EUROPEAN CENTRAL BANK
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Press release

24 April 2023

ECB and EIOPA call for increased uptake of climate catastrophe insurance

- Only one-quarter of EU climate-related catastrophe losses currently insured; gap expected to widen as impact of climate change grows
- Insurance gap poses risks to economy and financial stability
- ECB and EIOPA outline policy options to promote climate catastrophe insurance

The European Central Bank (ECB) and the European Insurance and Occupational Pensions Authority (EIOPA) today published a joint discussion paper on how to better insure households and businesses in the European Union against climate-related natural catastrophes such as floods or wildfires. The policy options set out in the paper are aimed at boosting the uptake and efficiency of climate catastrophe insurance while creating incentives to adapt to and reduce climate risks.

"We need to increase the uptake of climate catastrophe insurance to limit the growing impact of natural disasters on the economy and the financial system," said ECB Vice-President Luis de Guindos. "However, to reduce losses in the first place, we must ensure that a smooth and speedy green transition is complemented by effective measures to adapt to climate change."

EIOPA Chairperson Petra Hielkema added: "Insurance plays a major role in protecting businesses and people against climate-related catastrophe losses by swiftly providing the necessary funds for reconstruction. In order to efficiently protect our society, we need to address the concern of the increasing insurance protection gap by proposing and finding appropriate solutions."

Currently, only about one-quarter of all climate-related catastrophe losses in the European Union are insured. In some countries, the figure is below 5%. This is partly because many people underestimate the costs of climate-related damage. Some also shy away from insurance, preferring to rely on government support. As natural disasters become both more frequent and more severe, insurance costs are expected to rise. Some insurers may reduce risk coverage or stop providing certain types of catastrophe insurance altogether, which would widen the insurance gap further.

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The lack of climate catastrophe insurance can affect the economy and financial stability. If losses are not covered by insurance, the speed at which households and firms can resume their activities is reduced, slowing economic recovery. Lasting supply chain disruptions can also lead to spillovers from one firm to another and affect firms' ability to pay back loans, thereby increasing banks' exposures to credit risk. Additionally, the financial position of governments may be weakened if they need to provide relief to cover uninsured losses.

To foster insurance coverage, the ECB and EIOPA suggest that insurers should design their policies to encourage households and firms to reduce risk, for example by granting discounts for implementing effective mitigation or adaptation measures. To support the overall supply of insurance, the use of catastrophe bonds could be increased to pass on part of the risk to capital market investors. In the same vein, governments could set up public-private partnerships and backstops to partly cover the costs that insurers may incur in the event of major disasters. To protect themselves and ensure that public funds are used efficiently, governments should also provide strong incentives to reduce risks. Finally, national-level insurance schemes could be complemented by an EU-wide public scheme that makes sure sufficient funds are made available to European countries for reconstruction following rare, large-scale climate-related catastrophes.

The joint discussion paper is part of the ECB's climate agenda and, more broadly, its work to improve understanding of climate-related risk. The paper aims to foster debate on how to tackle the climate insurance protection gap. The ECB and EIOPA will collect feedback on the policy options and also discuss them in a workshop with regulators, policymakers, insurers and academics on 22 May 2023.

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