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Perfect

Financial Storm

MINDY LUBBER describes the rising threat to insurers and their customers from climate change

Hurricane Katrina was a poignant reminder that insurers, governments and consumers are at enormous risk from escalating losses from hurricanes and other weather-related events. While no one storm can be attributed to global warming, rising global temperatures are likely to cause significant increases in severe weather events – such as hurricanes, floods, hailstorms, wildfires, droughts and heat waves – in coming decades. Unless insurers and their regulators take steps to address this growing challenge, companies, governments and the public will suffer even greater financial losses in the future.

Insurance is threatened by a perfect storm of rising global temperatures, rising weather losses, and more people than ever living in harm's way. Insurers and

regulators have failed adequately to plan for the weather events that scientists predict will intensify with global warming.

Increased restrictions

As it happens, the U.S. National Association of Insurance Commissioners (NAIC) was planning to discuss the implications of climate change on the insurance industry at a meeting scheduled for September in New Orleans. Katrina forced its cancellation and the discussion is now slated for December in Chicago.

Even before Hurricane Katrina, consumers and businesses in many parts of the United States were seeing higher premiums, lowered limits and increased restrictions in coverage due to rising weather-related losses. Now

a new report commissioned from three insurance industry experts by Ceres – a US-based network of institutional investors, companies, and environmental organisations – has warned that if present trends continue, the availability and affordability of insurance will be at even greater risk for homeowners and businesses. State and federal governments can also expect more financial liability as they increasingly become “insurers of last resort” as private insurers further restrict coverage and withdraw from more markets.

Economic impacts

The report cites a 15-fold increase in insured losses from catastrophic weather events – those with over \$1 billion of damages – in the past three decades. The number of weather-related events and their economic impacts are increasing. Global insured and total property losses – \$45 billion and \$107 billion in 2004, respectively – are rising even faster than premiums, inflation, population or economic growth. Individual insurers from four continents have organised under the United Nations Financial Services Initiative, expressing concern about climate change: firms from Australia, Austria, Canada, ►

France, Germany, Italy, Japan, the Netherlands, New Zealand, Norway, Russia, South Korea, Spain, Sweden, Switzerland, Thailand, and the United Kingdom are all involved. Most notably, reinsurers Munich Re and Swiss Re have begun to explore how climate change will affect their investments and the policies they cover.

Some US insurers and other industry players have also expressed concern, but the American Insurance Association (AIA) viewed the threat from global warming as a relatively minor issue in a brief paper prepared in 1999, and no U.S. primary insurance trade associations have taken public positions or made recommendations, until now. The December meeting will mark the first time the US insurance industry fully examines the effect of climate change on its business.

Many studies predict that rising global temperatures from higher emissions of greenhouse gases (GHGs) will increase financial burdens for insurers globally and in the United States. A 2004 report by the Association of British Insurers concluded that a high GHG emissions scenario (where carbon dioxide levels double from today's levels, as predicted by many leading climate models) could require insurers to boost their capital requirements by 90 per cent, leading to substantially higher premiums and other adverse consumer impacts. Losses under a low-emissions scenario (carbon dioxide levels 40 per cent above today's levels) were only one-fifth as high.

New challenges

Weather losses are becoming more unpredictable, especially as insurers from the U.S. and other industrialized countries move aggressively into rapidly emerging markets such as China and India, which pose additional risks. With growth rates triple those in industrialized countries, premium volume from the developing world will represent half of the global total in the next few decades. Lack of building codes and other factors make them vastly more vulnerable to the costs and other impacts of climate change.

The following actions, among others, are required:

- Insurers need to: collect more complete data on weather-related losses; incorporate climate modeling into their risk analyses; analyze the implications of climate change on their business and investments and share the results with shareholders; and encourage policy action to reduce greenhouse gas emissions.
- Regulators need to: include climate risks in company solvency and consumer-impact analysis; review the "standards of insurability" to identify new challenges, including climate-related hazards; encourage insurers to collect more comprehensive data on losses; elevate standards for catastrophe modelling; and assess exposure of insurer investments and adequacy of capital and surplus to extreme weather events.
- Governments need to: foster and participate in

public-private partnership for insurance risk spreading; comprehensively assess their overall financial exposure to weather disasters; reduce vulnerability to disaster losses through improved early warning systems, land use planning and other measures; and – in China, India, the United States and Australia – take policy action to reduce greenhouse gas emissions.

Joel Ario, the Oregon State Insurance Administrator and Vice President of the NAIC, believes that insurers need to do more to assess their growing risks and financial exposure from climate change. "The insurance industry plays a vital role in identifying and quantifying catastrophic risks so that appropriate loss prevention and risk-spreading measures can be put into place," he says. "Reinsurers who provide a backstop on large losses are engaged on the climate issue, but much more work needs to be done by the primary insurers whom consumers rely on when catastrophes hit."

Though insurance companies have been slow to grasp the significance of global warming, institutional investors are leading the way in addressing it. Jack Ehnes, chief executive officer at the California State Teacher's Retirement System – at \$118 billion, one of the United States' largest pension funds – says "investors are increasingly more concerned about the financial risks posed by climate change, and our interest is especially strong for an industry that is so directly exposed to the physical impacts of global warming. Insurers must take active steps to understand and assess these daunting tasks." ■

Mindy Lubber is the president of Ceres, which directs the Investor Network on Climate Risk (INCR), a network of more than 50 institutional investors in the U.S. and Europe collectively managing over \$2.7 trillion of assets.



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