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Managing Supervening Circumstances in the Insurance Undertaking and the Insurance Contract

LEGAL, ECONOMIC AND MANAGERIAL PERSPECTIVES

BALANCING CONTRACTUAL STABILITY AND CORPORATE RESILIENCE

Sector Analysis and Reform Perspectives

Dr. Daniela Santarpia
PhD in Private Law, University of Siena

Introduction

- The issue of supervening circumstances plays a central role both in business activity and in the performance of insurance contracts.

- A supervening circumstance may be defined as a new event occurring after the conclusion of a contract or after a business decision has been made, capable of altering the original balance upon which that relationship was founded.

Insurance undertakings operate in an environment characterized by uncertainty and must be able to manage events that affect:

- the insured risk
- product profitability
- the solvency of the undertaking
- contractual relationships with policyholders

How can the balance between contractual stability and adaptation to changing economic and social realities be preserved?

Supervening Circumstances as a Legal Category

Definition of supervening circumstances

events arising occurring after the conclusion of the contract that change the context in which its performance takes place

Factual

unforeseen and unforeseeable changes in the factual assumptions underlying the contract

Regulatory

legislative or regulatory interventions, or developments in case law, that modify the relevant legal framework

Economic

macroeconomic phenomena, such as inflation, systemic financial crises or sudden changes in the target market

Legal effects of supervening circumstances

Performance of obligations

alteration of the ability to perform the obligations undertaken by the parties

Utility of the contract

alteration of the expected benefit compared with the initial intention

Economic equilibrium

alteration of the proportionality between the parties' reciprocal burdens

The management of supervening circumstances

raises a constant dilemma between the principle of pacta sunt servanda and the need to preserve contractual equilibrium

requires a balance between the stability of the binding relationship and the dynamism of economic realities

Practical implications

- contractual adaptation
- renegotiation of the contract
- remedies to restore contractual fairness

Supervening Circumstances in Business Activity

Disruption factors

Businesses operate in a dynamic environment, where external factors may rapidly change scenarios, objectives and outcomes, profoundly altering their business model.

Technological innovation

Rapid obsolescence and transformation of operational processes

Changes in demand

Constant evolution of consumer preferences and behavior

Legislative reforms

Regulatory interventions imposing new compliance obligations

Geopolitical crises

International instability and its impact on global value chains

Climate events

Extreme environmental risks that affect business continuity

Inflation and costs

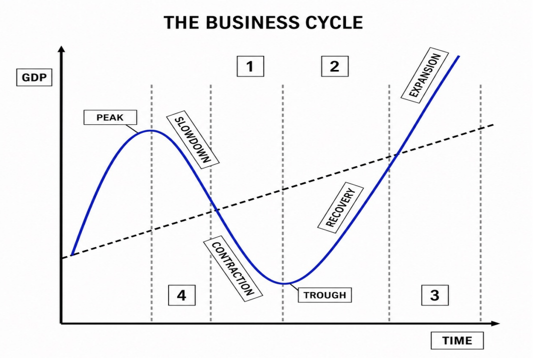
Pressure on margins resulting from the increase in input costs

Resilience and Governance

- The ability to manage supervening circumstances is a pillar of corporate resilience.
- A transition is needed from reactive management models to proactive ones.
- A strategic approach should be adopted to integrate uncertainty into corporate governance decision-making processes.

The ability to address supervening circumstances is a pillar of corporate resilience: modern governance is based on the preventive management of uncertainty.

Anticipating, monitoring and adapting are the keys to creating value and ensuring continuity.



ANALYSIS OF THE ECONOMIC CYCLE AND MARKET PHASES

The Insurance Sector and the Risk of Supervening Circumstance with particular regard to non life insurance

Systemic uncertainty: emerging risks

Insurance undertakings operate over an extended time horizon, assuming risks whose consequences may materialize many years after the contract has been concluded.

Innovation and Cyber Risks

New categories of loss arising from digitalization and systemic cyber threats

Developments in case law

Changes in the interpretation of the regulatory framework that could expand the insurer's liability

Climate change

An increase in the frequency and severity of claims related to extreme weather events

Pandemic events

Global supervening circumstances that simultaneously affect multiple insurance lines

Impact on Claims

Technical dynamics

Supervening circumstances affect the frequency (number of events) and severity (average cost) of claims, making historical statistical models obsolete.

Prudential supervision

Forward-looking risk management is crucial for financial stability and solvency. Continuous monitoring is necessary to adjust reserves and tariffs in real time.

Preserving the balance between capital stability and policyholder protection

Aggravation of Risk

When the insured risk increases significantly after the conclusion of the contract …

I

Inform

If changes arise that aggravate the risk, the insured is required to notify the insurer immediately where the new risk would have been relevant at the time of policy inception.

II

Adapt

Where risk has been aggravated, the insurer may propose an adjustment of the contractual terms in order to preserve proportionality between the risk assumed and the premium paid.

III

Terminate

Where permitted by law, the insurer may terminate the contract.

The legal framework reflects the fundamental principle of cooperation and good faith between insurer and insured.

Reduction of Risk

A reduction in the probability of loss constitutes a relevant supervening circumstance, altering the contractual synallagma and requiring a rebalancing of the parties' performances.

Economic impact

- Decrease in the statistical probability of occurrence of the insured event
- Reduction in the expected cost of coverage for the insurance undertaking
- Technical margin exceeding the original actuarial forecasts

Cost efficiency and sustainability

Protection of fairness

- The insured's right to request a premium reduction proportionate to the risk
- Guarantee of contractual fairness: the premium must be proportionate to the actual current risk
- Prevention of unjust enrichment by the professional contracting party

Rebalancing of the synallagmatic relationship

The legal system protects contractual fairness by preventing the insurer from receiving a premium no longer justified by the actual exposure to risk.

Extraordinary Supervening Circumstances and Contractual Equilibrium

The exceptional events of the last decade have affected the contractual basis of numerous long-term contracts, highlighting the need to move from the formal rigidity of contractual bond to a logic of dynamic adaptation in order to preserve relationships that develop over time.

COVID-19 pandemic

The pandemic caused temporary impossibility of performance or drastic alterations in the utility of performance

Geopolitical crises

Wars and international sanctions have interrupted established trade flows, making performance excessively onerous and impossible to perform

Energy crises

Extreme volatility in resource costs has had directly effects on industrial margins and on the equilibrium of contractual relationships

Inflationary phenomena

The accelerated erosion of the real value of monetary performances alters the exchange relationship originally agreed between the parties

STRATEGIC OBJECTIVE

Preserve contractual equilibrium in order to ensure continuity of the relationship and the resilience of the economic-insurance system

Inflation and Insurance

Rising costs, price pressure and the sustainability challenge

Effects of inflation: impact on costs and claims

Repair costs and Assets

Increase in the prices of materials and labour; revaluation of insured assets, such as real estate and vehicles

Claims settlement

Increase in the value of compensation for pecuniary and non-pecuniary losses

Healthcare costs and services

Growth in costs for medical services, diagnostic technologies and hospital fees, with a direct impact on health insurance policies

Managerial responses: insurer adjustments

Technical provisions

Need to recalculate incurred-but-not-reported claims reserves (IBNR reserves) to reflect the higher expected cost

Pricing policies

Review of tariffs and premiums to ensure technical equilibrium and long-term sustainability of insurance products

Actuarial models

Integration of inflationary trends into solvency projections and processes for calculating the probability of loss

Inflation acts as a systemic economic supervening circumstance that alters the contractual synallagma.

The challenge for undertakings is to preserve the sustainability of insurance products without compromising the affordability of coverage for the insured, balancing profitability and social inclusion.

Climate Change as a Systemic Supervening Circumstance

A structural and permanent supervening circumstance that permanently redefines the risk landscape for the entire insurance sector

BEYOND EPISODICITY

The effects

- **Extreme natural events:**
  increase in the frequency and severity of weather phenomena
- **Catastrophic claims:**
  increase in aggregate claims payments arising from systemic events
- **Increase in statistical uncertainty:**
  historical data lose predictive reliability

Integration into business processes

Underwriting processes

integration of climate risk into the process of risk assessment and underwriting

Pricing methodologies

calibration of premium structures to reflect the increasing frequency and severity of catastrophic events

Capital management

calculation of adequate capital reserves to mitigate risks

Strategic planning

integration of long-term climate risk into corporate strategy, product design and investment decisions

The insurance system must reconcile legal certainty with the flexibility required to manage emerging systemic risks.

«Integration» is no longer optional: adapting the business model to climate resilience has become the rule!

Solvency II and the Management of Supervening Circumstances

European prudential regulation

Solvency II requires insurance undertakings to adopt a continuous and forward-looking view of risks, transforming the management of supervening circumstances from a reactive into a proactive process, in order to ensure capital stability in extreme but plausible adverse scenarios.

ORSA

Own Risk and Solvency Assessment (ORSA)

- assessment of the overall solvency needs
- continuous compliance with capital requirements
- integration of emerging and sustainability risks into the strategic plan

STRESS TESTING

Simulation of the impact of exceptional adverse events on financial stability

- market shocks, including interest rates, spreads, equities
- catastrophic events, including pandemics and floods
- assessment of the resilience of technical provisions.

SCENARIO ANALYSIS

Multidimensional analysis of structural changes and combinations of risk factors

- evolving judicial and regulatory developments
- long-term climate change
- macroeconomic supervening circumstances , including inflation

The objective is to ensure that the insurance undertaking is able to manage supervening events and internalise their effects without compromising its financial stability.

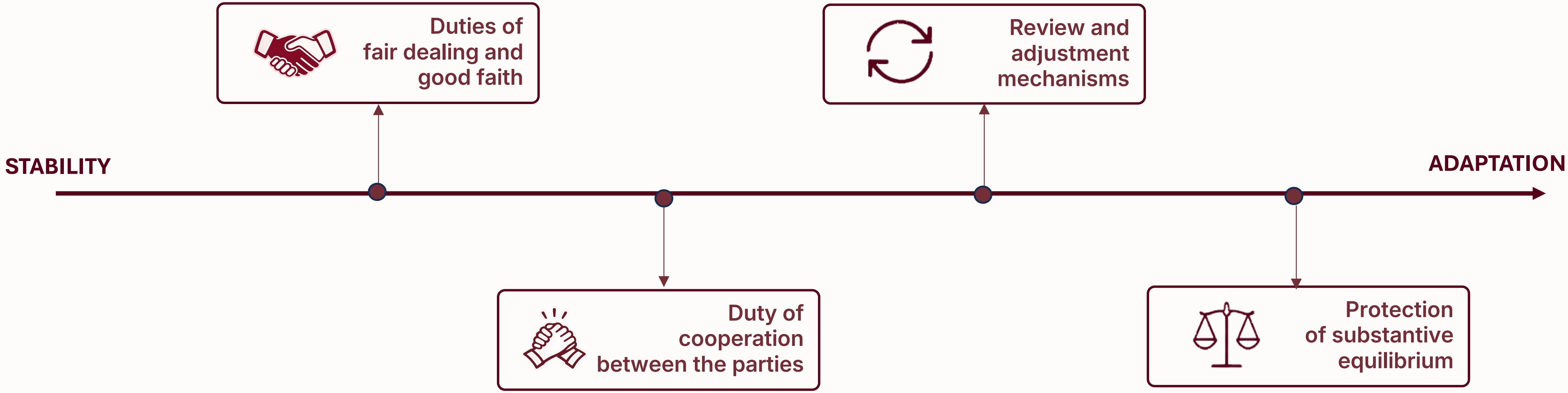
From the Immutability of the Contract to the Logic of Adaptation

Traditional contract model

- **Pacta sunt servanda**: immutability of the binding relationship
- **Static allocation of risk**: crystallized at the time of conclusion
- **Formal equilibrium** between the parties' performances

Modern view of the contractual relationship

- **Dynamic relationship**: a contractual relationship that may change over time if circumstances change
- **Structural flexibility**: provision of adjustment and renegotiation mechanisms to manage supervening circumstances
- **Substantive fairness** between the parties' performances



EVOLUTIONARY SYNTHESIS

The modern insurance contract is no longer a static bond, but an "adaptive reality".

The strength of insurance does not lie in its static nature, but in its capacity to renew itself and adapt to real-world challenges, so that the relationship between the parties remains effective, sustainable and balanced.

Conclusions

The management of supervening circumstances is the cornerstone of modern insurance resilience.

- **The management of uncertainty becomes a strategic imperative for the future of the insurance market.**
- **The effectiveness of the insurance system depends on its ability to combine legal stability and operational flexibility in order to address a context characterized by rapid and unpredictable change.**

STRATEGIC PERSPECTIVES

Legal certainty

Ensuring the stability of the legal relationship and the protection of the insured through clear and predictable rules and transparent contracts, also with a view to protecting competition

Protection of the parties

Ensuring substantive fairness between the contracting parties by reducing information asymmetries, thereby fostering trust in the insurance system and market stability

Contractual flexibility

Implementing mechanisms for dynamic adaptation of the relationship to preserve the functional synallagma in the face of regulatory, economic and climate-related changes

Corporate resilience

Integrating uncertainty management into governance and prudential supervision processes in order to ensure the undertaking's long-term sustainability and competitiveness

The stability of the insurance market lies in its ability to manage supervening circumstances, transforming the unpredictable into an opportunity for structured adaptation and shared protection.

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