CLIMATE RISK

How to address climate risk

The insurance industry can take action toward the provision, affordability and management of products to deal with climate risk, say Katy Reyner (left) and Sandra Hansen of Guy Carpenter.

In the light of current and future climate change impacts, we can expect an increase in catastrophic events, including greater potential for flooding and heat waves. In the Global Risks Report 2024 published by the World Economic Forum in collaboration with Marsh McLennan, extreme weather was cited as the top risk, with 66 percent of respondents listing it as the most likely material crisis on a global scale in 2024, as well as having the highest potential impact over the next 10 years.

With the increase in extreme weather events projected to continue, growing costs for insurers could drive insurance premiums toward unaffordable levels in some parts of the world. There are already significant protection gaps in some countries. For example, in the UAE, where there were record-breaking flood events in April this year, the insurance penetration rate is only 2.75 percent.

There are several ways the insurance industry can take action toward the adequate provision, affordability and management of products in a changing climate.

Underwriting: Insurance companies can assess the physical risks for current policies as well as the forecast change in future climate conditions. This analysis can help underpin robust underwriting decisions to ensure diversification of risk and sustainable portfolio composition.

Investment decisions: The transition to a low-carbon economy comes with investment risks and opportunities. Insurers and reinsurers are increasingly evaluating sustainable investment decisions as part of the transition toward a net-zero economy.

Capital management: Increasing physical risks have created more focus on solvency; insurers could be required to hold more capital, reducing investment opportunities, portfolio growth or other activities. Insurers may need to consider innovative ways to manage capital in a changing climate.

Reinsurance products: Insurers can assess alternative reinsurance solutions to manage capital and volatility to most effectively transfer risk for specific perils and regions.

KEY POINTS:

- Premiums could eventually become unaffordable
- Increasing regulatory requirements and potential solvency impacts
- Re/insurance industry has a key role

Regulatory requirements: Climate regulatory and reporting requirements are increasing. Consistency between approaches from the various national regulators would promote efficiency and common understanding of climate change risk.

Collaboration: The industry is uniquely placed to address climate change and contribute to resilience and adaptation measures. Industry partnerships across the public sector, academia, supervisors and their policyholders will be essential for enabling evidence-based decision-making for the insurance industry as our climate evolves.

“A longer-term view focused on climate sustainability will provide great societal benefit.”

The insurance industry is at the forefront of understanding the science behind changes in catastrophes due to climate change and is uniquely positioned to ensure economic stability through improving the accuracy and availability of climate-related data and analytics. While traditional insurance products are short term, a longer-term view focused on climate sustainability will provide great societal benefit.

How Guy Carpenter can help

One key challenge in assessing the relative risk of a changing climate is that the magnitude of impacts varies based on the perils and regions of insured risk profiles. Perils such as heat waves and coastal flood events associated with sea level rise are perils for which we have higher confidence of increasing impacts.

Other perils, such as wildfire, severe convective storm and cyclones, are influenced by migration of populations into risk-prone regions and there is more uncertainty surrounding how a changing climate can influence their frequency and severity. Understanding the major sources of loss drivers by peril is a key analytical outcome required to ensure rate adequacy.

Guy Carpenter provides various solutions to help insurers and reinsurers manage climate risks:

- Education: Briefings on the latest science, regulation and industry trends; executive training and workshops.
- Risk rating products: Climate assessment for global risk scores to assess underwriting and portfolio management strategies.
- Catastrophe model adjustments: Probabilistic losses under future climate scenarios to help with reinsurance structuring, capital management and regulatory requirements.
- Model suitability in present climate: How suitable are current catastrophe models given the levels of warming that have already transpired? Enhance understanding of present-day risk for underwriting, reinsurance structuring, capital management and regulatory requirements.
- Regulatory disclosure: Address requests around accumulation, sustainability and resilience. ●

Katy Reyner is assistant vice president, Global Peril Advisory at Guy Carpenter.

Sandra Hansen is head of International Peril Advisory at Guy Carpenter.