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GREEN PAPER ON THE INSURANCE OF NATURAL AND MAN-MADE DISASTERS

(European Commission, 16 April 2013)

ANIA's replies to the questions in the Green Paper:

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?

It should be remembered that penetration rates in the EU vary between Member States, not to mention differences within the same country in terms of the different insurance markets (in particular the difference between home insurance and insurance for commercial property). The reasons for these differences are varied and well known. They may depend on legislation, the presence or absence of insurance systems providing for State participation, the nature of the disaster risks to be insured and the prevailing prevention/insurance culture. In general, the penetration rate for more frequent events (e.g. storms and hail) is higher than for less frequent disasters (e.g. earthquakes and flooding), and the distribution is concentrated in those areas where the risk is actually perceived. It should be noted, furthermore, that cover for earthquakes and flooding requires large reserves of capital, not always easily available to operators. However, it is important to emphasise that today's greater availability of data and the opportunity to use simulations to model disasters of this kind are contributing, on the one hand, to the development of the insurance market's risk assessment ability and thus the possibility of drawing up a range of products in line with needs, and, on the other, to raising awareness of and thus demand for such cover.

In any event, as the OECD also recommends,¹ it is important for there to be sufficient disaster insurance products available so that the penetration rate can be increased and households and companies can become less vulnerable to the potential losses caused by natural disasters. Any research to better understand possible gaps in insurance supply and demand can be useful. It is important that this be done at the level of individual countries, for the reasons outlined above.

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?

More trenchant action to increase the proportion of properties insured against natural disasters would probably require legislative intervention (e.g. fiscal incentives on premiums, or the development of a public-private insurance system). Marketing insurance cover against natural disasters by way of multi-risk products not only meets the need set out in the Green Paper to diversify risks, but also has another positive aspect, namely focusing the insurance-related expenses (management and administration costs, etc.) on a single contract which is intended to cover all risks. This would make the market more efficient (by avoiding the duplication of costs

¹ *OECD – Good practices for mitigation and financing catastrophic risks- December 2010.*

if every risk were covered by an individual policy). It goes without saying that the efficiency of the market depends on many factors, so we should avoid any mandatory product bundling and let the market find the most effective and efficient solutions.

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?

Disaster insurance is not compulsory in Italy. The penetration rate for disaster insurance cover for private dwellings is low, while the market for cover for commercial property is fairly well developed. The reasons for the lack of cover for private dwellings vary and include the tradition of relying on the State for support after a disaster, the lack of incentives on disaster insurance premiums, the risk of not being accepted if a customer is considered to be in an at-risk geographical area and the potential intensity of any disasters because of the vulnerability of many buildings. An EU recommendation to introduce measures to remove obstacles to cover for the private dwellings mentioned above could be useful. However, any EU guidelines would have to take into account the great differences in disaster risk exposure within the EU, letting the Member States define specific standards on the basis of their own needs and actual risk exposure.

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

The most effective solution, as suggested by the OECD, is to apply premiums proportionate to the risk so as to implicitly provide incentives for responsible behaviour, i.e. the adoption of preventive or risk reduction measures. Moreover, to prevent moral hazard, insurance schemes should be designed with the application of excesses, deductibles and legal minimum limits so that policyholders also participate in the risk, as well as insurance schemes that provide cover only to local authorities that adopt minimum prevention measures (like the National Flood Insurance Program in the USA). Still drawing inspiration from the OECD, governments could adopt forms of transparent subsidies so as to create greater mutuality without artificially low insurance premiums in order to facilitate access to cover for poorer households or areas at high risk.

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?

Parametric insurance could be useful in certain cases, for example where the State or a representative organisation wishes to guarantee that it has proper protection (in terms of an amount of capital linked to the intensity of the event) to finance emergency measures or macroeconomic subsidies associated with a disaster. There remains the problem of the lack of intensity data published by third parties on which to base the parametric insurance.

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?

In a free market, insurance companies are motivated to set a price proportionate to the risk. Good practice in risk-based pricing is setting a rate which takes into account the main risk

factors (geographical area, type of construction, year of construction, etc.), the use of excesses and deductibles to raise policyholders' awareness of the need for risk prevention, and the possibility of a 'subjective adjustment' which takes into account particular risk prevention measures. A highly personalised level of pricing could involve significant costs for the insurer (for example, because of the cost of verifying actual vulnerability *in loco*), so it would not be worthwhile beyond the point where its cost becomes disproportionate compared to the expected benefit.

As the OECD affirms, premiums must be in proportion to the risk, without excluding mutuality arrangements to help areas most at risk and people on the lowest incomes, as stated above. It is technically easier to introduce levels of mutuality if insurance is mandatory.

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

A priori, this is impossible to evaluate, and the comments made in response to question 6 apply here too. The use of a flat-rate premium could be sensible in cases where it is not possible to determine a classification of various risk profiles. Any caps on pay-outs would obviously allow insurance companies to control their risk exposure better, while at the same time making policyholders more responsible.

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

As confirmed by the OECD, transparent subsidies in favour of low-income consumers financed by contributions from higher-income ones could be envisaged. Solutions of this kind could certainly fit within a mandatory or semi-mandatory public/private system.

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

Let us remember that the problem with multiannual disaster insurance policies is that it is difficult to take into account any variations (positive or negative) to the risk assessment over time. For this reason, a longer-term contract is likely to be pricier than a contract where premiums are adjusted annually, because of the uncertainty concerning future risks (e.g. as a result of climate change, the updating of the mapping of the phenomenon or the adoption of preventive or risk reduction measures), in addition to the fact that it would be difficult to find sufficient market capacity for a commitment over such a long period. The benefits for insurers include the potential for securing customer loyalty and the ability to mitigate the impact of sudden events by means of a more stable cash flow as a result of the collection of multiannual premiums. The duration of products should therefore, in our view, be left to the market.

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?

Almost all the elements listed in the question are already provided for under Italian law – most of it derived from EU law – in standardised contractual and pre-contractual information. For this reason, we do not think it is necessary for there to be any further EU-level harmonisation. However, it might be useful to harmonise the definitions (i.e. the characteristics of the insurable risks) of the various disaster events at European level, which could help in the development of more precise and effective risk models.

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?

In our view, deductibles and excesses have proved to be the most effective ways of mitigating moral hazard. It should not be forgotten, however, that co-insurance in the strict sense cannot be placed on the same level as other measures incorporated in insurance contracts; indeed, the use of solutions of that kind arises in particular as a result of the need to reduce individual companies' exposure to higher-impact risks. We take the view that it would be better to talk about additional, rather than alternative, terms and conditions. For example, requiring local authorities to take certain prevention and safeguarding measures as a condition for obtaining access to insurance instruments has proved to be an effective way of limiting moral hazard in various countries.

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)?

We note that publicly available data on past disasters are often not detailed enough (e.g. not making distinctions between damage to infrastructure, commercial property and private dwellings) and often do not record the intensity of the phenomena in question (e.g. the hydraulic head or the water level reached in the case of flooding). It would therefore be useful to harmonise the data on events so as to provide a certain level of detail (e.g. distinguishing the characteristics of the object damaged). In this regard, the EU's intervention to create minimum standards to which individual entities (insurance companies, States, evaluators) would have to adhere could be useful.

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).

The scientific community is unanimous on the need to apply simulation models based on the risk in question for estimating natural disaster risks. There are for-profit and non-profit initiatives developing such models, although it would be possible to obtain even better results through the creation of forums which, under the aegis of the EU institutions, could jointly develop models on the basis of the expertise of various experts in these fields. For example, it would be very useful to have damage caused by natural disasters ascertained and evaluated by experts so as to be able, over time, to perfect the vulnerability tables (the damage coefficients to be applied to the value of goods depending on the intensity of the event) to be applied to the simulation models, which have decisive consequences on the setting of premiums.

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?

See the replies to questions 12 and 13. As far as the insurance industry is concerned, there are already initiatives for the publication of pooled data (e.g. PERILS²).

It must be said that the publication of disaggregated data (individual reports) could interfere with an important competitive asset of individual companies. Nevertheless, insurance companies have always been very willing to share data. A very significant recent example is the decision of Eqcat Inc. and Risk Management Solutions Inc. to share a database model so that there is a uniform structure and sharing of input data between their software. This requirement arises from the fact that there are still various different mathematical models suggesting probabilistic risk scenarios which can be very different from each other which therefore compel insurance companies using such instruments for the definition of reinsurance agreements to make choices based on their own risk aversion rather than on more objectively reliable criteria. The insurance industry maintains very useful links with the civil protection authorities and the scientific community, which have a good overview of the country, access to large databases and technical and scientific capacity.

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 should be pursued for this purpose?

Certain joint initiatives between (re)insurance institutions have led to forms of micro-insurance³ or parametric insurance being offered, which have proven to be promising solutions. It is therefore vital not only to reduce the risks but also to raise the awareness of the political class and of citizens concerning the risks they face.

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

One of the most relevant aspects is the difficulty of fixing the price of insurance because the risk is little known and the insurance cover in question is not widespread in Italy. The lack of insurance cover for damage caused by pollution has many causes: the difficulty of developing an adequate database for the actuarial calculations needed by the insurance companies to analyse a disaster risk; the risk of being refused cover; the risk that, in many cases, the party responsible for the pollution is insolvent and that the clean-up costs will fall on the community and that third party victims will remain without compensation.

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?

There are some historical data but they are not enough to analyse emerging risks. The data

² A non-profit organisation based in Zurich which manages a participatory database of disaster events for various insurance markets.

³ Microinsurance programmes linked to financing provided by microcredit institutions in line with the principle that if every loan is insured against the risk of natural disasters, the clients, if such an event occurs, will be rapidly reimbursed, thus contributing to preventing contagion and strategic insolvency.

collected should also take account of non-insured losses and respect common standards so as to be mutually comparable. It would be useful to create standing inter-sectoral working groups in each Member State, dedicated to these issues (e.g. to collect information on any pollution events, by type of industry, with an indication of the cost of the clean-up and the damage caused to third parties, if not for past events then at least for future events, so as to be able to discuss the insurance and financial guarantees and the impact of environmental certification in the context of risk assessment).

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?

The insurance of offshore pollution risks must be treated differently to traditional industrial risks in terms of the technical profile, risk assessment, the type of damage, the maximum amounts needed to cover such risks and which may not be easily available, at sustainable cost, on the conventional insurance market. It is very difficult to reduce the uncertainty with regard to assessment, although it may be useful, given the huge sums involved, for information on the characteristics of the individual facilities to be in the public domain, applying risk assessment standards. We should also remember that some oil companies have sufficient assets to insure themselves .

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

The aim of third-party liability insurance is to protect the assets of policyholders from demands for compensation by third parties. It would therefore not be appropriate to disclose to third parties the conditions of such liability policies. Disclosing information of that kind could have undesirable consequences such as spurious demands for compensation from third parties which, although unjustified and therefore, ultimately, unlikely to be accepted, could nevertheless generate a great deal of undue administrative expense in the meantime.

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 see no need to harmonise this aspect.

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

We take the view that the Green Paper has addressed the main aspects of this matter.