THE GENEVA ASSOCIATION

COP 21 Paris Agreement: What Does It Mean for the (Re)insurance Sector?

A GENEVA ASSOCIATION RESEARCH REPORT

By Maryam Golnaraghi with contributions from David Bresch, Peter Höppe, Karsten Löffler, Masaaki Nagamura, and Ernst Rauch

February 2016

The Geneva Association

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Established in 1973, The Geneva Association, officially the 'International Association for the Study of Insurance Economics', is based in Zurich, Switzerland and is a non-profit organisation funded by its members.

About COP 21

The international political response to climate change began at the Rio Earth Summit in 1992, where the 'Rio Convention' included the adoption of the UN Framework on Climate Change (UNFCCC). This convention set out a framework for action aimed at stabilising atmospheric concentrations of greenhouse gases (GHGs) to avoid "dangerous anthropogenic interference with the climate system." The UNFCCC which entered into force on 21 March 1994, now has a near-universal membership of 195 parties.

The main objective of the annual Conference of Parties (COP) is to review the Convention's implementation. The first COP took place in Berlin in 1995 and significant meetings since then have included: COP3 where the Kyoto Protocol was adopted; COP11 where the Montreal Action Plan was produced; COP15 in Copenhagen where an agreement to succeed Kyoto Protocol was unfortunately not realised and COP17 in Durban where the Green Climate Fund was created.

France held the presidency of COP21 in 2015, also known as the 2015 Paris Climate Conference and played a leading international role in hosting this seminal conference. The conference attracted 19,385 delegates from governments, intergovernmental organizations, United Nations, NGOs and civil society as well as more than 10,000 observing participants. The COP21 Paris Agreement is the first new global climate deal since the Kyoto Protocol 18 years ago, which will be binding under international law.

To visit the official COP21 website for more information, click here.

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By **Maryam Golnaraghi**, *Director Extreme Event and Climate Risks Programme, The Geneva Assocation*
with contributions from:
David Bresch, *Head Business Development GP, Director, Global Partnerships, Swiss Re;*
Peter Höppe, *Head of Geo Risk Research, Corporate Climate Centre Work, Munich Re;*
Karsten Löffler, *Managing Director (Geschäftsführer), Allianz Climate Solutions GmbH, Allianz;*
Masaaki Nagamura, *Division Head of Corporate Social Responsibility, Corporate Planning Department at both Tokio Marine Holdings, Inc. and Tokio Marine & Nichido Fire Insurance Co., Ltd;*
and **Ernst Rauch**, *Head of Corporate Climate Centre, Munich Re.*

The Geneva Association

Talstrasse 70, CH-8001 Zurich | Tel: +41 44 200 49 00 | Fax: +41 44 200 49 99

secretariat@genevaassociation.org www.genevaassociation.org

Photo credits: Cover - Heads of delegations at the 2015 United Nations Climate Change Conference (COP21), which led to the signing of the Paris Agreement. By Presidencia de la República Mexicana under CC BY 2.0 via Wikimedia Commons.

February 2016

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Dr Maryam Golnaraghi, describes the implications of insurance being part of the recent Global Framework Agreement signed at COP21 in Paris.

Watch video

INTRODUCTION

On 12 December 2015, at the 21st session of the Conference of Parties (COP21) to the UN Framework Convention on Climate Change (UNFCCC), governments of 195 nations (Parties) reached a landmark international agreement, with binding obligations for all nations, putting the world on a track for long-term cooperation.[1]

In an unprecedented development, insurance and reinsurance are explicitly mentioned as a crucial component of risk management strategies. This report examines the most important aspects of the COP21 agreement from the (re)insurance perspective.

INSURANCE AS A KEY COMPONENT OF CLIMATE RISK MANAGEMENT STRATEGIES

It is clear from the explicit inclusion of insurance in the COP21 decisions and the Paris Agreement that both developed and developing countries recognise the importance of insurance as an integral part of national climate risk management strategies and the high potential for building financial resilience by expanding insurance.

INNOVATIVE INSURANCE SOLUTIONS TO FOSTER RESILIENCE

The outcomes of COP21 (and the Sendai Framework for DRR) have opened the doors for innovative insurance solutions, in both developed and developing nations. The insurance industry has the potential to contribute significantly to making societies more resilient with respect to the adverse effects of climate change and, at the same time, creating new business.

ACTIVE ENGAGEMENT OF THE INSURANCE SECTOR IN KEY DISCUSSIONS

The public sector is required to lay the institutional foundations, whilst the insurance industry is challenged to think and act more creatively to understand the risks, actively participate in defining the role of the private sector and consider new markets, products and strategies. To this end, active engagement in relevant public–private partnerships and closer cooperation amongst governments, (re)insurance, policy makers, regulators and other stakeholders is critical to paving the way.

SUPPORTING GREEN INVESTMENT AND EMISSION REDUCTION

It seems inevitable that by 2020 the (re)insurance sector will not only be providing a wider range of risk-transfer solutions, but also be supporting emission reduction efforts and transitioning to a low-carbon economy through its investment strategies as well as actively managing its carbon footprint.

IN SEARCH OF BETTER INVESTMENT STRATEGIES

Furthermore, with the agreements for the net-zero emission target by 2050, the (re)insurance industry has the opportunity to engage proactively with other key stakeholders to find the best investment strategies.

1. For a complete text of the Paris Agreements, see here.

ABOUT THE COP21 PARIS AGREEMENT

What is "historic" about this agreement is that, for the first time, a comprehensive approach to climate risk management was the underpinning theme. Also, all Parties acknowledged the anthropogenic causes of climate change, the need to limit the increase in global mean temperature to less than 2 degrees Celsius compared to pre-industrial temperatures, the need to develop and implement adaptation measures and to facilitate their financing.[2]

The final COP21 document consists of two segments: the first (pages 1–19) is the "COP Decisions" providing directions for the future work of the Parties, the UNFCCC and its associated bodies (Annex 1). The second (pages 20–31), is the legally binding "Paris Agreement" with 29 articles (hereafter referred to as the "Agreement").

The Agreement, the first new global climate deal since the Kyoto Protocol 18 years ago, will be binding under international law. Parties agreed to the period from 22 April 2016 to 21 April 2017 for its ratification.[3] The Agreement will be deemed accepted if it is ratified by at least 55 states accounting for an aggregate share of at least 55 per cent of global greenhouse gas emissions. If the Agreement is ratified, it will go into force by 2020, with the first global stocktaking in 2023 and every five years thereafter.

The three main objectives of the Agreement are: (i) mitigation of greenhouse gas (GHG) emissions (i.e. limiting the increase in global temperature); (ii) adaptation, including solutions for the management of loss and damage (i.e. increasing adaptive capacity and fostering climate resilience); (iii) financing through new commitments (make finance flows consistent with the first two objectives).[4]

What led to the success of the negotiations was that the negotiations took a non-confrontational and non-punitive approach to make sure that governments would comply with its provisions.[5]

2. The exact wording on the 2°C limit even goes beyond the original objective, targeting a temperature limit of 1.5°C, "holding the increase in the global average temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change" (Article 2).

3. UN Secretary General, Ban Ki Moon will be hosting a special event at the UN Headquarters in New York City on 22 April 2016.

4. See Article 2 of the Agreement.

THE PARIS AGREEMENT WILL BE BINDING UNDER INTERNATIONAL LAW

The Agreement is built on the concept of common but differentiated responsibilities (CBDR);[6] in other words, if ratified, the Agreement would apply to all countries, but almost all articles lay out different sets of requirements for developed and developing countries, considering the differences in their capacities.

Regarding decarbonisation, the net-zero emission target for after 2050 was agreed, providing a managed transition away from fossil fuels, with all countries officially on board. While the Agreement does not sanction if countries do not meet their voluntary targets (if it did, few parties would have agreed!), its major achievement is that all nations, developed and developing, are obligated to undertake and maintain plans for their nationally-determined emission reductions (referred to as the Intended Nationally Determined Contributions—INDCs).[7] They are also obligated to review and further raise their commitments every five years and report more transparently than before.[8,9]

Up to now, the UN has utilised a two-tiered system of reporting that imposes a much stricter requirement for developed nations than for those it classified as developing in 1992. However, the Agreement will establish a new, common reporting and monitoring system that would allow for simpler tracking of how much each country is emitting and what they are doing to reduce their contribution to climate change.[10]

5. Overall, much of the wording in the Articles related to reducing greenhouse gases and on the flow of financing in developing countries is formulated rather weakly, using "should" (voluntary) rather than "shall" (obligatory) terms. Furthermore, the target for the global greenhouse gas emission pathway is merely to achieve a maximum emission level as soon as possible, but without specifying any target year or time frame, "Parties aim to reach global peaking of greenhouse gas emissions as soon as possible, recognizing that peaking will take longer for developing country Parties…" (Article 4).

6. For more information, see here.

7. See here.

8. Exceptions are the Least Developed Countries and Small Island Developing States because of their special circumstances.

9. This agreement is much broader than the 1997 Kyoto Protocol, which limits GHG emissions in 37 developed nations.

10. Under this two-tiered system of reporting, for example, India and China are classified under the developing country category.

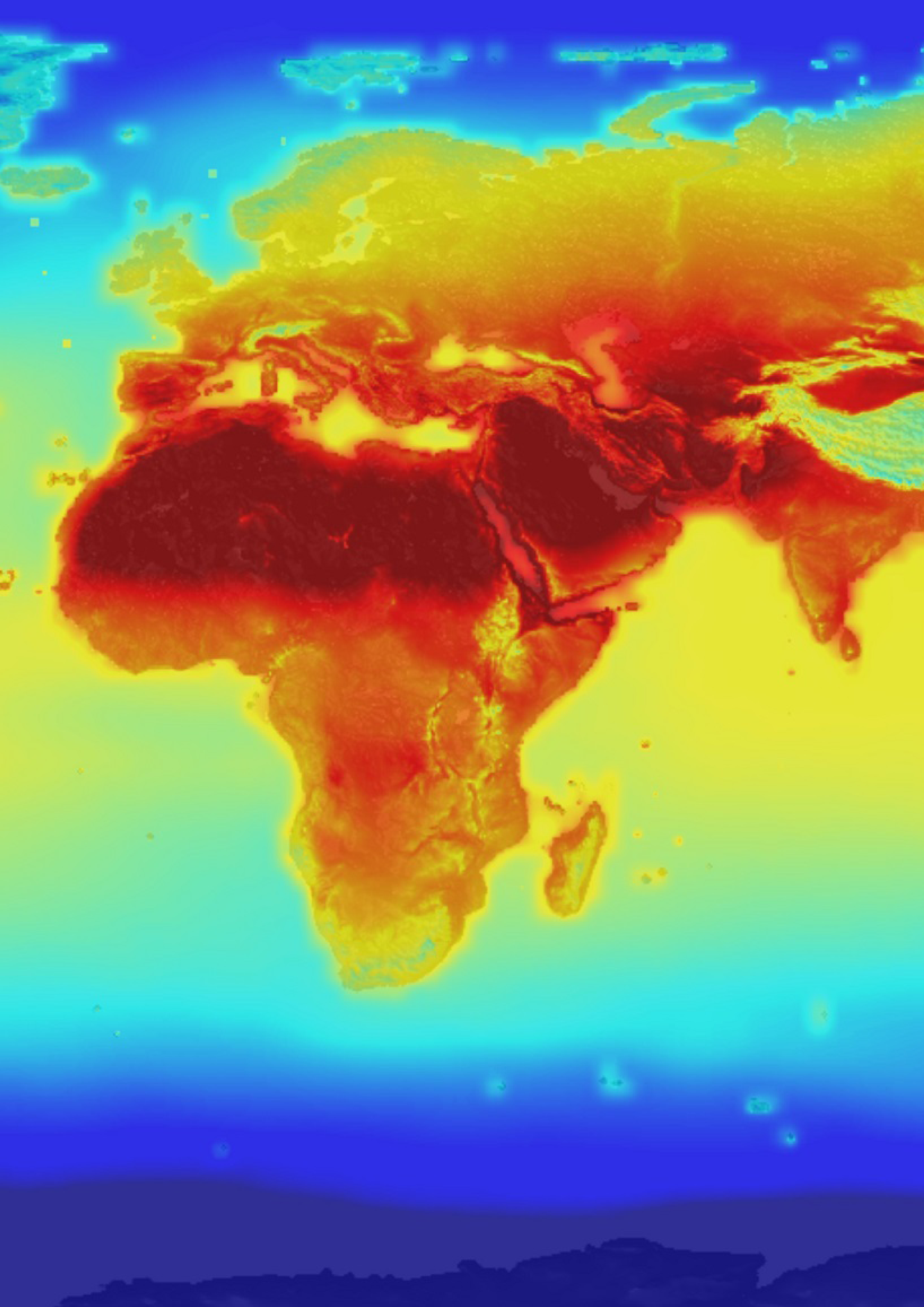
On the financing side, during the negotiations, the developing countries pushed to incorporate "obligatory terms" that would oblige the developed nations to deliver at least USD 100bn a year starting in 2020, as they had promised at COP15 (2010), and increase this amount thereafter. Yet, a number of developed countries hesitated to include the sum[11]. However, the Agreement obligates them to set a new collective sum of more than USD 100bn a year prior to 2025.[12] Also, only public financing is considered, and how private means may be leveraged is not yet resolved.

Countries experience different patterns of risks (risk being the product of hazards, exposures and vulnerabilities) and coping capacities; thus, they need specific strategies and measures for building climate resilience as part of their development agenda. Under its Adaptation and Loss and Damage objectives, the Agreement offers measures which include insurance and risk transfer.

Right: The new NASA global data set combines historical measurements with data from climate simulations using the best available computer models to provide forecasts of how global temperature (shown here) and precipitation might change up to 2100 under different greenhouse gas emissions scenarios. By NASA.

11. See Article 9 of the Agreement.

12. The following four entities are named as vehicles for administering the funds: the Green Climate Fund, the Global Environmental Facility, the Least Developed Countries Fund and the Special Climate Change Fund.



Leaders of the General sessions of the COP21 celebrate the adoption of the Paris Agreement. United Nations Conference on Climate Change - COP21 (Paris , Le Bourget)

COP21 AND THE INSURANCE SECTOR

Insurance is directly referenced in the two segments of the COP21 outcome document

DEVELOPED AND DEVELOPING COUNTRIES RECOGNISE THE HIGH POTENTIAL FOR BUILDING FINANCIAL RESILIENCE BY EXPANDING INSURANCE

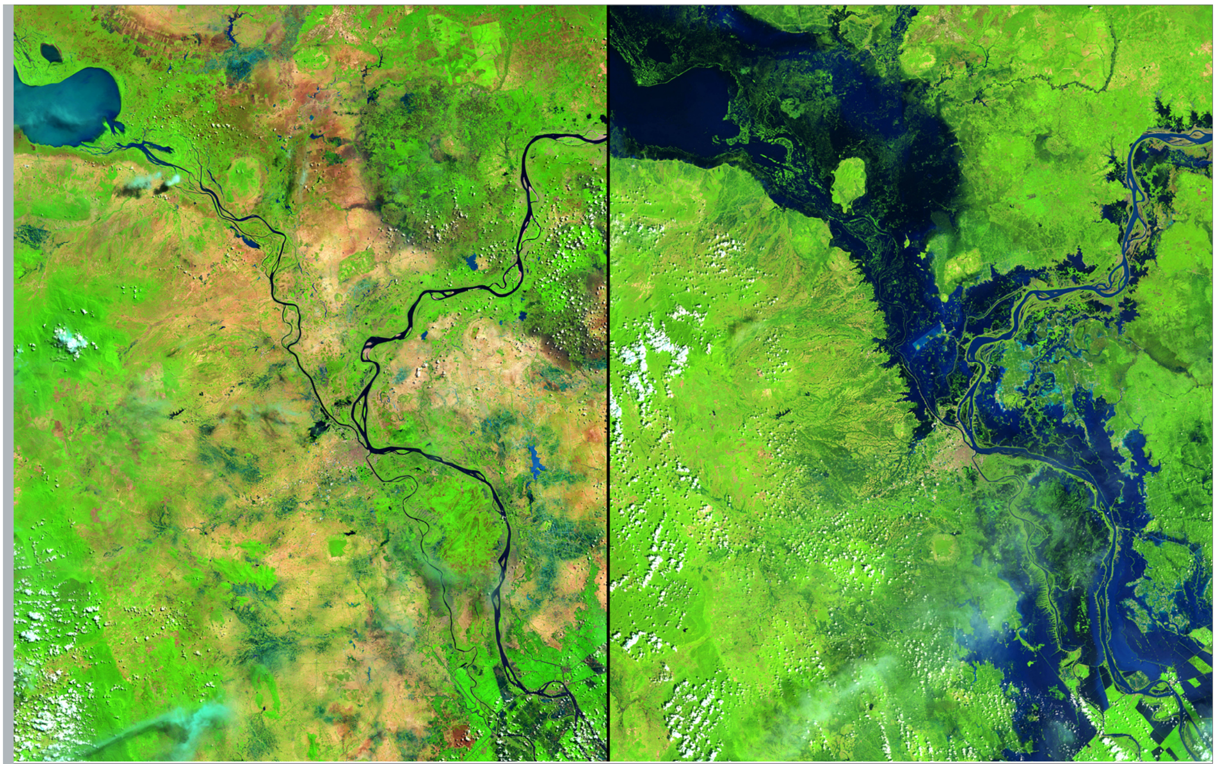
Insurance is considered as an essential tool to address loss and damage and is referenced directly under (i) Paragraph 49 (p. 7) of Section II ("Decisions to Give Effect to the Agreement") and (ii) Article 8 of the Paris Agreement (p. 25) (see Annex 2).

Under Paragraph 49, the Warsaw International Mechanism for Loss and Damage remains the main means to address this pillar.[13] Furthermore, the Agreement requires the UN and the International Warsaw Mechanism on Loss and Damage "*to establish a clearinghouse for risk transfer that serves as a repository for information on insurance and risk transfer, in order to facilitate the efforts [of countries] to develop and implement comprehensive risk management strategies*."

No further details about the clearinghouse mechanism exist at this stage, but ultimately, it could have a number of benefits such as providing the Parties with access to good practices.

Article 8, meanwhile, lists areas of action (by who is unclear), clearly highlighting comprehensive risk assessment and management; risk insurance facilities, climate risk pooling and other insurance solutions among other measures. In this context, explicit mentioning of insurance in the COP21 decisions and the Agreement is a signal that both developed and developing countries recognise the high potential for building financial resilience by expanding insurance.

13. At COP19 (November 2013) in Warsaw, Poland, the COP established the Warsaw International Mechanism for Loss and Damage associated with Climate Change Impacts ("Loss and Damage Mechanism"), to address loss and damage associated with impacts of climate change, including extreme events and slow onset events, in developing countries that are particularly vulnerable to the adverse effects of climate change. The implementation of the functions of the Loss and Damage Mechanism will be guided by the Executive Committee under the guidance of the COP. The initial two-year work plan of the Executive Committee has just been decided on. For more details, see here.



Disasters today: In October 2013, Typhoon Nari followed heavy seasonal rains to create substantial flooding along the Mekong and Tonlé Sap Rivers in Cambodia. The flood affected more than a half million people, and more than 300,000 hectares of rice fields are believed to have been destroyed. Images taken by the Operational Land Imager onboard Landsat 8. Source: U.S. Geological Survey (USGS) Landsat Missions Gallery "Flooding in Cambodia," U.S. Department of the Interior / USGS and NASA.

INSURANCE-RELEVANT DEVELOPMENTS ON THE SIDE-LINES OF COP21

Many relevant initiatives were launched at the side-lines of COP21

ANTICIPATE, ABSORB, RESHAPE (A2R)

UN Secretary General, Ban Ki Moon's A2R (Anticipate, Absorb, Reshape) Framework was launched at COP21 to help build resilience to disaster and climate risks in the world's most vulnerable countries with 13 members within the UN system.

This new initiative aims to raise funds and strengthen capacities in:

(i) early warning systems;

(ii) insurance and social protection, and;

(iii) resilience of infrastructure.

The Secretary-General's A2R Initiative is particularly focused on Small Island Developing States, Least Developed Countries and Africa.

THE G7 INSURESILIENCE INITIATIVE

The G7 nations pledged USD 420m with the aim of increasing the availability of risk-transfer and insurance solutions to an additional 400 million people over the next five years in the most vulnerable countries.[14]

LLOYD'S SYNDICATES

Eight Lloyd's syndicates are participating in the initiative and have a committed capacity of USD 400m towards solutions that address natural catastrophe risks in emerging and developing economies.

These syndicates are managed by Amlin, Beazley, Hiscox, Mitsui Sumitomo Insurance Group, Nephila, Renaissance Re Syndicate Management, Tokio Marine Kiln and XL Catlin. However, membership is open to the entire Lloyd's market and other managing agencies are welcome to participate.

FSB CLIMATE DISCLOSURE TASK FORCE:

Mark Carney, Chairman of the Financial Stability Board, announced the establishment of an industry-led disclosure task force with a focus on climate-related risks.

The premise is that effective climate-related disclosures by companies could promote more informed investment, credit and insurance underwriting decisions about those companies and ultimately, would enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system's exposure to climate-related risks. The Task Force has already been staffed with experts from different industries, including the (re) insurance sector, and will be led by New York's former mayor Bloomberg.[15]

THE CLIMATE INSURANCE FUND

Another initiative created by KfW, the German Development Bank, to contribute to the adaptation to climate change by improving access to and the use of insurance in developing countries.

REGIONAL RISK POOLS

Backed by private-sector reinsurance and capital markets solutions, regional risk pools such as the Caribbean Catastrophe Risk Insurance Facility (CCRIF), the African Risk Capacity (ARC) and the Pacific Catastrophe Risk Assessment and Financing Initiative (PCRAFI) have enabled smaller nations

14. The G7 Initiative on Climate Risk Insurance, also known as the G7 InsuResilience Initiative, was adopted at the G7 Summit, during the presidency of Germany at Elmau, Germany in June 2015 and is to be implemented in close partnership among the G7 states, developing countries and emerging economies. The overall objective of the initiative is to stimulate the creation of effective climate risk insurance markets and the smart use of insurance-related schemes for people and risk-prone assets in developing countries. For more information see here.

15. See here.

to secure a payment post-disaster to cover more urgent early recovery financial needs. A number of initiatives are providing additional funding for these risk polling mechanisms (e.g., InsuResilience and the A2R).[16]

RENEWABLE INVESTMENTS AND ALLIANCES

For example, the Breakthrough Energy Coalition led by Bill Gates.

THE LIMA TO PARIS ACTION AGENDA (LPAA)

This initiative is led by France, Peru, the UN Secretary General and the Secretariat of UNFCCC, providing a platform for major initiatives, (Parties and Non-Parties) that could help with the implementation of the outcomes of the Paris Agreements.

1-in-1,000 year historic flooding followed record rainfall across parts of the Eastern US during the month of October 2015, with particular emphasis in South Carolina. Total economic losses were estimated to be USD5.0 billion and insured losses were around USD700 million.[17] *Image by the U.S. Department of Agriculture.*

16. For more information, see: (1) http://www.ccrif.org/; (2) http://www.africanriskcapacity.org/; (3) http://pcrafi.sopac.org/

17. See the 2015 Annual Global Climate and Catastrophe Report

THE WAY FORWARD: LEVERAGING OPPORTUNITIES AND ADDRESSING CHALLENGES

The Paris agreement offers both opportunities and challenges for the insurance industry, especially in the areas of risk transfer for extreme events, sustainable energy and public-sector risk financing.

CLIMATE CHANGE PRESENTS A NEW RANGE OF CHALLENGES, WHERE THE RISKS MAY BE UNPRECEDENTED

By 2020, it can be expected that most nations will have ratified the Paris Agreement, developing their national regulatory frameworks, continuing to reduce their emissions and adapting to a changing climate. The net-zero emission target for after 2050 provides a clear time line. It seems inevitable that the (re)insurance sector will not only be providing a wider range of risk-transfer solutions, but also be supporting emission reduction efforts and the transition to a low-carbon economy through its investment strategies as well as actively managing its own carbon footprint. This would foster more transparency and serve to better align the industry with international policy.

However, the challenges in managing the transition to a low-carbon and climate-resilient economy cannot be underestimated in relation to risks, policy and the regulatory aspect, as well as capital and investment perspectives. This is where long-term thinking, industry-wide alignment and engagement as well as public–private partnerships become even more important.

The Paris outcome marks a milestone in climate policy, anchoring it within a comprehensive risk management paradigm providing many opportunities to the insurance sector. The text introduced in the COP decisions (risk-transfer clearinghouse) and the Paris Agreement (facilities, insurance solutions) explicitly recognise the role of insurance. Similarly, the role of insurance is reflected strongly in another landmark international agreement, the Sendai Framework for Disaster Risk Reduction (2015-2030) in relation to the managing of risks associated with natural and man-made hazards.[18,19] These developments along with concrete initiatives such as the G7 InsuResilience Initiative, set the stage for the next five years.

While the insurance industry has been best equipped for managing risks of extreme weather compared to any other sector, complexities and uncertainties associated with the adverse impacts of climate change combined with inter-connectivity within the global economy present a new range of challenges, where the risks may be unprecedented.

18. Golnaraghi, M., Surminski, S. and Schanz, K.U. (2016), "Benefits of an Integrated Approach to Managing Extreme Events and Climate Risks: From International Policy Dialogue to Action" (forthcoming).

19. For the text of the Sendai Framework on Disaster Risk Reduction (2015-2030), see here.

Pricing difficulties and often conflicting public-policy measures remain the key challenges for expanding the use of risk-transfer solutions in high-income markets. These, along with a range of other issues, hamper the introduction or scaling up of insurance in low- and middle-income countries, for example, weak (financial) infrastructure, access to reliable risk information, limited know-how and experience, lack of political stability, and distribution difficulties.

The public sector is required to lay the institutional foundations, whilst the insurance industry is challenged to think and act more creatively to understand the risks, actively participate in defining the role of the private sector and consider new markets, products and strategies. However, active engagement in relevant public–private partnerships and closer cooperation with policymakers, governments, regulators and other stakeholders, will be critical to pave the way.

The implementation of the Sendai Framework for Disaster Risk Reduction (2015-2030) and the Paris Agreement, when it comes into legal force in 2020, will lead to stronger multi-sectoral partnerships and cooperation, requiring:

i) An integrated multi-sectoral approach to national planning underpinned by a comprehensive approach to climate risk management; and,

ii) The implementation of comprehensive risk management schemes that include risk assessment, early warning systems, preventive measure, and risk financing and insurance.

The outcomes of COP21 (and the Sendai Framework for DRR) have opened the doors for innovative insurance solutions, especially in emerging or even new markets. The insurance industry has the potential to contribute significantly to making societies more resilient with respect to the adverse effects of climate change and, at the same time, creating new business. Furthermore, with the inevitable path towards the net-zero emission target, the industry has the opportunity to engage proactively with other key stakeholders to find the best investment strategies. The next five years are crucial in setting the stage for 2020 and beyond. The industry should take this unique chance!

THE NEXT FIVE YEARS ARE CRUCIAL IN SETTING THE STAGE FOR 2020 AND BEYOND.

ANNEX 1: STRUCTURES ASSOCIATED WITH THE UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE (UNFCCC) NEGOTIATIONS

UNFCCC

United Nations Framework Convention on Climate Change is an international environmental treaty negotiated at the Earth Summit in Rio de Janeiro in 1992 (entered into force 1994). Its objective is to "stabilize greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system". Currently 195 countries are signatories of this convention.

CONFERENCE OF THE PARTIES (COP)

The COP is the supreme decision-making body of the Convention. All States that are Parties to the Convention are represented at the COP, at which they review the implementation of the Convention and any other legal instruments that the COP adopts and take decisions necessary to promote the effective implementation of the Convention, including institutional and administrative arrangements.

SUBSIDIARY BODY FOR SCIENTIFIC AND TECHNOLOGICAL ADVICE (SBSTA)

The SBSTA supports the work of the COP through the provision of timely information and advice on scientific and technological matters as they relate to the Convention or its Kyoto Protocol.

SUBSIDIARY BODY FOR IMPLEMENTATION (SBI)

The SBI supports the work of the COP through the assessment and review of the effective implementation of the Convention and its Kyoto Protocol.

Executive Committee of the Warsaw International Mechanism for Loss and Damage: The Executive Committee of the Warsaw international mechanism was established by Decision 2/CP.19 to guide the implementation of the functions of the Warsaw international mechanism for loss and damage. The Executive Committee functions under the guidance of, and is accountable to, the COP.

STANDING COMMITTEE ON FINANCE (SCF)

The mandate of the SCF is to assist the COP in exercising its functions with respect to the financial mechanism of the Convention in terms of the following: improving coherence and coordination in the delivery of climate change financing; rationalisation of the financial mechanism; mobilisation of financial resources; and measurement, reporting and verification of support provided to developing country Parties. It was established by the COP at its 16th session by Decision 1/CP.16. Its roles and functions were further defined and its composition and working modalities elaborated on at COP 17.

ADAPTATION FUND BOARD (AFB)

The AFB supervises and manages the Adaptation Fund and is fully accountable to the CMP. The Adaptation Fund was established to finance concrete adaptation projects and programmes in developing country Parties that are particularly vulnerable to the adverse effects of climate change. The Adaptation Fund is financed by a 2 per cent share of the proceeds from certified emission reductions issued by the Executive Board of the Clean Development Mechanism and from other sources of funding.

LEAST DEVELOPED COUNTRIES EXPERT GROUP (LEG)

The COP established the LEG, the membership of which is to be nominated by the Parties, with the objective of supporting the preparation and implementation strategies of national adaptation programmes of action.

ANNEX 2: EXCERPTS RELATED TO INSURANCE AND RISK TRANSFER FROM THE COP21 AGREEMENT

PARTIES RECOGNIZE THE IMPORTANCE OF AVERTING, MINIMIZING AND ADDRESSING LOSS AND DAMAGE ASSOCIATED WITH THE ADVERSE EFFECTS OF CLIMATE CHANGE

The Paris Agreement references the role of insurance in supporting adaptation and in managing loss and damage from climate change-related extreme events. Specifically,

UNDER LOSS AND DAMAGE (PARA. 49, P. 7):

"Requests the Executive Committee of the Warsaw International Mechanism to establish a clearinghouse for risk transfer that serves as a repository for information on insurance and risk transfer, in order to facilitate the efforts of Parties to develop and implement comprehensive risk management strategies."

AND, UNDER ARTICLE 8 (P. 25), SPECIFICALLY:

1. Parties recognize the importance of averting, minimizing and addressing loss and damage associated with the adverse effects of climate change, including extreme weather events and slow onset events, and the role of sustainable development in reducing the risk of loss and damage.
2. The Warsaw International Mechanism for Loss and Damage associated with Climate Change Impacts shall be subject to the authority and guidance of the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement and may be enhanced and strengthened, as determined by the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement
3. Parties should enhance understanding, action and support, including through the Warsaw International Mechanism, as appropriate, on a cooperative and facilitative basis with respect to loss and damage associated with the adverse effects of climate change.
4. Accordingly, areas of cooperation and facilitation to enhance understanding, action and support may include:
    - Early warning systems;
    - Emergency preparedness;
    - Slow onset events;
    - Non-economic losses;
    - Events that may involve irreversible and permanent loss and damage;
    - Comprehensive risk assessment and management;
    - Risk insurance facilities, climate risk pooling and other insurance solutions;
    - Resilience of communities, live-lihoods and ecosystems.

This report analyses the implications of the COP21 outcome for the (re)insurance industry.

The Geneva Association—'International Association for the Study of Insurance Economics'
Talstrasse 70, CH-8001 Zurich | Tel: +41 44 200 49 00 | Fax: +41 44 200 49 99