Position Paper

FERMA contribution to the European Commission evaluation of the EU's Strategy on Adaptation to Climate Change

Recommendations for the evaluation of the Action 8 on the promotion of insurance and other financial products for resilient investment and business decisions

1st March 2018

EXECUTIVE SUMMARY

The Federation of European Risk Management Associations (FERMA) represents the interests of more than 4800 risk managers through its 22 national risk management association members in 21 European countries.

FERMA puts forward three recommendations to be embedded into the future evaluation report of the EU's Strategy on Adaptation to Climate Change. These recommendations ask the EU to address the specific needs of businesses as regards climate change adaptation from a risk management perspective:

1. Organise an EU-wide public access to climate-related risk data.

2. Promote professional risk management practice inside businesses and public entities.

3. Facilitate companies in making use of the available options for financing risks related to climate change.

Insurance capacity remains widely available and prices have changed little, even though 2017 was a record year for extreme weather events[1]. Nevertheless, financial damages are expected to rise with the predicted increase in severe and extreme weather events, which will put insurance industry capital under pressure. Consequently, reinsurers who ultimately underwrite much of the exposure for natural catastrophes for the insurance market will look to increase their prices, reduce the total capacity that they are prepared to offer or both[2], and these costs will be eventually passed on to via insurers to corporate clients.

The European Union remains the right level actor to reduce the costs of climate change for businesses and secure future EU economic growth. However, corporate risk and insurance management is still largely missing from the most recent works[3] performed for the action 8 of the EU Strategy "*promotion of insurance and other financial products for resilient investment and business decisions*".

FERMA considers that corporate risk and insurance management represents an untapped resource to better support businesses in adjusting to climate change in a future Adaptation Strategy. More

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[1] *Natural catastrophe review: Series of hurricanes makes 2017 year of highest insured losses ever*, Munich Re , 4 January 2018
Preliminary sigma estimates for 2017: global insured losses of USD 136 billion are third highest on sigma records, Swiss Re, 20 December 2017

[2] Most insurance companies use reinsurance to manage their exposure to natural catastrophe risks, and much of this capacity comes from European companies such as Swiss Re, Munich Re, Hannover Re, or SCOR. These reinsurance companies also provide significant catastrophe risk protection for other insurers around the world.

[3] *Insurance of weather and climate-related disaster risk: Inventory and analysis of mechanisms to support damage prevention in the EU*, European Commission, September 2017

specifically, the risk manager adds value to businesses by assessing the exposure of the company's assets to extreme weather events, before deciding what the optimum limits of insurance to purchase to protect their sustainability against catastrophe risks.

FERMA believes that it is urgent for European organisations to adopt professional and mature risk management strategies to reduce climate change impacts. This is supported by the EU High-Level Expert Group on Sustainable Finance (HLEG) which explicitly calls the insurance sector to **promote loss prevention and to support risk-mitigation behaviour**[4] in its January 2018 report but also in the study of the European Commission for the Action 8 stating that "***Proactive disaster risk management measures need to be taken***"[5].

To respond to this historical challenge, FERMA calls on the European Commission to promote a structured risk management strategy among EU organisations in the review of the Adaptation Strategy of the European Union to Climate Change. A professional risk management approach supported by qualified staff will allow organisations to gradually adjust to climate change and more frequent extreme weather events by exploiting the full potential of risk modelling and risk financing tools available globally.

Finally, FERMA urges the European Commission to facilitate companies in making use of the available options for financing risks related to climate change, including the insurance market. We believe this will encourage the adoption of good risk management practices through risk-related pricing and in this way generally reward the efforts of organisations to increase their resilience to disasters.

Recommendation 1: Organise an EU-wide public access to climate-related risk data

Building on the work done by the EU Floods Directive on the assessment and management of flood risks[6], the adaptation strategy of the EU should foster a much wider public access to climate-related risk data.

Anticipation
Using more reliable and accessible risk data enables public and private decision makers to be in a better position to apply risk management practices in order to increase the resilience of public infrastructures and services and commerce, and reduce the financial impact of weather-related events.

Informed decisions
Ensuring wider access to climate-related data reduces the risk of asymmetric information between insureds and insurers, in which there is a significant risk of adverse selection, and so creates a solid foundation for a fairer dialogue between corporate insurance buyers and the insurance market.

[4] Page 70, *FINANCING A SUSTAINABLE EUROPEAN ECONOMY - Final Report 2018 by the High-Level Expert Group on Sustainable Finance*, HLEG on Sustainable Finance, 31 January 2018
[5] Page 21,*Insurance of weather and climate-related disaster risk: Inventory and analysis of mechanisms to support damage prevention in the EU*, European Commission, September 2017
[6] Directive 2007/60/EC on the assessment and management of flood risks entered into force on 26 November 2007

Financial benefits

Ultimately this would support economic growth, because it would reduce the financial impact of weather-related events on businesses in terms of physical damages and business interruption and keep insurance costs at a sustainable level.

To be actionable, data from both public and private sources should be delivered in an **accessible** and **interactive** format. This is already the case in some countries, such as France (French Géorisques portal), Slovenia (Geoportal ARSO), the United Kingdom (UK Flood map), and through other initiatives notably the Global Wind Atlas used for the energy sector and the European Climate Database (ECAD). To allow all economic actors to develop adaptation strategies, climate-related risk data should be aggregated on **joint platforms** and **kept up to date by their operators**.

Private organisations and Member States should be encouraged to share data publicly at EU level for all types of climate-related disasters (storms, floods, droughts and wildfires…). Insurers should be closely involved and incentivised by public authorities to actively provide and update EU-wide weather-related risk data.

Recommendation 2: Promote a professional risk management practice inside businesses and public entities

The use of an enterprise risk management (ERM) approach is necessary for the sustainability of all organisations: public or private, small, medium or large. The risk management process allows proper identification of the risks, analysis in terms of potential frequency and severity, and evaluation and quantification in terms of possible impact. Frequency includes estimates of the likely number of severe weather events over a certainty period and their seasonality. Severity takes into account expected and worse case scenarios, using parameters such as wind speed, event duration, and flood extent and depths.

A professional risk management approach ensures that the organisation has an accurate view of its risks from exposure to climate-related events. This enables the organisation to make the appropriate decisions to mitigate current risks, evaluate the risks of investment projects and ensure it can recover quickly from threats that materialise. Post-event mitigation including emergency response, crisis management and business continuity plans is also part of the risk management toolbox.

Having implemented suitable and cost-effective prevention and protection measures, the organisation is still likely to have potential losses for which it has no appetite or financial capabilities. A company will look to transfer these residual risks from its balance sheet to a large insurer or into the reinsurance market via a captive insurance subsidiary.[7]

The value of professional risk management applies in the same way to the public sector. Economies rely on the quality and resilience of public infrastructures, and a professional risk management process should be in place to ensure that public funding is directed effectively to reduce the social and financial consequences of disasters, including on commerce.

[7] Other alternative solutions might be considered to transfer/ share the financial impact of an event in addition to the conventional insurance (captive insurance company, catastrophe insurance bonds or contractual sharing of risks).

The business interruption consequences of a natural disaster are often more financially harmful than physical damages. Public and private risk management are, therefore, interconnected when it comes to business interruption risks linked to power outages, disruption to transport networks, loss of access and loss of water supply etc.

FERMA believes that to ensure a better use of insurance by businesses against natural catastrophes, the future evaluation report of the EU's Strategy on Adaptation to Climate Change should explicitly mention well-recognised risk management references like enterprise risk management (ERM) methodology[8] and the ISO 31000 standard[9], which are widely applied in large public bodies and private organisations and used by their risk managers. There is indeed a direct link between the quality of a company's risk management and its ability to buy suitable insurance at an acceptable price.

Recommendation 3: Facilitate companies in making use of the available options for financing the risks related to climate change

Households and small businesses are more vulnerable than large companies and should always benefit from a solidarity principle regarding the compensation of climate-related disasters. This often means the creation of state-sponsored schemes, which can take various forms. We welcome incentives from Member States for organisations to adopt a risk management approach to climate change related risks, whether or not they are members of a public scheme. This will encourage investments in resilience.

Finally, FERMA urges the European Commission to facilitate companies in making use of the available options for financing risks related to climate change, including insurance. We believe this will encourage the adoption of good risk management practices through risk-related pricing, and in this way generally reward the efforts of organisations to increase their resilience. Ultimately, this will also help to maintain a good spread of risks for the insurance market and so keep insurance products widely available at sustainable costs. The private insurance market, thus, adds risk capital to that provided by state-sponsored schemes and so supports economic growth.

As the representative body of risk managers in Europe, FERMA stands ready to contribute to the dialogue between the insurance market and the public authorities and to support the development of sustainable disaster risk insurance solutions.

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[8] COSO defines ERM as "*The culture, capabilities, and practices, integrated with strategy-setting and performance, that organizations rely on to manage risk in creating, preserving, and realizing value*",Committee of Sponsoring Organizations of the Treadway Commission (COSO), 2017, *Enterprise Risk Management Integrating with Strategy and Performance*.
For similar definitions see also: *"Enterprise Risk Management (ERM) is a strategic business discipline that supports the achievement of an organisation's objectives by addressing the full spectrum of its risks and managing the combined impact of those risks as an interrelated risk portfolio." RIMS Strategic and Enterprise Risk Center. RIMS the Risk Management Society*

[9] ISO 31000:2018, Risk management – Principles and guidelines

Contact person

Julien Bedhouche, FERMA EU Affairs Adviser, julien.bedhouche@ferma.eu
See also FERMA's response to the EU *Green Paper on the insurance of natural and man-made disasters, 2013*

About FERMA

The Federation of European Risk Management Associations brings together 22 risk management associations in 21 European countries, representing more than 4800 risk managers active in a wide range of organisations. FERMA provides the means of co-ordinating risk management and optimising the impact of these associations outside their national boundaries on a European level.

Member associations are from the following countries: Belgium (BELRIM), Bulgaria (BRiMA) Czech Republic (CZRMA), Denmark (DARIM), Finland (FinnRima), France (AMRAE), Germany (GNVW), Italy (ANRA), Luxembourg (ALRiM), Malta (MARM), Netherlands (NARIM), Norway (NORIMA), Poland (POLRISK), Portugal (APOGERIS), Russia (RusRisk), Slovenia (Sl.RISK), Spain (AGERS and IGREA), Sweden (SWERMA), Switzerland (SIRM), Turkey (ERMA) and United Kingdom (Airmic).
FERMA is a member of the International Federation of Risk and Insurance Management Associations (IFRIMA). www.ferma.eu