and policy makers in the UK, EU and internationally, driving effective public policy and Regulation.
- Advocate high standards of customer service within the industry and provide useful information to the public about insurance.
- Promote the benefits of insurance to the government, regulators, policy makers and the public.

The ABI's registration number on the European Commission's Register of Interest Representatives is **730137075-36**.

1) 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?

The penetration rate of disaster insurance in the EU varies from Member State to Member State. This reflects, amongst other things, the diversity of risks against which people and business may need to protect themselves, and the variety of national governmental programmes that are available to citizens and business in case of disaster.

For instance, in the UK, the penetration rate of insurance against volcanic eruption is extremely limited, reflecting the fact that the UK is not at risk of suffering from volcanic eruption. In contrast to this, flooding penetration rate is extremely high – indeed, flood insurance is an integral part of property insurance, which is demanded, for example, by banks when a mortgage is taken out to purchase a property.

To our knowledge, there is no evidence of a gap in insurance supply and demand, or insurance availability and coverage. We do not believe that there is need for more research in this matter. Instead, we believe that more efforts should be put into enhancing insurability. This could be achieved by increasing the steps that individuals and businesses, national



governments and the EU take in order to ensure accurate prevention and preparedness against disasters.

2) What further action could be envisaged in this area? Would mandatory product bundling be an appropriate way to increase insurance cover against disaster risks? Are there any less restrictive ways, other than mandatory product bundling, which could constitute an appropriate way to increase insurance coverage against disaster risks?

Product bundling is already an area under intense scrutiny in other EU initiatives, such as IMD II and we should not anticipate the outcomes of those deliberations.

It is our firm belief that product design and product bundling should remain a free market option, and not be mandated. Mandating product bundling would be to the detriment of consumers, leaving them with less choice, because innovation would be stifled and competition reduced. Where it is appropriate (for instance, due to the wide spread of the risk involved) and where it is driven by consumer demand, bundled products will develop and flourish in a free market.

For instance, in the UK, without any legislation dictating product bundling, insurance against a variety of natural perils such as floods, storms and earthquakes has been bundled into property insurance over the last 60 years. This reflects the fact that spreading the risk among all the insured persons is, in this case, best for the consumer, these risks in general being widely dispersed across the UK. While this works very well in the case of flood insurance, this may not be the case with other insurance products against other natural catastrophe risks particularly risks that are extremely location-specific, such as volcanic eruption.

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?

To the best of our knowledge, there is no compulsory disaster insurance in the different Member States.

We do not see any benefits to introducing any form of compulsory insurance. First, as mentioned in the answer to the first question, there is no evidence that there is any problem that needs to be addressed; no evidence has been put forward to suggest that action is needed; indeed the UK market shows that high penetration rates can be achieved without any form of compulsion. Second, as expressed in the response to the second question, mandating product bundling would only hurt consumers, by reducing the choice of products that are available to them.

We believe the most important action the EU can take is to encourage measures for prevention and adaptation.

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



Mandated disaster (re-)insurance programmes would increase the problem of moral hazard. Furthermore, depending on the design, state or state-mandated disaster (re-)insurance programmes could discourage the take-up of private insurance reduce the ability to use insurers' expertise to identify, assess and mitigate the risks.

Member States should increase their work on prevention and adaptation. They should also raise awareness of the risks that citizens and businesses face and promote awareness of the insurance products that exists to cover these risks. This will enable citizens to make informed choices about the cover they need and help them ensure they are not underinsured.

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

We do not believe that parametric insurance can be used in all Member States. For instance, parametric insurance is not widely used in the UK. While parametric insurance might bring some advantages, it is worth noting that it also poses significant problems, for instance by establishing a poorly correlated link between insurance claims and actual losses. In other words, a situation where claims either exceed (not efficient) or are not sufficient to meet (which is bad for consumers) the actual losses incurred.

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 was mandatory? Do insurers in general adequately adjust premiums following the implementation of risk prevention measures?

As stated above in response to the other questions, we believe that disaster insurance should not be mandatory.

Risk-priced insurance is the correct approach in the majority of situations. It is economically efficient, and it incentivises individuals to take pro-active measures to reduce their risk, or to put pressure on Governments to do so. In turn, the management of flood risk does lead to insurers adjusting the premiums, as it is in their interest to reflect flood risk in premiums as accurately as possible in order to gain a competitive edge.

However, there are other circumstances where risk-based pricing should sit in a framework that protects those individuals who are at the highest risk and could, therefore, be unable to afford the cover they need.

For instance, in the case of flood insurance in the UK, we believe that a completely free market based solely on risk-based pricing could have negative consequences on those most at risk, with over 200,000 households facing a struggle to access affordable home insurance. Therefore, we are currently looking at implementing in the UK a new framework for flood insurance, known as Flood Re.

Flood Re would be established as a non-profit entity to which insurers could reinsure any domestic flood policy at an (affordable) set price which varied by the Council Tax band¹ of the property. These 'set' premiums would be complemented by an annual £180m levy on the industry (based on domestic property insurance market share), which equates to an average

¹ More information on Council Tax in the UK can be found at <https://www.gov.uk/browse/housing/council-tax>



of £10.50 per household. In this sense Flood Re effectively introduces flat rate premiums for those at the highest flood risk and funds this from the whole market. However the vast majority of households (~98%) would still pay premiums that reflect the flood risk they face.

On June 27th 2013 the UK Government and the ABI announced a Memorandum of Understanding to take Flood Re forward as the preferred option for implementation by the summer of 2015.

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

There is a wide diversity of perils and markets across the different Member States. In some markets, risk based pricing might work best, in others it will be a case of public private partnerships, in others it will be a case of flat-rate premiums - each market needs to find what works for their set of circumstances.

For the UK market, we do not believe that flat-rate premiums would present benefits in general. As they remove the link between the risk insured and the premium, they raise the likely impact of moral hazard, as individuals are not incentivised to take risk preventative measures to lower the risk. In the case of the 'Flood Re' proposition mentioned in the previous question, we are proposing a degree of flat-rate pricing by effectively setting a maximum cap on the flood premium (although around 98% homes will end up being risk priced below this level). Flood Re would aim to reduce moral hazard around housebuilding by excluding newly built properties from support – it would only be available to homes built before 2009.

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

In the UK, we have proposed a model, Flood Re (see Q6), which would enable low-income consumers at high flood risk to access affordable flood insurance. It achieves this through linking the premiums charged to a proxy for ability to pay (in this case, the Council Tax band of the property).

However, no one size fits all, and the needs (and expectations) of consumers in each member state are different, and best addressed by the national competent authorities that are closest to those customers.

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

The costs of introducing long-term disaster contracts would outweigh the benefits.

Long-term disaster contracts (multi-year contracts) are extremely problematic for insurers and for customers. For consumers, they reduce choice, and are likely to increase cost. Annual policies mean individuals can switch providers, shop around to find the policy that best suits their needs. For insurers, they decrease the control they have over their portfolio. Overall, the outcome would be reduced competition in the market and potentially increases in rates as a result.

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 prevention measures 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 believe there is no need to harmonise pre-contractual or contractual information requirements at EU level. There is no evidence to suggest that this would be necessary. Indeed, this would only have negative consequences, because it would fail to acknowledge the differences that exist currently across Member States. For instance, it would fail to recognise the diversity of legislative frameworks (including civil law) and regulatory requirements, the diversity of the liability and competition regimes, the diversity of the nature, particularities and capacity of the different insurance markets, the diversity of customer requirements etc.

Following the adoption of the Insurance Mediation Directive (IMD) in 2002, the UK regulator rolled out similar requirements for the UK, but found there was no benefit for consumers, and that in fact it simply increased administrative costs for insurers, which were inevitably passed on to the consumer in premium prices. There is also a danger that when mandating the content of pre-contractual documentation, important information for specific product types may be overlooked. We believe it is better for insurers to bear responsibility for determining which information is important for the consumer to be aware of. Both Solvency II and the Insurance Mediation Directive already contain a number of pre-contractual information requirements, and we believe these are sufficient.

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

Deductibles, excesses co-reinsurance and other exclusions help mitigate moral hazard and they are, alongside other issues, part of the discussion that individuals have with the insurer to ensure the most appropriate terms and conditions are reached. For instance, the insurer may be able to advise the individual on adaptation measures that can be taken to reduce the risk. For those adaptation measures that cannot be taken by the individual, more needs to be done to encourage the relevant Member State to take the needed steps to reduce the risk. Again, we would like to reinforce that the focus of Member States, and the EU, should be encouraging prevention, preparedness and taking the appropriate adaptation measures. Prevention is better than cure.



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

One of the most effective ways to improve the data on the impacts of past disaster is to ensure that there is a free, transparent and timely flow of information from Member State authorities to insurers and other entities that help prevent and mitigate the risk, and that help those affected by the risk to recover.

Some of the data about the impacts of past disasters should also be made public so that individuals' awareness of the risk they face and of the right level of cover they need is increased.

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,29 civil protection cooperation³⁰ and promotion of EU risk guidelines³¹)?

Investments should continue to be made to ensure that the authorities responsible for mapping disasters are able to use the latest technology. When mapping these risks, we would encourage national authorities to consult with all stakeholders who use these maps (including insurers) to ensure the right data is captured in the right way. This would enable all stakeholders to contribute their expertise from the beginning of the process.

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 insurance industry and policymakers be encouraged in this area?

The EU should ensure that any legislative proposals in other areas do not hinder the sharing of data in this respect. For instance, careful consideration must be given to the data protection regulation proposal that is currently being scrutinised in the European Parliament and in Council, to make sure that there are no unintended consequences on the ability to collect, use and share data that is necessary for the assessment of risk.

15) How can the Union most effectively help developing countries to 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 the international institutions that should be pursued for this purpose?

There is no one-size-fits-all solution to the risk management of disasters. While developing countries might have some common features, we encourage the EU to evaluate the situation in each of the countries concerned, as each country is likely to require different solutions. As a first step, we believe the EU should help raise awareness of the multitude of solutions present in Member States, which will enable developing countries to see the advantages and disadvantages of the systems in place in the different Member States.

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

It should be noted from the outset that natural catastrophes and man-made disasters are two very distinct categories of risks. Furthermore, discussions on the ELD should not be integrated in the discussions on the traditional natural catastrophes liabilities.



The main challenge in covering environmental risks remains the fact that ELD products are relatively new. Identifying and quantifying the risks is problematic because ELD accidents are likely to occur extremely rarely (providing very little historical data on which to build) but the possible impact level is likely to be extremely high (this is made worse by the unclear term 'baseline condition' in the ELD).

Crucially, it is important to highlight that while environmental liability is a relatively new market, knowledge of these risks is gradually developing. The insurance industry needs time to continue to develop their understanding of environmental liability risks. As with any new strand of risks that the industry is learning to cover, it is essential that enough time is given for the legislation to bed down. We therefore believe the ELD should not be reviewed or amended. As ELD products continue to grow and diversify, a voluntary ELD market remains best suited for the variety of risk exposures existent across Member States.

The EC should continue to facilitate cooperation, such as the useful regular ELD workshops currently being organised by the Commission.

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 data and tools available to perform an integrated analysis of relevant, and emerging, industrial risks is improving daily. As noted above, one of the most effective ways to improve the data on the impacts of past disaster is to ensure that there is a free, transparent and timely flow of information from Member State authorities to insurers and other entities that help prevent and mitigate the risk, and that help those affected by the risk to recover.

It is worth noting that, because of pre-existing legislation in some Member States, environmental accidents tend to be reported under this relevant national legislation rather than under the ELD. This may lead to poor ELD data collection by the authorities, which, in turn, might lead to incomplete data being gathered or data across Member States not being comparable. It would be useful if there was greater clarity as to when reporting should be under the ELD rather than other legislation.

Furthermore, the EU should ensure that any legislative proposals in other areas do not hinder the sharing of data in this respect. For instance, careful consideration must be given to the data protection regulation proposal that is currently being scrutinised in the European Parliament and in Council, to make sure that there are no unintended consequences on the ability to collect, use and share data that is necessary for the assessment of risk.

18) Considering the specificities of the offshore oil and gas industry, what kind of innovative insurance mechanisms could be appropriate? Are there ways for the insurance industry to reduce the 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?

While the offshore oil and gas industry does pose some uncertainties for assessing risk (for instance, it is nearly impossible to assess the possible damage to biodiversity in offshore



regions), there is no evidence to suggest that the current insurance availability is unsatisfactory.

Insurance has a part to play in covering risks associated with the offshore oil and gas industry, but it must be recognised that insurance cannot provide a complete solution to this type of problem. For instance, the costs that have been associated with the 2010 Gulf of Mexico oil spill (Deepwater Horizon) could not have been covered solely by the insurance industry because the costs exceed the overall insurance market capacity. A requirement for offshore participants to purchase insurance or other financial cover at levels reflecting the full cost of Deepwater Horizon could prove damaging to the competitiveness of the oil and gas sector as any lack of insurance capacity may result in only the very largest companies able to secure the required financial security from their own resources. Moreover, it would not be sensible to create a situation whereby the liability should be passed from an entity whose financial resources are larger than those of even the biggest insurers (BP) to a different financial entity which has more limited resources (an insurer). It seems perverse to transfer the risk from very robust entities such as major oil companies that have a great loss absorption capacity.

Insurance can be useful to cover, in part or in full, several types of liabilities that are involved in an offshore oil and gas incident, through the different markets – environmental, personal injury, business interruption, property damage – but it cannot be seen as a solution that could cover all possible risks, up to an unlimited value. Any insurance will be subject to terms and conditions, including exclusions, at a premium that the underwriter views as reflecting the risk, but that a client may not be willing to pay, with limits on the amounts that can be recovered in the event of a claim. The product will reflect factors such as the insurer's capacity, reinsurance availability and the regulatory regime under which the insurer operates, including rules on solvency.

Furthermore, it is worth noting that the offshore insurance market is not a European market, but a truly global market. EU waters are not only threatened by offshore activities within the territorial waters of EU member states. Therefore, any efforts to enhance the liability regime for the offshore oil and gas industry, or to look at related financial instruments, should not take the ELD as a starting point. Current legal arrangements regarding compensation for traditional damage caused by accidents on offshore installations are sufficient and the Offshore Pollution Liability Agreement (OPOL) is a proportionate and reasonable approach to the determination of liability and of financial responsibility in the event of an offshore pollution incident.

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

As far as we know, there is no evidence to suggest that there is a problem that could be addressed by increasing information disclosure. We do not agree that there should be a general requirement to disclose details of liability insurance policies to third parties in the case of man-made disasters.

Not only do we not see any benefits to introducing this, but we believe this would go against the polluter pays principle, as it would allow the polluter to transfer entire responsibility for any legal action to their insurer; making it easier for the polluter to avoid being held responsible for any wrongdoing, thereby increasing moral hazard. The polluter pays principle is a fundamental pillar of EU legislation in this area, and we believe this should be maintained,



strengthened and not weakened by proposals such as the a general requirement to disclose details of liability insurance policies to third parties in the case of man-made disasters

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 believe that greater harmonisation of loss adjusting would be beneficial. The differences in loss adjusting practices reflect the different legal, regulatory and taxation regimes in the different Member States, as well as a variety of market practices and risks covered. Therefore, it is hard to see how loss adjusting could be harmonised further.

More importantly, we do not believe there is any evidence to suggest that there is a problem that needs to be fixed by harmonising loss adjusting. There are a limited number of circumstances where individuals or businesses require cross-border expertise of loss adjusting, and, where that is the case, there are specialist loss adjusters who are able to provide the required services.

21) This paper addresses specific aspects related to the prevention and insurance of natural and manmade disasters. Have any important issues been omitted or underrepresented? If so, which?

There are no other specific areas that should have been covered.

However, we would encourage the EC (and Member States) to give more prominence to the importance of prevention and preparedness in relation to natural catastrophes.

We also urge policymakers to ensure that any future policy acknowledges the different types of liabilities (natural vs man-made disasters, industrial vs ELD vs offshore liabilities etc)

**Association of British Insurers
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