The protection gap paradox: How insurance fuels the risks it covers

ShareAction's cheat sheet on the insurance protection gap

WHAT IS THE INSURANCE PROTECTION GAP?

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The insurance protection gap is the portion of financial losses from climate-related events that is not covered by insurance. This gap is widening.

As extreme weather events, such as flooding and wildfires, become more frequent and cause greater damage, insurance is becoming **harder to secure and more expensive**. As providing insurance becomes more costly, insurers are increasing the prices of policy premiums or withdrawing coverage in high-risk areas. As a result, many households and businesses are left **without affordable protection, making them vulnerable to storms, floods, or other harmful events.**

This is already a serious issue in parts of the United States, where the price of insurance is skyrocketing in hurricane- and fire-prone states like Florida or California. In Europe, prices are also soaring across the continent. For instance, thousands of municipalities across France are struggling to secure affordable insurance coverage, partly due to increased extreme weather events. The same is true in the UK, where at least one municipality has officially become "uninsurable".

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WHY IT MATTERS

When insurance is not affordable or simply unavailable, **the consequences extend across the whole economy.** For banks, this means increased risk, decreased asset value and reduced lending activities. For businesses, certain geographical areas become just too risky or expensive to operate in. For people without insurance, selling a home or getting a loan becomes challenging or even impossible. Communities become overall more vulnerable, and increasingly reliant on government support to repair and rebuild after extreme weather events.

As a result, citizens often end up paying twice: once through higher insurance premiums, and again through taxes if the government has to intervene and use public funds to provide support.

THE PROTECTION GAP PARADOX & OTHER CHALLENGES

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- Despite the growing protection gap, **insurers are making record profits, in part by supporting polluting industries such as fossil fuel companies** through insurance coverage and investments in their projects. Paradoxically insurers profit from both activities that drive climate change and from protecting households, businesses, and local authorities against the increasing damage caused by the climate-related disasters these activities help create.

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- **Insurers have a critical role to play in tackling the insurance protection gap.** However, **the issue extends beyond insurance** to urban planning, land management, building codes, energy policy, consumer protection, and public finances - among others. Effective action thus requires concerted efforts across different sectors.

- **The gap varies widely across countries.** Different natural catastrophe schemes, different risk levels, and overall different rates of insurance coverage make a unified European solution more difficult to achieve.

- The European Union and national governments could address the insurance gap in a coordinated way. Yet, current approaches risk making the gap larger and longer lasting.
  - **National governments still subsidise fossil fuels,** which are the number one cause of climate change, intensify extreme weather events and accelerate natural processes.
  - **EU policymakers** are enacting laws that undermine the transparency and accountability needed from companies to transition to a more sustainable economy.

4 WHAT IS MISSING FROM CURRENT DEBATES

- **Current debates often sideline the root causes of extreme weather events.** Many proposals prioritise transferring risk instead of reducing it, despite clear evidence that failure to address the root causes undermines the value of investments in adaptation.

- **Accountability for the role of insurers,** and other major actors, in contributing to climate change **is rarely addressed,** underscoring the need for public-private collaborations that combine responsibility with concrete action.

- **Affected communities are too often excluded** from these discussions, even though their perspectives and real-life experiences are essential.

- **Long-term financial risk management remains insufficiently prioritised**, despite the strong link between financial stability and the availability and affordability of insurance.

- The spotlight is currently on **industry-led innovation** to create new solutions and tools to address the insurance protection gap. However:
  - Innovation **focuses solely on financial products**, such as catastrophe bonds or parametric insurance, that transfer risk, rather than on practices and instruments to boost protection and resilience, such as risk-reduction incentive programs or nature-based solutions;
  - Innovation rarely extends to **the rules, structures, and decision-making processes that determine how insurers operate**, which could be rethought to make the sector more adaptive and fit for purpose.

JOINT EFFORTS AT THE EU LEVEL TO ADDRESS THIS GAP 5

EU member states, institutions, and supervisory authorities are increasingly working with **insurers** and **civil society organisations** to address the issue. **Municipal and regional authorities** are also emerging as key local stakeholders.

The European Commission is currently developing a plan to help Europe prepare for climate change - **the European climate resilience framework** – where insurance plays a prominent role. The public consultation is now open, and a legislative proposal is expected by the end of 2026. The consultation explains the main ideas under consideration, such as making all policies more climate-proof, providing people with better information about risks linked to climate change, helping governments and businesses manage climate risks, and making insurance more accessible and more affordable.

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SHAREACTION'S POLICY RECOMMENDATIONS

To close the protection gap and protect communities, EU financial policymakers must:

- Address the root causes first:
  - **Implement the recommendation made in 2024 by the European Insurance and Occupational Pensions Authority (EIOPA), the EU insurance supervisor,** to properly account for the high climate risks of investments in fossil fuels, which would make such investments more expensive;
  - Mandate **further research** to explore the application of the same principle to insurers' coverage of high climate risk projects.
- Require insurers to:
  - Consider the risks of climate change on investment and underwriting strategies over **longer time horizons;**
  - **Enhance transparency** in natural catastrophe insurance pricing and coverage;
  - **Support and incentivise people** to take measures to make their properties more resilient, including through discounts on the price of their insurance.
- When developing EU wide solutions:
  - Make sure that insurers taking part in public-private schemes **have developed and adopted solid transition plans and do not fuel climate change via their business decisions;**
  - **Address structural gaps in communication and coordination between insurers and other financial institutions**, such as banks and pension funds, that contribute to the widening of the protection gap;
  - Explore practical **mechanisms to hold polluters financially accountable and ensure they contribute** to the costs of resilience and adaptation;
  - **Strengthen the inclusion of representatives from civil society, consumer organisations, and affected communities** in debates and proposals.

About ShareAction

ShareAction is an independent charity and an expert on responsible investment. We work to build a world where the financial system serves our planet and its people. We set ambitious standards for how financial institutions, through their investment decisions, can protect our planet and its people and we campaign for this approach to become the norm. We convene shareholders to push companies to tackle the climate crisis, protect nature, improve workers' lives and shape healthier societies. In the UK and EU, we advocate for financial regulation that has society's best interests at its core.

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