

COVERAGE OF EXTRAORDINARY RISKS ARISING FROM CLIMATE CHANGE: THE SPANISH "EXTRAORDINARY RISK INSURANCE".

1. INTRODUCTION.

Importance of insurance systems. Insurance systems are vital in a context where present and future consequences and risks associated with climate change are becoming palpable.

The Spanish "Extraordinary Risk Insurance" (ERI). It is managed by Consorcio de Compensación de Seguros (CCS), a state-owned enterprise, covers damages caused by so-called "extraordinary risks", which may be caused by natural phenomena. This includes, among others: floods (fluvial, pluvial and coastal) and windstorms.

The peculiarity of the ERI lies in the public-private partnership system on which it is designed. When a person freely hires a property or life insurance, aiming to insure property damage, life, accidents... there is a surcharge to the premium that is compulsorily paid to the CCS. Consequently, the CCS coverage is automatic if there is damage or injury caused by any of the listed perils on an insured property or person.

The ERI is not priced according to the level of exposure to a given risk, but it is rather calculated based on achieving an overall technical balance for all the risks covered by the system. In any case, the amount of the surcharge depends on the type of property protected and the capital insured in each policy.

Self-sustainable system. This allows very broad coverage at a very affordable cost, making the system self-sustainable and not requiring any type of contribution from public budgets. Although the number of compensations has grown significantly in recent years, the system has also grown in the number of policies and has perfectly maintained its balance and financial robustness.

The CCS thus constitutes the central figure of a unique catastrophic damage compensation system in the world.

2. CLIMATE CHALLENGES AND RISKS FOR THE INSURANCE SECTOR.

Climate change can have a major impact on the insurance sector. In Europe, according to reports from the IPCC, the most likely risks include:

- An increase in the duration and frequency of heat waves, particularly important in urban heat islands.
- A higher incidence of droughts, risk of forest fires, soil degradation and earth movements in semi-arid regions such as the Mediterranean basin.
- Reduction in average annual rainfall and increase in torrential rains, with flooding of land and cities.
- Coastal flooding due to an increase in the mean sea level, with damage to infrastructure and loss of soil due to salinization

Solvency of insurance companies. Under these conditions, the solvency of insurance companies could potentially be harmed if they do not adapt their risk management systems or do not trigger some kind of risk prevention and reduction mechanisms, with possible increases in premiums that could reduce insurance coverage, making it hypothetically unviable.

3. OBJECTIVES.

Essential characteristic: double coverage. The essential characteristic of the extraordinary risks system is the ability to automatically provide the insured party with coverage against some risks that are considered extraordinary, through their mandatory inclusion in the policies policyholders contract with insurance companies of their choice.

Double coverage. This allows for the same policy to offer double coverage (I) ordinary risks, borne by the private insurance company; (II) extraordinary risks, assumed by CCS, a public company attached to the Ministry of Economic Affairs and Digital Transition. Private companies sell the policies and thus, they retain the capacity of risk selection. On the other side, the binding extension of the covers to some of the most adverse weather effects, such as floods and windstorms, allows for a wide take up rate of flood insurance, for instance, that is equal to the amount of properties insured, reducing the insurance protection gap to a minimum.

Other elements to be considered. The most important global risk today is the lack of mitigation and adaptation to climate change. Without mitigation and adaptation, no insurance system will be sustainable in the long term. There is a general consensus that, among growing hazards, other elements such as greater concentration of population and goods in vulnerable areas, are also determinant.

From the regulatory point of view, it is important to set out strategies clearly to better adapt to climate change. It is also important that education programs are implemented to raise awareness of the importance of insurance against extraordinary risks, reducing the existing protection gap against certain adverse phenomena such as floods.

4. ADAPTATION TO CLIMATE CHANGE.

The insurance sector itself has underlined its important role as a tool for adaptation to climate change, both directly in terms of risk distribution and by using the extensive registry of damages due to natural disasters available thereto, providing essential information for conducting studies on natural risks and their foreseeable variation with climate change. CCS collaborates with research centres for the development of knowledge related to extraordinary risks, which allows them to obtain information of interest for the improvement of risk management and, in addition, it uses its own statistical information to commission open access studies to gain insight on the prospective trends for different issues, such as windstorms. Other essential applications of CCS's loss database are to use it as a decision tool to prioritize investments in risk reduction and check the best options through cost-benefit analyses.

Some of the organisations with which the Consortium works are: Ministry for the Ecological Transition and the Demographic challenge (Directorate General for Water, Basin Management Bodies, Spanish Climate Change Office, State Meteorological Agency), Centre for Public Works Studies and Experimentation (CEDEX), Spanish Directorate-General for Civil Protection and Emergencies, EU Joint Research Centre, etc.

ANNEX:

5. DATA AND SPECIFIC EXAMPLES

- Both compensation claims and the average annual cost of compensations have multiplied 4 times in the past 30 years. Nevertheless, it should be noted that the number of policies with CCS coverage has also multiplied in a similar proportion, thus maintaining the balance and capacity of the system.
- Recent loss events include the cut-off low induced floods of September 2019, causing more than 70,000 claims costing nearly 450 million euros in a large section of SE Spain. Non-related to weather, we can mention the indemnification of the 2021 La Palma volcanic eruption in the Canary Is., which caused around 8,500 claims costing about 210 million euros.

CCS has a combined ratio of less than 60%, meaning that the difference between the revenue (from surcharges and investment returns) helps create an equalisation reserve with is deemed sufficient to cover the 200-years return period events of all the perils covered, In fact, given the growth of the Spanish insurance market in the last decades, the surcharge rate has been lowered twice in the past 20 years in order to keep the growth rate of the equalisation reserved moderate. CCS funds are separate of those of the State and the institution receives no funding from the State budget. In the past 30 years, natural-caused events amounted for 95% of all total losses (some man-made perils, such as terrorism, are also considered as 'extraordinary'), and hydrometeorological hazards caused 84.8 % of all losses (67.4 % flood; 17.4 % windstorm).

As of December 2021, almost 59 million properties were insured against such extraordinary perils, with an insured capital of 6.17 Tn € (4.33 Tn € in residential properties; 1.73 Tn € in civil works, industrial and commercial properties and 109 Bn € in motor vehicles).

STAKEHOLDER SERVICES

Collaboration is essential. The primary stakeholders of the ERI are the policyholders and, by extension, insurance companies and brokers. It is essential to collaborate closely with all of them to sustain the entity's operability and functionality. For this reason, the CCS always offers a special and adequate attention through truthful, simple, and clear information, speeding up the procedures that affect them.

Assistance mechanisms. For this purpose, the CCS has set up:

- The institutional Internet portal and the Call Centre, both of which are permanently updated and whose objective is to facilitate contact between the insured and the CCS as much as possible.
- The CCS's Policyholder Assistance Service, an ideal complement to the direct contact channels, to deal with possible claims arising from final resolutions issued by the CCS.
- Face-to-face consultations with policyholders or their representatives (these are less frequent; all procedures can be carried out online or by telephone).