



# Time to act on climate change

Insurers are seizing the commercial benefits from climate change, but is the industry doing enough to address climate-related problems, or worse still, contributing to them?

Climate change has become a hotter topic than ever before, thanks to the new political leadership in the US following the election of Barack Obama. The insurance industry appears to finally be taking climate change seriously, with a flurry of reports being issued in recent months.

Climate change has long been on the radar of the insurance industry. Surveys of industry analysts, representatives and boards consistently rank climate change among the top risks facing the industry. But a criticism often levelled at insurers is that, while paying lip service to the threats associated with climate change, there has been very little action.

This is strange given that insurers have more incentive than most other industries to influence global policy on climate change. Though 2008 brought no Katrina-scale catastrophes, catastrophic losses to the economy were the third-highest ever, exceeding \$200bn globally in 2008, including \$40bn losses from hurricanes Ike and Gustav in the US alone, according to Munich Re.

While the growing frequency of severe climate-related natural catastrophes has been well documented, the insurance industry has quickly come to realise that uncorrelated effects associated with climate change pose just as an important threat to the industry.

In addition to the increasing incidence of freak weather events, there is growing concern that climate change will increase water scarcity, alter food production and dramatically change energy supply and migration patterns.

A report released by Lloyd's, *Climate Change and Security: Risks and Opportunities for Business*, launched in conjunction with the International Institute for Strategic Studies earlier this year, warns that failure by governments and the private market to address climate change could have severe consequences on global security.

Speaking at the launch of the report, Nigel Inkster, director of transnational threats and political risk at the institute, warned that changing rainfall patterns could lead to a scarcity of water supply in certain regions, resulting in the potential for conflicts related to large rivers that flow through several countries.

For instance, the neighbouring nuclear powers of India and Pakistan could find themselves in conflict over access to the diminishing supply of water from the Indus valley basin.

"The [Indus Water Treaty of 1960] has proved remarkably resilient," says Inkster. "However, climate change may bring this into question and Pakistan may not be able to cope. The question is how they will behave."

The report also warns that climate change may generate serious problems for global food supply, manifesting first as sharp price increases and subsequently as absolute scarcity.

The world's population has tripled in the past 60 years, but it is all being fed from essentially the same land as before. And with the population estimated to grow to at least 9bn by 2015, from about 6.8bn now, food nationalism is an increasing threat.

In the case that food-exporting countries decide to take a protectionist approach and break binding contracts to supply food to the global market, Inkster warns that the global food market could cease to "function in the way we are accustomed".

Climate change is also likely to produce destabilising waves of refugees. Population movements brought about by the climate are likely to lead to the rise of the megalopolis, a large urban development comprising several cities and towns.

Large areas of cities, such as Rio de Janeiro, have become effectively unpoliceable and have fallen under the control of organised criminal groups.

"In Brazil battles have taken place between security forces and organised criminal groups, which the governments concerned did not win," says Inkster. "The risk of the unmanageable megalopolis is something we must take into account as the world becomes more urbanised."

Such threats may appear uncorrelated to traditional catastrophe-related risks faced by the insurance industry. But Domenico del Re, director of product management at Risk Management Solutions, says such issues will become equally important.

"In a more uncertain world the potential cost of business interruption claims caused by political unrest and disruption to supply chains will be borne by the insurance industry," he says. "To create an environment to maintain insurability we must be able to quantify how unrest and water scarcity disrupt options of policyholders in business interruption claims."

#### A changing mood

Such concerns are not going unnoticed by the insurance industry. According to a report by Ceres, a national network of investors, environmental organisations and other public interest groups working with companies and investors to address sustainability challenges such as global climate change, the insurance industry is making progress in developing products and services to help global consumers and businesses reduce their exposure to climate change – and to reduce the emissions causing global warming.

The report identifies 643 real-world examples from 244 insurers, reinsurers, brokers and insurance organisations from 29 countries – a 50% jump in such activity compared with November 2007, when Ceres issued a similar report.

Insurance coverage for green buildings, renewable energy, carbon capture and storage and carbon trading are being offered by more insurers than ever before.

Michael Butt, chairman of Bermudian insurer and reinsurer Axis Specialty, says it is important for insurers to encourage clients to make changes in response to climate change.

"We can send pricing signals to encourage adaptation. If a client comes and says, 'I have done this to my property,' it should be reflected in the premium," he says.

Insurers are offering products and services especially designed for new green buildings and upgrades to green traditional buildings either following a loss or in the course of normal renovations.

According to Ceres, the sophistication and specificity of existing products is increasing, with 22 companies surveyed in the report collectively offering 39 products or services for green buildings and equipment.

Speaking to **Reactions** at a recent Association of Insurance and Risk Managers conference, Stefano Tranquillo, vice-president of



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UK operations at FM Global, says his firm is working to better understand green buildings and onsite renewable energy supply and the exposures that will bring about.

"We are working on coverage and hope to later this year come out with a sustainable endorsement," he says.

"If a building is burnt down and the owner commits to a sustainable green building, coverage should be extended to include the increased costs."

Insurers are also looking at climate-related innovations in liability insurance. For the first time, two insurers, Zurich and Liberty Mutual, have introduced directors' and officers' liability (D&O) coverage specifically tailored to address liability risks associated with climate change, an important development given pending lawsuits that could allocate large costs to the biggest emitters of greenhouse gases.

Almost all of the climate-related innovations in liability insurance for D&O, political risk, professional liability, and environmental liability have appeared in the past year.

Renewable energy is also receiving more attention as a market for insurance products and services. Cover for energy providers faced with lower-than-anticipated solar or wind energy production has been introduced by Axa, Munich Re, Navigators, Sampo Japan, and Tokio Marine.

But, while many of the new products are able to cash in on emerging industries and risks associated with climate change, Andrew Tunnicliffe, chief operating officer of Aon Global Risk Consulting, questions how much some policies are aligned with corporate responsibility.

"Take the established market for catastrophic weather events. Is that type of market totally aligned with corporate responsibility? It takes advantage of a long-term issue in a short-term sense and is not addressing the fundamental problem," says Tunnicliffe.

"What about other insurance products where you can argue that if they are not structured correctly they will promote reckless

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behaviour? Look at environmental cover. Does it encourage people to act recklessly?”

### Work to be done

Insurer activities go far beyond offering new products. The Ceres report documents the industry’s growing investment in businesses that are developing and offering low-carbon and no-carbon technologies – specifically, a total of \$11bn in direct investments by 15 insurers – nearly double the figure in 2007.

However, according to the report, the industry’s response – judging by areas such as underwriting, investment and public policy engagement – is still incremental.

The bulk of market activity is in Europe, primarily from property/casualty insurers, but even among these firms, the offerings – and overall market saturation – are very limited, Ceres says.

While property insurance companies are driving the majority of the activity through homeowner, commercial, and auto policies,

life and health companies are lagging far behind.

Tunnicliffe at Aon agrees the industry could be doing more. “There are carbon emission insurance products around such as for hybrid cars that attract lower rates. But are insurers going the extra mile, are they looking at supply chain and asking how green is your supply chain? They need to take this seriously.”

While insurer investment in and financing of low and no-carbon technologies is becoming more common, it remains a tiny proportion of the industry’s total investments of \$16.6 trillion in 2005. The Ceres report catalogues a total of \$11bn in cumulative direct investments in low- and no-carbon technologies by 15 insurers, almost double the figure in 2007.

European insurers remain far ahead of their US and Asian counterparts in investing in climate solutions and setting voluntary standards for sustainable investments, with the notable exception of American International Group as a leader among US insurers.

In July, for example, Munich Re established Desertec, an industrial initiative to analyse and develop the technical, economic, political, social and ecological framework for carbon free power generation in the deserts of North Africa.

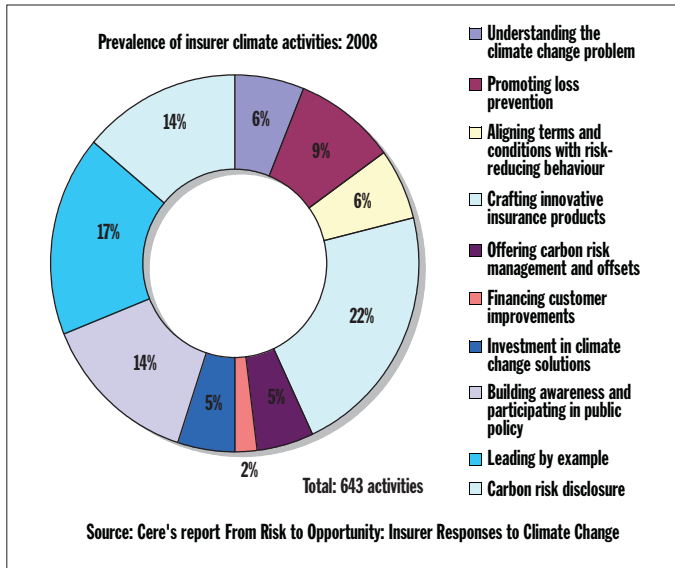
The Desertec concept describes the perspectives of a sustainable power supply for all regions of the world with access to the energy potentials of deserts.

“If it is successful, we will make a major contribution to combating climate change,” said Torsten Jeworrek, member of the board of management at Munich Re, when the initiative was announced. “The ecological and economical potential is huge.”

### Walking the talk

While most trade organisations remain quiet on climate change, the Association of British Insurers has become an important hub





of activity in the UK and the Reinsurance Association of America adopted its first climate change policy in 2008.

And global reinsurers such as Swiss Re and Munich Re have been proactive in producing research in order to provide a better evaluation and management of climate risks.

It is in the area of thought leadership that Tunnicliffe at Aon believes the insurance industry can take a lead in combating climate change.

“With the industry’s knowledge and experts we genuinely could assist others in a substantial way. As an industry we have got to be prepared to give away intellectual property to help support emerging markets and where you have got macro problems,” he says.

Signing statements is one thing, following up with actions another. And for insurers to be taken seriously when promoting the need of businesses to engage in climate conscious practices, they must first show that insurance is itself a socially responsible industry.

“Measurable actions include further reductions of our – relatively moderate – carbon footprint,” says Butt at Axis. “Much more relevant, however, are measures related to our core business: the management and absorption of risk. This is a powerful lever to pull as it directly affects the behaviour of individuals and organisations.”

Insurers are increasingly recognising the importance of addressing their own carbon footprints. The Ceres report estimates that the global industry emits about 12 million metric tons of carbon dioxide each year, which is equivalent to the emissions from 2.5 million US cars, four large electric power plants, or 60,000 train cars full of coal.

According to the report, 17 insurers and reinsurers and six brokers have achieved carbon neutrality, and others have public commitments to attain carbon neutrality at a specific point in the future.

But in order to improve the insurance industry’s credibility in the climate change debate, it must develop solutions that aid the transition to a low-carbon economy, encourage and make direct investments in projects that help reduce emission levels and effectively embed incentives for climate-conscious behaviour into its policies even if this goes against short-term revenue maximisation.

Despite the positive words, this pragmatic approach still seems a distant reality. ●

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