A Powerful Agent of Change?
The global insurance industry as a driver for greenhouse mitigation and adaptation

One view of Hurricane Katrina
Source: www.katrinadestruction.com

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What insurance can and can’t do

No insurer can hope to restore the love of a lost one or the aesthetic value of an original work of art. An insurer can only make a partial restoration of the economic loss. This is all that insurance can do today. It is all that insurance could ever do. (Pfeffer & Klock, 1974, p.4)

Can insurers extend their self-chosen historical role in addressing root causes (as founders of the first fire departments, building codes, and auto safety testing protocols) to one of preventing losses at a much larger scale, namely, the global climate? (Mills, 2005, p.1043)
Outline

1. Climate change and the potential for insurance industry responsiveness
2. Risks to profitability I: Constricting limits to insurability
3. Risks to profitability II: The end of predictability?
4. Insurance’s critical socio-economic role
5. Looking to the insurance industry for leadership
Climate change and the potential for insurance industry responsiveness

- Research, lobbying, media work, more recently some products with climate dividends

Bases for expectations of industry action in response to climate change

1. Core capacities are risk management & loss prevention
2. Global insurance is the world’s largest industry with:
   - annual premium income of US$3.4 trillion
   - investment income of US$1 trillion
   - in comparison, global oil revenues estimated at less than US$2 tril., military exp. at around US$0.77 tril.
3. Climate change is constricting limits to insurability
Risks to Profitability I: Constricting limits to insurability

Figure 1. U.S. Insured Catastrophe Losses Growing Faster than Premiums, Population, GDP
Source: Mills, Roth, and Lecomte (2005) updated to show 2005 losses

Insured Catastrophe Losses in the US, 1971-2005, compared to premiums, population & GDP.
Risks to Profitability I: Constricting limits to insurability (cont’d)

- Not every risk is insurable, e.g. nuclear power plants
- Financial losses due to climate change-implicated adverse weather-related events (!) are increasing
- Industry responses to increased risk of financial losses:
  - Limiting access to cover e.g. Florida coast, Thames valley
  - Using catastrophe bonds and other financial instruments to shift financial risk outside of the insurance sector and onto capital markets – more funds available
- Climate change is constricting limits to insurability
Risks to Profitability II: The end of predictability?

• Beyond arithmetic & exponential increases in event frequency & intensity and on to climate chaos?

Which graph describes future weather?

Three future weather scenarios?

• Spreading financial risk to capital markets combined with technical advances in long-range forecasting: solution or stop-gap?
Insurance’s critical socio-economic role

- Code of Hammurabi, Babylon circa 2250 BC
- Historically the ability to transfer risk is associated with the growth and flourishing of commerce
- Insurance a critical component of contemporary socio-economic systems
- Insurance is highly regulated by states to ensure access and viability of the sector
- Maintaining access to insurance’s socio-economic function in an equitable and just manner
Insurance’s critical socio-economic role (cont’d)

- **Governments** use insurance in support of specific public policy objectives:
  - Support trade, e.g. export credit agencies
  - The modern welfare state (i.e. unemployment benefits, universal health care, etc)
Insurance’s critical socio-economic role (cont’d)

- The **insurance industry** as ‘custodian of the insurance function’ also initiates significant socio-economic change in support of loss reduction:
  - Direct engagement e.g. establishment of the first fire brigades
  - Research into loss reduction and prevention, e.g. lift, building and vehicle safety
  - Lobbying for safety standards
Looking to the insurance industry for leadership

- Since the mid-nineties environmentalists have looked to insurers for leadership in climate politics
- Focus on lobbying and SRI
- Those hopes for action have largely NOT been met
- Paterson’s (2001) argument from a political economy perspective for why this is the case
- Mills (2005) argues for the potential for industry action – an expansion to global scale of the industry’s historical interest in loss reduction and prevention
Looking to the industry for leadership (cont’d)

• Optimism is well-founded:
  – historical role, current scale and capabilities: the potential is there
  – Financial risk as a motivator
  – Reputation risk as a motivator
• If the insurance industry try takes leadership on climate change, can the industry push government to support them?
• What would industry need from government?
Conclusion and directions for further research

• Potential for industry leadership
• Recognise and build on:
  – Insurance industry’s historical involvement in research and action on loss reduction
  – State use of insurance in support of explicit policy objectives
• Associated questions:
  – What’s at stake for the insurance industry – profitability or existence?
  – Broader socio-economic implications
  – How to ensure continued socially just access to insurance?
Selected references