



TOPICS:

ESG Risk

SOURCE:

European Insurance and Occupational Pensions Authority & European Stability Mechanism

EIOPA-ESM: A European Approach to Natural Catastrophe Risk Management

- The paper outlines a **proposed EU-level framework** to address the widening insurance protection gap for **natural catastrophes**.
- The paper identifies a **structural challenge**: natural disasters in Europe are increasing in frequency and severity, while insurance coverage remains limited. Historical and model-based estimates suggest that between 50% and 75% of economic losses are uninsured, with significant variation across countries and perils. This gap exposes households, businesses, and governments to substantial financial risk and weakens economic resilience.
- To address this, the paper proposes a **European risk-sharing mechanism** combining two core components. First, a **pan-European insurance pool** would aggregate risks across countries and hazard types. By leveraging diversification, this pool reduces overall capital requirements - model results indicate potential risk reductions of up to 67% compared to national approaches. This improved capital efficiency enables insurers to expand underwriting capacity and reduce costs for policyholders.
- Second, a **loan-based public backstop** would provide liquidity for extreme, low-probability events exceeding the pool's capacity. The backstop operates on market-based terms and is designed to be fiscally neutral over time, with loans repaid by participating insurers. Estimated capacity requirements range from €10 billion to €65 billion, depending on risk scenarios. This mechanism enhances financial stability, reduces reliance on ad hoc government support and smooths volatility in insurance markets.
- The proposed structure relies on **risk-based pricing, broad participation, and pre-event funding** to mitigate moral hazard and ensure efficiency. It is intended to complement - not replace - existing national schemes and private insurance markets, while incentivising greater private sector involvement.

