

Insurers Eager To Rise To The Challenge Of Emerging Climate Change Exposures

BY MARK E. RUQUET

The science of climate change might remain controversial among skeptics, but within the insurance industry there is a growing consensus that the risks are real, and that carriers must deal with the growing exposures as well as seize the opportunities the problem presents.

In a report released by Ernst and Young—"Strategic Business Risk: Insurance 2008"—the consulting firm reviewed the top-10 strategic risks insurers face, placing climate change atop the list and calling it "a long-term issue with broad-reaching implications that will significantly impact the industry."

Changes in weather patterns caused by climate change "will bring about a fundamental shift in the underlying probability of insured loss (by windstorm or flood) and require insurers to scrutinize their insurability criteria for certain risks," the report concluded.

Climate change will also affect carrier pricing and reserving policies, as well as raise solvency and corporate viability issues, the report pointed out.

Windstorms, flooding and heat waves produced by global warming can lead to "broader and more gradual consequences" the report warned—increasing mortality and health problems, spreading environmental litigation, raising political risk linked to conflicts for control of resources, and also affecting the capital markets.

"These implications could result in correlations across geographies and insurance classes—perhaps sooner than expected," according to the report.

"One of the main ways in which human populations currently cope with the risks of extreme weather-related hazards... is through insurance," according to a report released by modeler Risk Management Solutions—"The Role of Insurers in Promoting Adaptation to the Impacts of Climate Change."

Pointing out the scientific evidence that climate change exists, it cites actions insurers are taking to deal with the growing reality and the challenges they face. The report also notes some of the differences between the United Kingdom and Europe versus the United States in dealing with the exposure issues climate change presents.

Bob Ward, director of global sciences network for RMS and one of the authors of the report, said his purpose was to convey the message to insurers that now is an opportunity to assume a leadership role in identifying the exposure, working to control those risks, and taking a front seat in the general debate over climate change and its potential impact on people and property.

He noted that from a political stand-point, it is easier to talk about the issue in the United Kingdom than in the United States, where global warming remains a hotbed of controversy.

He also observed that in general, U.S. insurers have been slower to come to grips with the exposure issues stemming from climate change than have those in the United Kingdom and Europe.

He said the challenges from climate change will not remain the same over time, and as those shifts occur, there needs to be more attention paid to the evolving risk.

One way insurers can go about promoting adaptation to climate change and the associated exposures, he suggested, would be to charge premiums that truly reflect the risk, creating an incentive for policyholders to mitigate their potential losses.

"Global climate change is the biggest challenge facing the world, and it is going to require the public and private sectors, and the public as well, to help [meet it]," he said. "If we do not adapt, the risk will go up, and that has potential consequences for the insurance system."

One positive difference is that more and more insurers are starting to confront the potential exposures of climate change, according to Fred Perez, vice president for McLarens Young International, a claims adjusting firm based in Los Angeles.

"We are talking more about this issue than we were five years ago, and [the dialogue] is growing," he said.

From a claims perspective, the issue is not limited to property damage but extends to professional liability and general liability as well—affecting engineers, consultants, architects and others who can be accused of not considering the potential impact of climate change in their work.

Suits can and are being filed affecting general liability exposures over the production of greenhouse gases by corporations, he noted. Meanwhile, states are suing utilities over toxic emissions crossing state lines, causing property damage from acid rain, he added.

Directors and officers of companies also face litigation from shareholders suits, where some weather or natural event that could be related to climate change occurs that negatively affects the firm's stock price.

The accusation, he noted, is that executives did not warn, or failed to perform their duty to be aware of the effects of climate change on the business.

As claims professionals, Mr. Perez said, "we have to become more educated on global warming and its effect." He compared this to years ago, when pollution exposures began to grow, and claims adjusters had to become expert in the effects this had on soil, air and waterways.

"Now we must become experts on climate change for the same reason," he said.

While some are urging insurers to become more aware and involved in the debate and response efforts regarding climate change, carriers are already more involved than many realize, according to William F. Stewart, an attorney for Cozen O'Connor who co-chairs the firm's climate change practice area.

He said the industry "takes such a beating sometimes," and has a bad reputation on many fronts—but on climate change the reality is many underwriters are at the forefront of the issue with products and education efforts.

"As a whole, the insurance industry has responded and is ahead on this issue, and has been a leader in the debate on climate change," he said.

In a report titled "The Business of Global Warming: Managing the Risks and Opportunities of Climate Change," Mr. Stewart and Peter J. Fontaine discussed the issues and legal challenges corporations face regarding climate change.

In their 62-page report, they noted that because of the insurance industry's financial clout, as well as its ability to identify, evaluate and manage risk, insurers have a unique role in advancing risk mitigation and adaptation efforts—such as improved building standards, or changing land-use rules to move construction away from vulnerable coastal areas.

The report found that insurers have produced hundreds of products and services to deal with global warming issues, and that a number of carriers—most prominently AIG, Allianz, AXA, Royal SunAlliance, Munich Re and Swiss Re—have been playing major roles in promoting discussions and thinking on the issue.

In the claims arena, the report identified professional liability and D&O as two major areas of potential litigation. While there are no exclusions today, disputes could begin to arise as insurers develop and implement endorsements in response to a growing tide of climate change litigation.

At some point, the United States will likely pass legislation imposing greenhouse gas emission restrictions—no doubt by the end of the decade, the report predicted. This could mean the establishment of either carbon taxes or cap-and-trade systems, to encourage and reward risk mitigation.

Either system, the report said, could generate litigation over D&O or professional liability should certain companies fail to live up to their legal obligations, prompting lawsuits against those outside experts hired to help firms comply with the law.

"This is an extremely thorny and complex problem," said Mr. Stewart. "It is hard to get your hands around it. The idea [of our report] is to give the problem some context and help readers have a sense of context for the problems."