



**European Commission**  
Internal Market and Services DG  
Financial institutions  
Unit H.5 – Insurance and Pensions

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Brussels, 15 July 2013

Dear Sir, Madam

The Federation of European Risk Management Associations (“FERMA”) welcomes the opportunity to contribute to the Green Paper on the Insurance of Natural and Man-made disasters.

We have done our best to provide the Commission with the position of our members, which are large companies who potentially face major disasters, natural or human-made. We have summarised in the attached document the answers to each question. Nonetheless, some high level issues seem not to be addressed by this questionnaire.

Generally speaking, as insurance buying and risk management professionals, our members do not see any reason for a mandatory framework to improve the insurance market capacities. The biggest and medium sized companies are already aware of their exposures in case of a major event. Their risk managers have, for a long time, pushed their managements to mitigate this risk, first by increasing technical defenses, improving processes and training the management how to handle crises, and then by buying insurance to be able to finance the damages, business interruptions and third party liabilities.

The insurance market capacity is often limited to 1 or 2 billion euros, although some clients (international companies) would like to find higher coverage. The different options, assessed in this green paper, do not seem to bring enough disruption so as to improve the capacity of the market.

Pools (and FERMA is very pleased to see that the EU Commission recognises that pools could be a good option for some large risks), mandatory insurance or public funds are already implemented in different EU countries. Whereas FERMA thinks it is important to consider how to improve market capacities, we think all the tools are already available in the insurance market. Member States could be encouraged to improve their systems based on a collection of best practices at EU level.

# FERMA Position Paper



Whatever the mechanism is composed of, one question is pending and does not seem to be addressed: which body would have the authority to decide whether an event qualifies as a major disaster at EU level?

Such a mechanism suggests that some events are more important than a catastrophic one recognised and decided at a national scale. Which criteria are going to be taken into account? How would it be possible to get a quick consensus through EU Member States to finance the damages in one or a few countries?

The green paper suggests neither any governance nor criteria for this decision. FERMA, as a representative of insurers' commercial clients, worries about the delay that these clients could have before this decision is made, and thus, before they will be able to claim from their insurers.

Our last point refers to the varying levels of expectations and regulations among different countries and activity sectors towards safety and security. If a mandatory mechanism is set up to cover disasters across the EU, it will be premature, because not all Member States have the same understanding of good safety and security requirements.

Some Member States with a high level of requirements for safety and security or companies implementing very high standards in their processes could react negatively if they think they will have to pay for countries or companies with lower standards in loss prevention.

This feeling could apply to both natural and human-made disasters, as both require the development of skills and technical responses as a business continuity investment.

A mechanism, if it is implemented or encouraged, must promote best practices as long as they are affordable, so reducing the impact of such disasters when they are implemented. The insurance market does well when it adapts premiums according to the quality of the risk management of each customer and a proper audit of the assets.

FERMA would be pleased to discuss further the views expressed in this paper with the relevant European institutions and would be glad to collaborate to any future initiative at EU level.

Yours sincerely,

Jorge Luzzi  
President



## DRAFT FERMA Response to the Green Paper on Natural & Man-Made Disasters

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Contact Person: Julien Bedhouche, FERMA EU Affairs Adviser, [julien.bedhouche@ferma.eu](mailto:julien.bedhouche@ferma.eu)

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## ▪ MARKET PENETRATION OF NATURAL DISASTER INSURANCE

- 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

European markets are very diverse and with very strong national business practices and cultures. Depending on your location, it is possible to find a general property insurance policy with a built-in extension for the NatCat risks. Market capacities exist but they remain difficult to compare because of a lack of standardised data on insurance penetration rates among Member States.

Differences in penetration rates might be explained by several reasons such as the presence of state-controlled systems, low demand, uninsurable risks and lack of maturity of the local insurance market.

## ▪ PRODUCT BUNDLING

- 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 could be seen as an interesting option for small to medium-sized companies because these policies may be more cost effective and easier to manage.

For larger companies which need flexibility in implementing their insurance strategy, it would not be an ideal solution as product bundling offers pricing that does not discriminate between different categories of risks and losses and does not reflect the efforts and investments made for risk prevention and control.

In both cases, product bundling should not be considered as a mandatory insurance product to increase coverage against disaster risks. It will not be seen as an incentive to build a risk management framework and process with an appropriate assessment of the company-specific risks. Companies must be able to fine tune their insurance strategy to optimise the costs of coverage. It could be interesting for example to have the possibility of an “opt out” from a NatCat bundle. Product bundling should remain a free market option.



## ▪ COMPULSORY DISASTER INSURANCE

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?

Spain with the *Consortio de Compensacion de Seguros* and France with the *Cat Nat* regime are two of the few EU Member States to have compulsory disaster insurance. When compulsory, NatCat cover is often bundled with more “traditional” compulsory policies like fire. It has the advantage that coverage is always provided.

On another hand, it is more expensive than any voluntary insurance solution, especially when the private market is mature and is working well. With no possibility to opt out, a company could not be rewarded for its efforts made towards risk management and control strategy.

Therefore, there is a moral hazard because it does not encourage companies to develop and implement risk control measures.

## ▪ DISASTER INSURANCE POOLS/ GOVERNMENTS AS (RE-) INSURERS AND (RE-) INSURERS OF LAST RESORT

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

State or state-mandated disaster (re-)insurance programmes should be designed to take into account the risk exposure and cover and the price adjusted to reflect this.

State programmes will always contain a degree of moral hazard and discourage the take up of private insurance. As practice has shown in Spain and France, such solutions tend to be rather more expensive than private market solutions.

Public risk management is also necessary and the Member States have the responsibility to develop public policies to reduce the magnitude of disasters through the adaptation of current and planned public infrastructure.

## ▪ PARAMETRIC INDEX-BASED WEATHER INSURANCE AND OTHER INNOVATIVE SOLUTIONS

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 suited for other regions on the globe but does not seem relevant for the European Union where the industrial base is so dense and spread all over the EU. The size, the diversity and the complexity of the risks at stake cannot be compared with the Caribbean or Pacific regions, mentioned as examples in the Green Paper, where there are a small variety and density of industries and a great frequency of natural disasters.

The level of data that would need to be collected and processed on an EU scale makes the parametric insurance option a potentially very expensive and uncertain one.

Innovative insurance solutions are a good idea as long as they are driven by insurance market initiative and with freedom of choice for companies.



- **DISASTER RISK AWARENESS, PREVENTION AND MITIGATION/ INSURANCE PRICING AS AN INSURANCE MARKET-BASED INCENTIVE TO PROMOTE RISK AWARENESS PREVENTION AND MITIGATION**

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?

Pricing for industrial insurance programmes including NatCat coverage is generally risk based. For some specific risks like earthquake or tornado, insurers can undertake site inspections to verify if adequate prevention measures have been undertaken and will adjust their pricing accordingly. Still, across the EU and depending on the local market maturity, there is sometimes very few risk-based pricing to reward the efforts made by companies and industry to reduce disaster risks like storm or flood.

Natural disaster risks and risk-based pricing must be connected to reflect the on-going efforts of companies and industry to adapt their sites to more frequent and more severe natural disasters due to a global climate change.

Mandatory insurance schemes have the opposite effect. The price is not linked with the risk exposure, thus it is expensive and does not promote a risk management culture.

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

Flat-rate premiums are only useful when no relevant statistical data on losses, locations, intensity or frequency can be collected to build a fair pricing for the coverage of the risk. It may be relevant for exceptional events with a very low frequency such as the meteorite blast over Russia in February 2013, the ash cloud in Iceland in 2010 or solar storms.

A flat-rate premium is not a risk-based premium, which is the basis for pricing industrial insurance programmes. They may also not provide sufficient revenues to build the financial capacity to cover the payment of potential claims, therefore leading to caps on pay-out.

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

Not relevant for FERMA

- **LONG-TERM DISASTER INSURANCE CONTRACTS**

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

Long-term disaster contracts are an interesting option which would require further analysis and feedback on the existing solutions. To be accurate, a multi-year insurance policy must rely on a deep assessment of the company management regarding the insured risk. A great level of experience and trust is necessary between the risk manager and the insurer to avoid underinsurance or overpricing.

To match the ever changing needs of companies, these contracts must be fully transparent and not exceed a 3 to 5 years period. More than 5 years would not really make sense with regard to the current state of the economy. In their favour, these contracts offer an opportunity to think and finance long term in economic times when companies are forced to look short term.



## ▪ PRE-CONTRACTUAL AND CONTRACTUAL INFORMATION REQUIREMENTS

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?

Large companies already benefit from policies with a high level of pre-contractual or contractual information, harmonisation of policy wordings across jurisdictions and common processes for claims notification and management. Because of the cross-border nature of their industrial client operations, main insurance carriers have already adapted and harmonised some large risks insurance policies across their European branches.

There is also the question of the pre-contractual or contractual information required from the insured company by the insurer. The level of information varies a lot in Europe and can range from a questionnaire in France to a policyholder's duty (in some circumstances) to give binding pre-contractual information to an insurer in the UK.

The contractual effects of what information is provided (Basis of Contract Clause) is a current "hot topic" with risk managers in some jurisdictions.

## ▪ INSURANCE TERMS AND CONDITIONS

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-insurance and other exclusions and policy conditions do contribute to minimise the moral hazard. These are standard insurance industry approaches which could be completed by a more transparent (with a clear indication of the rationale for these and their value in the premium) and rewarding pricing (with the net risk indicated in the premium).

Pricing should reflect as accurately as possible the efforts to adapt the company infrastructure in order to increase its resilience to disasters.



## ▪ DATA, RESEARCH AND INFORMATION

**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)?**

It is important to ensure for insurers and risk managers a free and equal access to NatCat data collected and processed by public entities. As insurance buyers for large businesses across the EU, risk managers need to access data on the amount of paid losses, reported damages or level of coverage at EU level and for specific areas where they operate. Many insurance carriers already make their data on natural and industrial disasters available to the public through their clients.

The collection and sharing of public risk data at EU level should be consistent through cooperation between Member States, insurers and risk managers in order to be comparable. Standard formats would contribute towards this. Data protection laws should be evolved accordingly to allow such a step forward.

**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) ?**

It is the responsibility of both Member States and insurers to cooperate and design tools that would compile NatCat data and to decide to what extent such a new database could be communicated to companies for future risk management purposes.

Because of their specific resources and powers, public authorities have a critical role to play in coordinating the mapping of NatCat risks throughout the EU. Only Member States can identify the high-risk areas like flood plains and prohibit the building of new properties or undertake heavy infrastructure adaptations in the public domain to prevent or minimise NatCat damage.

**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?**

Regarding the private data aggregated by insurers through their research efforts, it is important to preserve this competitive aspect to not discourage private investments into the development of technical tools to assess Nat Cat risks.

Nevertheless it is also fundamental to allow the EU to work with the Member States to create the basis for standardised and comparable data on NatCat on a European scale.





## ▪ PROMOTING RISK FINANCING INITIATIVES AS PART OF EU DEVELOPMENT COOPERATION POLICY

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?

Beyond providing advice based on how financial protection is working in Europe, the EU and the Member States have also a lot of expertise to share with developing countries. The establishment of an efficient public crisis management policy and a risk management system will set up better prevention and response measures regarding their risk and business continuity knowledge. It will also participate to reduce their risk exposure, for example through an appropriate legislation on urbanism, health and safety legislation and compliance, early warning systems, public staff training and the integration of these efforts with local companies.

Member States and the EU are already acting in the field of cooperation and should be able to provide this support to help these countries become more resilient when they face disasters.

## ▪ MAN-MADE DISASTERS/ ENVIRONMENTAL LIABILITY AND LOSSES FROM INDUSTRIAL ACCIDENTS

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

The Environmental Liability Directive (ELD) has been enforced by the Member States for 3 years now and some of them like Spain, France and the UK are just starting to develop an ELD expertise with mapping tools, for instance. It is time to consolidate and to share these practices, not to introduce new regulatory changes.

The ELD is challenging to enforce for national authorities because the Directive itself remains unclear on some key concepts such as the definition of the "baseline", i.e. the initial state of the area prior to the damage, or the "significance" threshold, i.e. the level of damage that would trigger the liability.

For insurers and operators, this uncertainty, lack of clarity and the absence of statistical data are making ELD risks quite challenging to insure even if innovative ELD insurance products are developed and known by the operators.

At this stage, a mandatory financial security would destroy the emerging ELD insurance market and impose unfair insurance conditions regarding the huge industrial diversity of the operators targeted in the Annex 3 of the ELD.

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?

Sharing data on emerging risks is not easy because there is no consensus around the definition of these risks and what they should encompass and by the fact that data on these risks will be limited. Therefore any analysis should be undertaken with care as it will represent one conception of an emerging risk over other ones and may be based on limited data and the "unknown".

Regarding liabilities and losses from industrial accidents, the treatment of this data is easier because it relates to "known" facts and data. The communication of this data should be structured at EU level to provide risk managers with a better basis for risk information and knowledge.



## ▪ OFFSHORE OIL AND GAS OPERATORS' LIABILITY INSURANCE

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 offshore oil and gas industry is covered by a specific insurance market which is operating globally. The EU based activities for which insurance is provided do not represent an important part of the worldwide market in terms of revenues.

The current pollution and third party liability coverage for the sector is not sufficient in term of capacities to meet demand. As a result, most companies partially or totally self-insure by setting up a captive.

It is highly doubtful that a regulation on an EU mandatory financial security or insurance fund

- would bring more financial capacities than what the global market is already able to provide on a voluntary basis;

- would be able to impose a requirement on capacity providers and insurers to sell a product that would encompass all disasters (wording exclusions...).

Mandatory insurance mechanisms on a European basis will not be an answer to protect Member States and victims. In addition there will be a moral hazard which would have the opposite effect as it would not be an incentive to build a risk management process to prevent disaster loss.

The focus should rather be set on certifying the operator's ability to operate in the safest conditions possible. This goes through a reinforced licensing regulation at EU level involving the demonstration that the operator has a continuous risk management system in place.

## ▪ INFORMATION RIGHTS OF VICTIMS OF MAN-MADE DISASTERS

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

When disaster happens, the liable company must face the consequences and provide for adequate compensation for the victims and their losses. Any company which is concerned about its responsibilities, the society in which it operates, its future and its reputation is fully aware of this.

The recovery of a company after a disaster should also be a concern at some point. To avoid a "deep pocket" syndrome, compensation must remain based on the suffered losses and liabilities and not the financial capacity of the defendant.

Disclosure to third parties of the private contractual conditions of third-party liability insurance policies in the case of man-made disasters could be seen in some countries as a forfeiture of basic rights. It would also mean disclosing the level of coverage and this may send the wrong message to third parties. It will contribute to biased litigation, unfair treatment and eventually a threat to the survival of the company, destroying jobs and industrial capabilities. In addition to that, what would be the real benefit for the third-party in terms of claims from this information disclosure? Are there really issues related to the lack of contractual information for third-parties?

Finally, it is reasonable to expect some difficulties to find coverage for third-party liability and rising premiums if such a disclosure should one day become binding.



## ▪ LOSS ADJUSTING

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?

In the EU, the loss adjusting profession is functioning through networks relying heavily on local expertise. This is necessary considering the great diversity in how national markets are operating according to their legal and regulatory environments, traditions, their customary habits, their language specificities or the way they define a disaster.

With the existing networks and the use of the freedom to provide services that allows operating cross-border for some specific disasters, it is very unlikely that the loss adjusters would benefit from an EU-wide harmonisation.

## ▪ GENERAL REMARKS

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?

The following matters could have been included:

- The role of Member States as the first public risk manager to build resilience to disasters is underestimated. Adaptation measures for roads, rivers, building regulations (including permits and safety standards), crisis management systems and public education can greatly mitigate the impact of natural or man-made disasters.
- In some EU-countries, the mandatory contribution for Natcat-coverage could be up to 20%. A reduction of this “tax” should be taken into consideration as it makes such coverage very expensive whilst at the same time it does not engage companies into solving problems arising out of NatCat.
- The question of terrorism as a man-made disaster: the insurability is challenging for companies operating EU-wide.
- The need for an EU-wide database on NatCat is underestimated and would be a necessary step before any move towards a mandatory financial security scheme.