

Property damage and natural disaster insurance for companies

Diot-Siaci would like to present the key legislative and regulatory developments affecting property damage and business interruption insurance for companies as a result of:

- the Baudu law of December 28, 2021 which modified legislation governing Natural Disasters in France (known as “Cat Nat”),
- its implementing decrees that came into force on January 1, 2023 and January 1, 2024,
- the Decree of December 22, 2023 modifying the additional premium rates applicable on January 1, 2025.

This Newsflash does not cover the special cases of agricultural risks, assets for non-business use, local authorities, and motorized land vehicles.

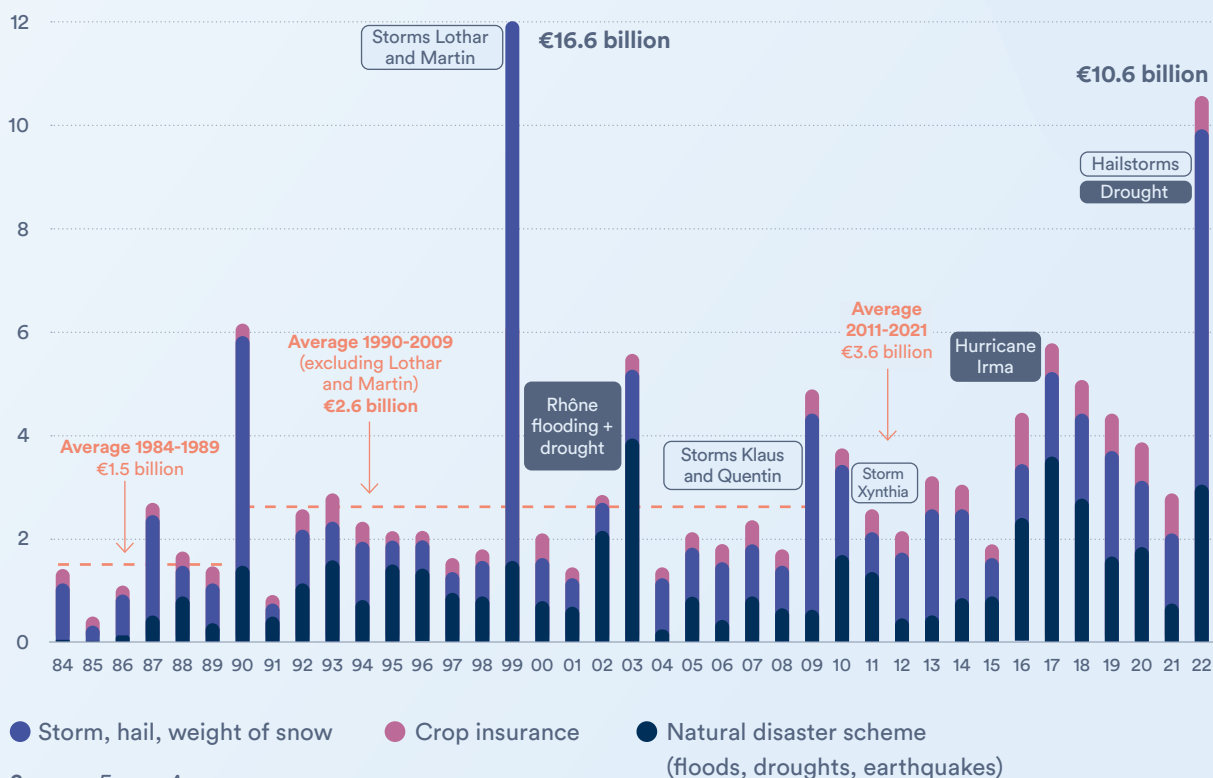
The reasons for these regulatory developments lie in the worsening financial imbalance of the French natural disasters scheme, which even raises the question of the insurability of certain assets. Against this backdrop, on Tuesday, January 30, the French Prime Minister, Gabriel Attal announced a reform of the natural disasters scheme, meaning that the above-mentioned legislative developments are the first stage of the adaptation of the scheme created by the Law of July 13, 1982.

Current state of play

Since 1984, we have seen the relative proportion of natural events rise by more than 240% of the average in constant euros.

When it comes to Natural Events covered by the French Natural Disasters scheme, the increase has been even more spectacular. Prior to 2015, average annual natural disaster claims were below €1 billion, rising to an annual average of over €2.5 billion over the period 2016 to 2020, and peaking at €3.1 billion in 2022.

Cost of weather-related claims
(2022 in billions of constant euros)



Sources: France Assureurs

The statistics from France Assureurs confirm the imbalance reached by the Natural Disasters scheme, with a claims/premium ratio averaging around 110% over the last 5 years.

It should be noted that the financial burden of natural events in France is set to increase by between 60% and 93% by 2050 according to the White Papers published by Covea (February 2022) and France Assureurs (October 2021) respectively.

The impact of floods and drought will increase sharply and, consequently, the relative impact on the Natural Disasters scheme will also rise. The Natural Disasters/Storm, Hail, Snow ratio is expected to rise from 57/43 to 70/30 by 2050.

The 2023/2024 period looks set to be in the region of €3.5 to €4 billion, with a number of major events:

- earthquake in southwest France on June 16 (€350 million),
- storms Ciaran and Domingos from November 1 to 5 (€1.3 billion),
- Hauts-de-France flood in mid-November 2023 (€550 million), drought (over €1 billion),
- Pas-de-Calais floods of January 24: estimated at €90 million, bringing to €640 million the insured amount for floods in this department since November 2023.

Focus on Italy



Following a similar trend in Italy and a 2023 heavily impacted by natural events (hail, winds, and thunderstorms in Northern Italy and flooding in Emilia Romagna) amounting to an estimated €2.2 billion, article 24 of the 2024 Finance Act published on December 30, 2023 provided for the introduction of a new compulsory insurance system to come into force before the end of the year and covering the following events: earthquakes, landslides, floods, and overflows.

To make this system work, SACE S.p.A., a state-owned insurance and reinsurance company, is authorized to provide reinsurance protection of up to 50% of risks and up to €5 billion a year to market insurers, with a first demand guarantee from the state. The regulations set maximum deductibles that may not exceed 15% of the damage and stipulate that premiums must be proportional to the risk. Implementing decrees are awaited to clarify certain points (what are the possible coverage limits? Are stocks and land subject to this obligation?).

This situation gave rise to an initial discussion on how to develop the Natural Disasters scheme in France and review the system's resources to enable it to return to balanced technical results.

Legal framework

The plan is still based on 3 fundamental principles:

- a single pooled rate for additional premiums,
- unlimited coverage provided by public reinsurer CCR, with an unlimited government guarantee,
- recognition of the state of Natural Disaster by decree.

However, the Baudu law and the following legislative texts have brought about changes in the scheme:

- **The Baudu law of December 28, 2021 (Implementing decree of December 30, 2022) has made the scheme more flexible:**
 - › With effect from January 1, 2023, the timeframe for making a claim has been extended from 10 to 30 days, and the timeframe has also been extended for clay shrink-swell, while various measures have been adopted to make it easier to obtain compensation.
 - › Since then, this law has been supplemented by **the implementing decree of December 30, 2022 and the decree of August 2023**. These new measures came into force on January 1, 2024 for the reimbursement of home relocation expenses (primary residence only) and the adjustment of deductibles, with the possibility of setting a minimum policy deductible (historically this minimum was equal to the Damage deductible). It should be noted that this last point is currently being clarified as it is not certain if the legislator really intended to change the existing arrangements (minimum applicable deductible = fire deductible).
- **Independently of that, the Decree of December 22, 2023, published on December 28, 2023**, amending the Natural Disasters law no. 82-600 of July 13, 1982, provides for rate increases applicable from January 1, 2025.

It should be noted that the “*Fonds de prévention des risques naturels majeurs*” (Fund for the Prevention of Major Natural Disasters known as the “Barnier Fund”) created in 1995 is financed by insurers and represents the equivalent of 12% of the Natural Disasters additional premium (paid by insurers). It will in fact increase in proportion, but this percentage remains unchanged.

Focus on changes to deductibles from January 1, 2024

The natural disasters reforms apply only to:

- policies renewing on or after January 1, 2024,
- losses occurring after January 1, 2024.

The new regulations for occupational risks are as follows:

- the requirement to update the Natural Disasters appendix (which is currently being drafted by the insurers and should be published in the next few weeks),
- in the interests of transparency, Natural Disasters deductibles must now be specified in the policy in respect of property damage.

Natural disasters deductibles

Assets for business use

Direct physical damage

Clay shrink-swell: The higher amount between the **policy deductible** and 10% of physical damage per establishment and per event, with a minimum of €3,050

Other contingencies: The higher amount between the **policy deductible** and 10% of physical damage per establishment and per event, with a minimum of €1,140

Establishments with a surface area $\leq 300\text{m}^2$: the deductible cannot exceed €10,000

Other establishments: possible reduction in the policy deductible if preventive measures are in place

Operating losses (unchanged)

3 working days - minimum €1,140
or policy deductible if > these amounts

The key change for professionals relates to the Direct Damage deductible: the minimums and percentages remain unchanged but the Fire deductible was previously applied by default if it was higher.

There must now be a specific reference to the standard deductible, which is no longer necessarily the fire deductible. There will need to be a case-by-case discussion with insurers on the nature of the default deductible to be set in the policy, with the option essentially lying in the choice of the fire or natural events deductible.

We also note that the minimum physical damage deductible, expressed as a percentage, remains uncapped for premises larger than 300 m² and corresponds to 10% of the amount of the damage.

Focus on pricing

The decree of December 22, 2023 modifies Natural Disasters premium rates with effect from January 1, 2025. **The additional premium applicable to professional risks will increase from 12% to 20%.**

Although this rate increase is very significant, it means that the scheme, which is currently in deficit, will barely break even with the claims/premium ratio expected to reach 70% before taking into account the various charges applicable to premiums.

It is therefore likely that these new conditions will rule out the possibility of financing future deterioration due to climate change, meaning that other levers (deductibles, prevention, etc.) will need to be activated.

Outlook

In light of the above, Diot-Siaci anticipates the need for a major overhaul of the system in the medium term. This is due to:

- the effects of climate change and the shift in land use in France towards areas that are more exposed to Natural Disasters (particularly coastal areas),
- the need to take into account the impact on economic inflation of a potential increase in additional premiums in the future.

In fact, the natural disasters scheme is struggling to reach financial equilibrium, while the scheme set up to cover terrorism through the GAREAT* pool has seen very few claims. Even if the volatility of terrorism risks, notably due to the legal obligation for insurers to cover “dirty bombs” (“Nuclear, Biological, Chemical and/or Radiological”), requires high premiums and reliance on the global reinsurance market, we are convinced that it will be difficult to apply a Natural Disasters additional premium of 20% to a scheme that will struggle to remain balanced, on top of high-level additional premiums for the GAREAT scheme.

Although it is difficult to imagine any form of convergence between the two systems, it will inevitably be necessary to look at the economic optimization of arrangements covering a mixture of attritional claims and volatility (Natural Disasters) on the one hand, and pure volatility (GAREAT) on the other.

* GAREAT: *Gestion de l'Assurance et de la Réassurance des Risques Attentats et Actes de Terrorisme or Management of the Insurance and Reinsurance of Terrorism Risks*



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