FERMA
Federation of European Risk Management Associations

White paper

Insuring the transition

The issues confronting risk managers

FERMA FOCUS
RISK TRANSFER

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SUSTAINABILITY

Insurance is a pressing issue for enterprises at this stage of the transition to climate neutrality.

FERMA believes that the (re)insurance industry must do more than it is doing right now to support its corporate clients in making the transition.

Key points

- The shortage of insurance capacity is holding back transition to low carbon.
- Insurers seem unwilling to cover new products and technologies that are part of the transition.
- Data issues are over-stated.
- The insurance industry's aversion to risk and slow integration of knowledge aggravates data shortages.
- Insurers only gain experience if they underwrite.
- Insurers must play a more supportive role in the transition.

I) Context

This paper sets out the views and concerns of risk managers regarding the approach taken so far by the private insurance market to underwriting the transition.

As the representative body for the risk profession at European level, FERMA takes an active interest in the various implications of the transition to a carbon-neutral economy.

Since the topic has far-reaching implications, our paper is aimed at the private (re)insurance market, industry supervisory bodies and regulators, as well as a more political audience.

It conveys our wish that these actors address the insurance-related issues that could hold back the ability of enterprises to succeed in fostering this transition.

Risk-taking is necessary for innovation, and innovation is necessary to facilitate the transition to a carbon-neutral economy.

In FERMA's view, insurance helps enterprises to take on such risks because:

1) The pricing mechanism of insurance makes risks more transparent for the enterprise.
2) Insurance mitigates the financial exposure for investors and stakeholders.

FERMA encourages members of the (re)insurance industry to read the following comments from their corporate customers so they can build a better partnership to facilitate the transition.

II) Issues confronting corporate insurance buyers

Insurers´ reaction to pressure

Overall, FERMA members have the impression that **insurers are making a knee-jerk reaction to i) regulatory pressure and ii) pressure from NGOs and civil society** in terms of their underwriting activities with little (or no) regard to their clients' needs. The hard insurance market that companies are facing exacerbates this situation.

This results in businesses experiencing restrictions on insurance coverage regarding their transition activities. These restrictions can be witnessed in three ways:

1) **Limited or unavailable cover because of current or past activities**, such as links with coal or mining. This makes it more difficult for these companies to proceed with transition.

2) Lack of coverage for **specific 'new technologies' or materials**. This includes (offshore) solar panels, (offshore) wind farms, hydrogen fuel or storage, new construction techniques, solutions or materials, which all underpin the transition from fossil fuels.

3) **Exclusions of specific risks**. Property damage and bodily injury may be excluded when there is a direct or indirect link with coal plants, and mining activities, or when battery packs are stored or used in for instance in sprinkler pumps.

Data

Corporate insurance buyers regularly hear from insurers that **there is not enough data** to underwrite certain risks or projects, such as those involving timber. To insurance buyers, this appears overly risk-averse and backward looking.

Further, we find that insurers are slow to incorporate new information into their technical and underwriting standards. This is especially the case when it comes to safety systems where insurers do not yet recognise many of the technical developments.

From the client's point of view, there is plenty of information available for most new technologies or materials, which could be incorporated in insurers' models.

It is also our view that insurers could improve the use of available data. Risk aversion in the insurance industry, and the slow integration of knowledge and learnings aggravate what insurers perceive about lack of data.

Insurers cannot build knowledge without the experience of taking on new risks. Understanding losses from one project might help avert claims from many other projects. If projects do not go ahead or only proceed slowly due to lack of insurance coverage, loss experience does not develop quickly enough, either.

Lack of consensus

Another problem for insurance buyers is the lack of consensus in the market. In many respects this is a normal consequence of the market functioning. However, this lack of consensus has caused practical difficulties for insurance buyers. For instance:

- **Lack of consistency**. Each insurer sets different terms and conditions, standards and requirements for clients. Conforming to all these demands can make it challenging for companies to obtain full cover.

When enterprises are implicitly forced to cater to different requirements by several insurers in multiple lines of coverage, insurance management is difficult at best and unmanageable at worst.

- **Unsuitable standards.** For example, some European enterprises are witnessing that the insurance inspectors' standards for solar panels and roof loads are US-driven and so do not reflect the realities and needs of European clients. This can prevent some enterprises from installing solar panels because they cannot find suitable insurance coverage.

- **Lack of transparency.** Insurance buyers have to complete an increasing number of questionnaires for coverage, and these vary widely. Among the common complaints from insureds with regard to these questionnaires are:

    - For some data points, there is no clear explanation how they determine the extent or price of coverage.
    - The client cannot know how their answers will impact the insurability of the project.

This lack of transparency and subsequent absence of dialogue about risk mitigation measures in some cases prevents the execution of projects that could have otherwise gone ahead.

- **Poor service standards from some 'local' insurers.** This ranges from the underwriting process to claims handling. For example:

    - An enterprise was dealing with an insurer in country A, but the specialist team is in country B. There was little-to-no evidence of a link between them, nor a possibility for the enterprise to deal and engage directly with the specialists in country B.
    - Where there is damage to property, clients often have little or no input nor support from insurers on how to build back more sustainably.

More risk, less innovation?

Based on this current market environment, **clients are unsure about their coverage options moving forward.**

Some buyers observe that they are paying higher premiums and increasing retentions for insurance coverage needed for contractual reasons with their customers, or to ensure financing from investors.

There is also an issue on affordability and adequacy of certain coverages. One example we have seen is the doubling of premiums by insurers with warranty clauses that would expose the insured to the full loss for certain timber projects.

Furthermore, the word 'uninsurable' is increasingly used by corporate insurance buyers about specific risks. More than 4 in 10 risk managers surveyed by FERMA in the 2022 European Risk Manager Report believe that some of their locations or business activities will become uninsurable in the future.

As a result, corporates increasingly feel that they need to self-insure or manage more of the risk on their own. Captives are becoming even more attractive as a solution, but they are not a panacea. The lack of sufficient risk transfer capacity will limit investments in innovative technologies innovation often entails new risks.

III) FERMA views

There is a clear call from insurers' corporate clients to encourage **innovation.**

- **Businesses should not feel punished** by insurers for embracing the green transition.

    - Insurers must continuously improve their value-proposition. Underwriting should be business-minded with an eye on better understanding the risks.

    As a community of insureds, we are calling on insurers to move away from a strict adherence to backward-looking underwriting guidelines.

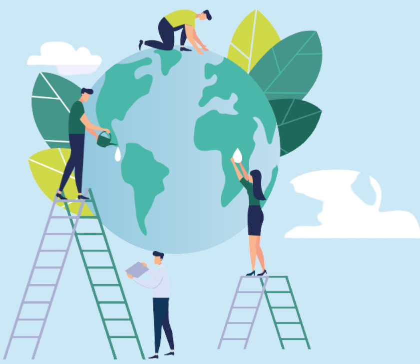
    Instead, corporate customers encourage insurers to gain a holistic understanding of their risks and needs, which would give more flexibility to underwriters and engineers to do business beyond rigid guidelines.

- There is a huge **social role** for the insurance industry, not only in cushioning losses but also in guiding activities and prevention measures.

    - Insurers' data around the impacts of climate change and its effects on their clients could have enormous power if shared more widely, prudently and in confidence.
    - By studying losses and sharing loss experience related to innovative techniques, insurers could help drive forward the safety level of these innovations.
    - Through claims handling, insurers could – and arguably should – play a bigger role in helping clients build back better and more sustainably.
    - Insurers' risk inspection and engineering expertise should be used for assessing risks to support the transition.

- **A taxonomy of the data** shared between insured and insurer and even among insurers themselves, could be a way to build more market consistency.
    - As part of this taxonomy, underwriting guidelines could be updated more frequently to ensure they incorporate new insights and lessons.
    - Further, insurers should put more effort into understanding losses involving new and innovative techniques and should share their expertise with their clients.
    - This taxonomy can be linked to ongoing initiatives at EU level such as those on open finance or on the European Single Access Point and the Corporate Sustainability Reporting Directive.
- There is merit in exploring an **EU-wide mechanism** that can support insurers provide their corporate clients with more financial protection in the transition. For instance, a mechanism that could help compensate insured losses caused by essential activities.

FERMA believes that as part of society, the (re)insurance industry should and can do more to support the transition to climate neutrality, by providing risk transfer capacity to its clients and by building understanding of the challenges and solutions.



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