

Building an EU Resilience Framework for Catastrophic Risks

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Catastrophic risks threaten the integrity of the European Single Market

The spread of COVID-19 around the world, and particularly within the European Union, has revealed a systemic weakness in insurance markets. Although the insurance sector provides coverage for a range of unforeseen events, there is currently little to no coverage available for financial losses resulting from non-physical damage business interruption (NDBI).¹

The Federation of European Risk Management Associations (FERMA) believes it is necessary for the European Union to develop a Resilience Framework for Catastrophic Risks (RFCR) to address this limitation. The cross-border nature of COVID-19, and other similar catastrophic risks, warrants such an action, especially if the European Union is to create a resilient Internal Market, equipped to handle future crises.

The following position paper sets out FERMA's vision for such a framework. We aim to deepen discussions with relevant stakeholders, including public authorities and the insurance sector, and develop solutions for both short-term crisis management and long-term business resilience.

Systemic risks exceed the capabilities of the private insurance sector and existing pools

Systemic risks, including inter alia pandemics, climate change, cyber risk, terrorism and social risks, refer to those with the potential for a breakdown of a system, rather than a single isolated point. In the case of the COVID-19 pandemic, the entire financial system is under threat, facing a severe economic downturn arising from global business interruption and containment measures.

Due to their large-scale effects, it is beyond the capital of the private insurance market to provide material capacity for the transfer of such systemic risk. Consequently, despite being able to provide targeted coverage for disruptions resulting from physical catastrophe (such as floods or fires), the private insurance market alone is unable to cover situations that result in NDBI triggered by system risks. This poses a significant challenge for both enterprises hoping to insure against future losses and for governments. Particularly when key national industries are threatened, government solutions

¹ NDBI is a situation in which a business is unable to operate normally, despite suffering no physical damage, due to circumstances beyond its control (*force majeure*). For example, a factory might be compelled to cease operations because temporary national measures prohibit employees from going to work. Although there is no physical reason for the factory to close, it still suffers business interruption and financial loss. Apart from national pools, there is currently very limited insurance coverage available in Europe for NDBI.

often result in tax-payer bailouts of select industry sectors. Put simply, when handling systemic risks, governments are called upon to resolve market failures on an ad hoc basis, with little to no support available from the insurance community as has been the case during the current COVID-19 crisis.

In response to the present COVID-19 crisis, a few member states, such as France, Germany and the UK, envisage expanding their existing national pooling schemes: public-private partnerships which have the capacity to address systemic risks.² National catastrophe pools are useful where available and in the present situation should be utilised, where they exist, to the maximum extent possible.

However, the geographical reach of such pools and existing coverage for cross-border NBDI is limited, even if such pools are available in a particular member state. Indeed, the lack of cross-border coverage is antithetical to the European single market and the freedom of movement of capital and services. Without a framework for cross-border coverage, the EU insurance market remains fragmented, disrupting the functioning of the Internal Market especially when NBDI occurs as a result of events in another member state, outside the scope of existing national pools. In order to increase harmonisation across member states, a European response is needed that upholds the principle of subsidiarity.

The Resilience Framework for Catastrophic Risks (RFCR) meets the challenge of systemic risks

Although FERMA recognises that a uniform, homogeneous solution at European level is impossible due to the high complexity of national insurance markets, FERMA is committed to participating in the construction of a Resilience Framework for Catastrophic Risks (RFCR). Our aim is a multi-layered and graduated public-private partnership that would provide sufficient flexibility to enable an effective response to a range of catastrophic risks leading to currently uncovered NBDI. The RFCR would function on four levels:

1. Enterprise-level risk management: anticipation, prevention, identification and mitigation of risks
2. Transfer of risk to private insurance and reinsurance markets, developing enhanced coverage for NBDI
3. National Member State pool guarantees
4. European Union support for, and coordination between, national governments

This holistic approach ensures that the RFCR would have the capacity to benefit all businesses, from small and medium-sized enterprises facing immediate liquidity issues, to the largest transnational

² GAREAT is a national public-private partnership, committed to managing the reinsurance of risk of terrorist attacks developed to manage the reinsurance of the risks of attacks and acts of terrorism in France; Extremus Versicherungs-AG is another example of national pool developed in the wake of the 9/11 attacks in the United States under the leadership of the German Insurance Association (GDV). Together, a uniform definition of terrorism was developed, and a solution was agreed to form a specialist insurer for writing terrorism cover; Recent examples of NBDI and the costs associated with it include, WannaCry/NotPetya (€2 billion), Ebola virus (€800 million) and yellow jacket social unrest (€1 billion).

corporations concerned with supply chain disruptions,³ supported by the insurance sector, national governments and EU institutions.

Coordination across these stakeholders will be necessary to incentivise the accumulation of reserves for pandemics and other catastrophes ahead of a crisis. As the 2017 OECD Recommendation on Disaster Risk Financing Strategies recommends, an integrated approach to the financial management of catastrophic risk, involving cooperation and coordination across organisations in the public and private sectors, and including different levels of government, is needed in order to increase resilience.⁴

In addition, the RFCR will optimise the use of tax-payer's funds by giving enterprises fair access to state funds. Insurance-based schemes, such as the RFCR, permit the establishment of clear and proportionate parameters utilising tried and tested risk management methodologies, such as Enterprise Risk Management, that can accurately assess contributions that may be required by enterprises in order to access the system. The RFCR will therefore enhance business resilience by incentivising risk management methodologies that encourage the prudential assessment and identification of risks needed to access public funds.

In order to trigger a collective sense of individual responsibility towards future catastrophes and manage systemic risk efficiently, it is necessary to recognise the limitations of traditional risk transfer tools, increase investment in risk reduction, and support initiatives to raise awareness. Crucially, this level of preparedness will not only help to mitigate the effects of pandemics (such as the present one), but will also address a range of other catastrophic events that could threaten the security of the Internal Market in the future, including mass cyber-attacks, extreme weather events, and socio-political upheaval. Regardless of the trigger, the RFCR framework would help to ensure that European businesses have the financial security to continue operations in even the most difficult circumstances and to recover quickly from unexpected catastrophe.

Despite the exceptional steps the EU has taken to mitigate the effects of this pandemic, such as the establishment of the SURE program,⁵ fragmented landscape across member states with regards to the availability of existing insurance pools point to a weakness in insurance markets that must be addressed if the European Union is to increase the resilience of the Internal Market.

An RFCR framework will support the development of NDBI coverage that will give European enterprises the financial security to maintain flexibility in the face of catastrophic events, and incentives to apply risk management methodologies throughout the continent.

³ There will be many other constellations, such as lack of customs, and borders closed etc.

⁴ OECD (2017), OECD Recommendation on Disaster Risk Financing Strategies. Retrieved from <https://www.oecd.org/daf/fin/insurance/OECD-Recommendation-Disaster-Risk-Financing-Strategies.pdf>

⁵ A European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE): https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-financial-assistance/loan-programmes/sure_en

Although national efforts to repurpose current pooling schemes will hopefully be successful, these solutions are geographically limited, and should be complemented by a larger framework built on partnership between all relevant stakeholders. Hence, it is essential that RFCR is managed by an organisation under the governance of the EU.

The COVID-19 crisis has shown that the only response to a virus threatening the fabric of society is a collective exercise in solidarity, one that makes each individual responsible for the health of his or her neighbour.

About FERMA:

FERMA has been the single recognised voice of European risk managers for more than forty years. With a membership of 21 risk management associations spanning 20 European countries, FERMA is the leader of an international network that influences industry, the public sector, finance and other services. FERMA advocates on behalf of nearly 5000 risk management professionals while promoting communication and education across Europe. 50% of member organisations are listed on the stock exchange, and over 80% have a turnover of more than €50 million, making them notable players in the European economy.

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