Spanish Catastrophic Risk Insurance

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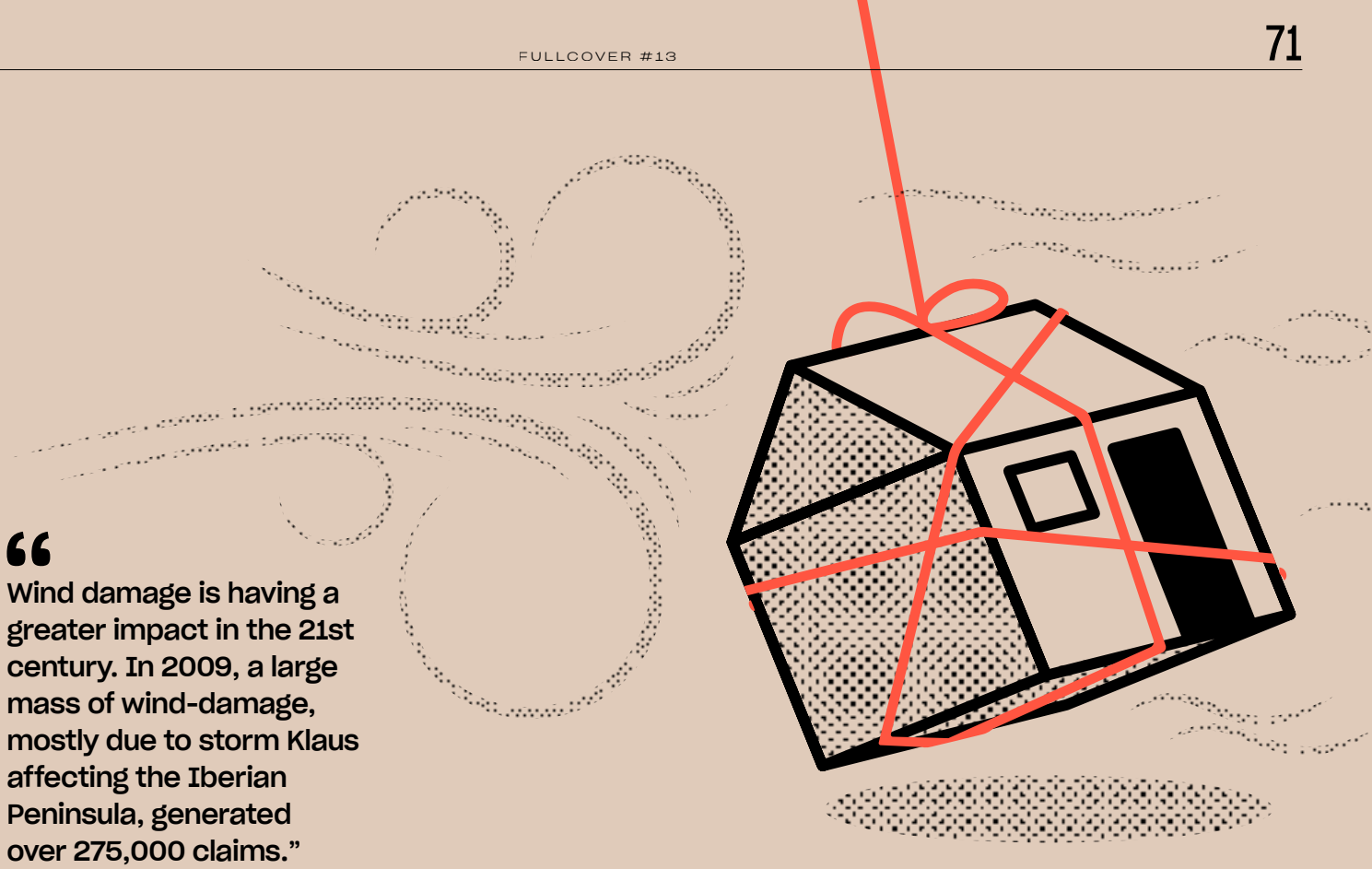

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The basic principle behind the Spanish catastrophic risk insurance system is a mandatory coverage of a number of perils deemed as catastrophic by most property[1] insurance and all life and casualty policies purchased in Spain. Extraordinary risks include damage from natural perils (flood, earthquake, strong winds etc) and that caused by humans (terrorism, riots and civil unrest).Insurers offering the primary policy should include all or part of the above perils. Should this not be the case, as often happens, automatic complementary cover is provided by the CCS.

So the CCS acts as an insurer, exclusively covering the property and people named on insurance policies.

In late 2018, catastrophic risk insurance covered almost 130 million policies in the Spanish market: 59.2 million life and casualty policies, 53.7 million property policies and 5.7 million business interruption policies. The total sum insured in 2018 was over €17 billion euros; split into 65% life, around 33% property and 2% business interruption.

The impact of climate change

If we consider loss across all lines of business over the past 30 years, flooding accounts for the highest proportion – around 69% of payments. Wind damage is second, at 17%, and earthquakes third, at 7%.

Wind damage is having a greater impact in the 21st century. In 2009, a large mass of wind-damage, mostly due to storm Klaus affecting the Iberian Peninsula, generated over 275,000 claims; the largest single event in the history of Spanish extraordinary risk insurance, creating the highest number of claims. If we were to include the as-yet unconfirmed 2019 data, we would see that floods became an extraordinary burden, responsible for nearly €700 million in claims, of which more than €500 million are directly due to floods in southern Spain in September 2019.

With this torrent of data, we could rightly ask ourselves what conclusions we can make on trends over the past few decades regarding the payouts per catastrophe, specifically those due to water and weather (floods and strong winds) whose greater frequency enables the collation of statistics. The number of policies that include catastrophic risk insurance has practically grown six-fold, so logically the number of claims under this type of insurance should also similarly increase. However, disregarding inflation, the constant amount indemnified over the same period only doubled.

There could be two separate explanations for this, or a combination of the two. Firstly, risk management has clearly improved, especially our ability to predict water and weather risk (as have the risk management skills of reservoir managers and the emergency services). Naturally, the insured also have a greater awareness. Alternatively, it could be to do with the mass penetration of insurance in Spain and the fact that a few decades ago, only property of considerable value was insured. Presently, insurance covers most socio economic segments and, therefore less costly risks are also covered.

Combined agrarian insurance *(seguro agrario combinado)* can be particularly impacted by climate change. Currently, this insurance almost universally protects

Consorcio de Compensación de Seguros – The Risk Compensation Fund

Originally designed as a provisional, ex post funding tool for the damage caused by the Spanish Civil War, in 1954 it was decided Consorcio de Compensación de Seguros (CCS) would become a permanent fund to compensate for damage caused by various catastrophic risks, through an ex ante funding scheme. It soon acquired other insurance-related responsibilities.

Today, the CCS has a multi-functional role – to support the Spanish insurance sector (which it is part of) in insurance and non-insurance related activities. This includes: catastrophic risk insurance, mandatory auto insurance, combined agrarian insurance and insurer liquidation.

In other countries, these roles are taken on by the wider market or specific public and private institutions, but Spain presents a unique case, because thanks to a team of over 300, this single entity supports all these areas.

agricultural and livestock activities from a variety of risks. Agroseguro manages a pool of insurers where CCS is responsible for 10% of the risk and it's the pool's reinsurer.

Another factor is the diverse climate in Spain. When assessing the impact of climate change, it is important to differentiate between water/ weather events (heavy rainfall, hailstorms, floods, strong winds) and climate--based events (cold snaps, heat waves, drought, forest fires). Naturally, climate change affects both types, but in different ways. At present, the rise in the Mediterranean region mean temperature is 1.4° C above pre--industrial levels. Such an increase has produced evident changes to the amount of frost days, and the intensity, frequency and duration of heat waves, as well as a 10- 15 day addition to the actual thermal summer. As for rainfall, because it's intrinsically irregular in the Mediterranean, it's more difficult to be conclusive, but the general consensus is that things are getting worse; the number of dry days is increasing and when it does rain, there's more torrential rainfall. This means drawing conclusions and projecting water/weather risk is more difficult than projecting climate change risk whose effects, like droughts and forest fires, appear with increasing ferocity on the Iberian Peninsula.

Going back to the insurance system and its cover, extraordinary risk insurance covers water and weather risk, whereas combined agrarian insurance covers water, weather and climate risk. 2017 and 2018 were the first two consecutive years with negative outcomes for agrarian insurance, and CCS had to respond and stabilize the imbalance. It would be premature to declare climate change is the cause, but there's clearly signs of this.

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Compensation for all

Insurance is a risk transfer mechanism and risk comes from an aggregation of threat, exposure and vulnerability. It seems highly likely that in most cases, the threats posed by climate change will increase: rainfall will become more irregular and intense, leading to greater flood risk, especially from thunderstorms and rain-caused flooding; rising ocean levels will lead to a greater risk of coastal flooding and increased temperatures will lead to a greater risk of drought and forest fires, with specific implications for agrarian insurance.

Spain has a flexible insurance system that caters for all stakeholders and has demonstrated its ability to respond to wildly varying climate and weather challenges. Catastrophic risk insurance in particular, extends to all the insured capital in the country, and by sharing exposure to potential rises in claim and accident rates, the more vulnerable do not have to compromise their cover. This is where the word ‘compensation’, which forms part of the CCS brand, gains its fullest meaning.

One single public company, the Consorcio, complements the entire private sector by forming part of a collective partnership – a pool – that insures difficult risks. The system is designed so it can absorb increasing perils and exposures and, additionally, is flexible enough to modify coverage, rates or surcharges whenever necessary. Regardless, in order to guarantee long-term sustainability for extraordinary risk insurance and, perhaps even more importantly, for combined agrarian insurance, we must learn from accident and claim rates and reduce vulnerability and risk exposure. To do so, the CCS works with national institutions that identify and manage such risks and, increasingly aware of its role in the risk management chain, proactively focuses on controlling and mitigating risk. ●

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