Climate Finance, Spring 2024
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Insurance: Materials for Class on Thursday March 28

Recently news stories have emphasized a growing crisis in insurance markets as home insurance policies become unaffordable or unavailable because of weather-related events.[2] Hurricanes, flooding and wild fires are causing increasing amounts of damage. And even severe thunderstorms are causing more significant damage than they used to. The Florida insurance market has been complicated since Hurricane Andrew in 1992, and subsequent developments have not helped.[3] But the problem is not just a Florida problem. Recent increases in prices for property catastrophe reinsurance are being passed on to customers. The issues of unaffordable or unavailable (bluelining) insurance because of climate risks involve questions of fairness: what can insurers do to protect their customers?

Property insurance is not the only area of insurance affected by climate change. As I mentioned in the reading for the first class, climate change has implications for health insurance.[4] And, as the law develops to address issues of liability for climate change and for greenwashing and inadequate corporate responses to climate change, insurers may face losses on policies which cover legal liability.

In addition to being affected by climate change as underwriters of risks, insurers are also affected as investors, because they invest insurance premiums until they need to pay out on policies. The value of investments may be affected by climate change, because of physical or transition risks.

Insurance also involves the sorts of issues we looked at in the material on divestment. Advocacy groups argue that insurers are contributing to climate change by insuring harmful

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[2] *See*, *e.g.*, Ian Smith, Attracta Mooney & Aime Williams, the Uninsurable World: What Climate Change Is Costing Homeowners, Financial Times (Feb. 13, 2024).

[3] *See*, *e.g.*, Gabriel Carrillo, Dana Telljohann & Charles Nyce, The 30th Anniversary of Hurricane Andrew: Evolution of the Florida Homeowners Insurance Market, 25 Risk Management and Insurance Review 239, 240 (2022) ("Hurricane Andrew shifted the paradigm of the insurance industry. Homeowners insurance waspreviously believed to be a profitable and stable line with low volatility; however, after HurricaneAndrew, insurers began to think of property insurance in terms of catastrophe-prone and non-catastrophe-prone areas. Homeowners insurers in catastrophe-prone areas faced higher loss ratioswith high volatility. To counteract this, insurersbegan relying on a new tool, catastrophe modeling,to better predict how a catastrophic event would impact their profitability.")

[4] *See, e.g.*, pwc, More than Property Is at Stake: the Impact of Climate Change on Life, Health and Long-term Insurance Liabilities, at https://www.pwc.com/us/en/industries/financial-services/library/climate-change-impact-insurance-industry.html.

activities,[5] such as fossil fuel pipelines and mines. And they point out "the cognitive dissonance of insurance firms identifying rising climate risks and refusing to provide insurance for individuals in disaster zones, while continuing to enable the projects that are fueling the disasters."[6]

These issues raise some general questions about what are appropriate expectations of financial businesses, including insurers. The International Association of Insurance Supervisors (IAIS) issued a call for action in November 2023 in which it identified five areas where supervisors could address natural catastrophe protection gaps: "[a]ssessing insurance protection gaps.. [i]mproving consumer financial literacy and risk awareness.. [i]ncentivising risk prevention and reduction of insured losses.. [c]reating an enabling regulatory and supervisory environment to support availability of insurance and uptake of coverage... [and a]dvising government and industry, including on the design and implementation of public-private partnerships (PPPs) or insurance schemes."[7] The call to action notes that a lack of insurance for natural catastrophes can spill over into the rest of the financial system (for example affecting banks if households or businesses are unable to pay back loans) and the real economy causing financial stability problems; and also has implications for financial inclusion.[8]

One idea that IAIS focuses on relates to incentivizing risk prevention and the reduction of insured losses, with examples of where supervisors have done this, including the NAIC (National Association of Insurance Commissioners) study on wildfire risk mitigation strategies.[9] Insurers could be required to provide premium discounts for risk prevention measures.[10]

IAIS also encourages supervisors to support innovation in the insurance market, such as parametric insurance, which has lower underwriting and loss adjustment expenses than traditional property insurance. Parametric insurance:

> "describes a type of insurance contract that insures a policyholder against the occurrence of a specific event by paying a set amount based on the magnitude of

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[5] Insure our Future, Thousands Take Part in Powerful Global Week of Action Demanding Insurance Industry Take Climate Action (Mar. 5, 2024).

[6] Keerti Gopal, 'Insure Our Future:' A Global Movement Says the Insurance Industry Could Be the Key to Ending Fossil Fuels, Inside Climate News (Mar. 8, 2024).

[7] IAIS, A Call to Action: the Role of Insurance Supervisors in Addressing Natural Catastrophe Protection Gaps, 4 (Nov. 2023).

[8] *Id.* at 8.

[9] *Id.* at 14-15.

[10] *Id.* at 15.

> the event, as opposed to the magnitude of the losses in a traditional indemnity policy. An example is a policy that pays $100,000 if there's an earthquake with a magnitude of 5.0 or higher. The contract needs to specify the payment amount, the trigger (in this case, the earthquake magnitude), and a third party that checks if the trigger happened. Usually, a government agency, like the National Earthquake Information Center, does this. There might be backup verifiers in case the main agency can't do it. For example, if the earthquake damages the sensors of the National Earthquake Information Center so that their issuance of an official magnitude is delayed, another agency's reading will be used so that payment is still timely."[11]

The IAIS has been developing its work on climate change and insurance more generally, and identifies climate change as a priority for its work in 2024.[12] The IAIS carried out two consultations in 2023 on climate scenario analysis,[13] and on market conduct issues[14] relating to climate risks. The market conduct paper identifies the insurance protection gap issue, but also addresses risks associated with insurers developing sustainable products and integrating sustainability practices in their business:

> "Whilst these developments are welcome, they could lead to new risks. For example, risks may arise when claims made by insurers and intermediaries on their own sustainability and the sustainability of their products are either misleading or unsubstantiated, potentially leading to accusations of greenwashing. If not adequately identified, monitored and mitigated, such reputational and legal risks could have a substantial impact beyond individual insurers and intermediaries, affecting the insurance sector and even the economy as a whole. In particular, if customers are misled into buying products with questionable sustainability features, their funds may not be invested in sustainable products, thereby not meeting the consumers' expectations. Furthermore, this type of practice could generate a general loss of confidence in the role the sector can play

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[11] Parametric Disaster Insurance at https://content.naic.org/cipr-topics/parametric-disaster-insurance .

[12] IAIS 2023-2024 Roadmap (updated Jan. 2024).

[13] IAIS, Draft Application Paper on Climate Scenario Analysis in the Insurance Sector (Nov. 2023). Scenario analysis studies how a firm's solvency would be affected by a combination of circumstances. *See*, *e.g.*, *id.* at 6 ("Climate-related scenario analysis is still in its early stages as a risk assessment tool but continues to evolve rapidly and, for this reason, the IAIS expects to supplement this work in the coming years as new tools, techniques and data becomes available. It also means the utility of climate-related scenario analysis will increase over time as data gaps are filled, the relationship between climate risks and financial risks is better understood and the capacity of supervisors and insurers improves.")

[14] IAIS, Draft Application Paper on Climate Risk Market Conduct Issues in the Insurance Sector (Nov. 2023).

in financing the transition."[15]

The NAIC has announced that it was going to help state insurance regulators collect data to allow them to understand coverage and protection gaps and issues of affordability and availability of insurance.[16] And the NAIC has a Climate and Resiliency Task Force which has been studying scenario analysis, and developing a National Climate Resiliency Strategy for Insurance (currently in draft form).

[15] *Id.* at 4.

[16] NAIC to Issue Data Call to Help Regulators Better Understand Property Markets (Aug. 15, 2023).