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New Ceres Report Warns of Rising Threat to U.S. Insurers and their Customers from Climate Change

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BOSTON – Hurricane Katrina is a most poignant reminder that U.S. insurers, government and consumers are at enormous risk from escalating losses from hurricanes and other weather-related events. While no individual hurricane can be attributed to global warming, rising global temperatures in the coming decades are likely to cause significant increases in severe weather events, such as hurricanes, floods, hailstorms, wildfires, droughts and heat waves. Unless insurers and their regulators take steps to address this growing challenge, particularly in an era of escalating climate change impacts, companies, governments and the public will suffer even greater financial losses in the future, according to a new report released today by the Ceres investor coalition.

The report, authored by three industry experts, documents the precipitous rise in insured and uninsured weather-related losses in the U.S. and how climate change will likely magnify these losses in the years ahead, whether in homeowner losses due to hurricanes, crop losses due to drought or business interruptions due to lightning strikes. The report cites a 15-fold increase in insured losses from catastrophic weather events (those with over \$1 billion of damages) in the past three decades – losses that have far out-stripped premium increases, inflation and population growth over the same time period.

Even before Hurricane Katrina, consumers and businesses in many parts of the U.S. were seeing higher premiums, lowered limits and increased restrictions in coverage due to rising weather-related losses in Florida, Texas, California and elsewhere. If climate change trends and insurance trends continue, the report warns, availability and affordability of insurance will be at even greater risk for homeowners and businesses. State and federal governments can also expect more financial liability as they increasingly become "insurers of last resort" in response to private insurers further restricting coverage and withdrawing from more markets.

"Insurance as we know it is threatened by a perfect storm of rising weather losses, rising global temperatures and more Americans than ever living in harm's way," said Mindy S. Lubber, president of Ceres, which commissioned the study. "Insurers and regulators have failed to adequately plan for these escalating weather events that scientists predict will intensify in the years ahead due to warming global temperatures."

The evidence, the report details, is spread throughout the U.S., including:

- In Texas, homeowners saw their premiums double after skyrocketing water-related mold claims – \$3 billion in 2002 – caused dozens of insurers to stop writing or renewing homeowners policies. Mold exclusions are now commonplace in many U.S. states.
- In Florida, last year's wave of hurricanes prompted seven private insurers to stop writing new homeowners policies this year or to exit the market completely, even after they'd won substantial rate increases. Meanwhile, a new state-run insurance company has become Florida's second largest insurance provider, and last year it incurred about \$2.5 billion of losses from the hurricanes.
- In the Midwest, crop insurance losses have grown 10-fold in recent decades and many states are currently facing a prolonged drought that has many counties being declared agricultural disaster areas.
- In the West, the average wildfire is twice as damaging compared to the 1970s, and a new study projects that wildfire damage in parts of California will quadruple in the coming years due to warmer temperatures and stronger winds as a result of climate change.

The National Association of Insurance Commissioners (NAIC) was scheduled to discuss the implications of climate change on the insurance industry at its fall meeting scheduled for Sept. 10-13 in New Orleans. The meeting was subsequently cancelled due to Hurricane Katrina and the climate change discussion is now slated for the NAIC's winter meeting in December.

"After New Orleans, it's becoming clearer that we are experiencing more frequent and more powerful weather events that pose huge challenges for the insurance industry," said Tim Wagner, director of the Nebraska Department of Insurance, noting that warmer-than-usual water temperatures in the Gulf of Mexico may have added to Hurricane Katrina's strength. "This is both a coastal issue and a heartland issue. We're seeing all kinds of extreme weather in the Great Plains, including drought, tornadoes, brushfires and severe hailstorms."

Today's report comes as the number of weather-related events, the variability of total losses and the economic impacts and demographic drivers are all on the rise. Insured and total property losses (\$45 billion and \$107 billion globally in 2004, respectively) are rising faster than premiums, population or economic growth both globally and in the U.S. Even after correcting for inflation, weather-related catastrophe losses in the U.S. property/casualty sector have grown from a few billion dollars a year in the 1970s to an average of \$15 billion a year in the past decade, punctuated by three peaks of over \$25 billion a year and a record high in 2004 that included \$30 billion in hurricane losses alone. Hurricane Katrina's impacts could far exceed those losses.

These rising losses are having a visible effect on U.S. insurers' profitability. U.S. catastrophic losses have grown 10 times faster than premiums since 1971 and that's not even counting the thousands of small weather events not considered catastrophic. (U.S. insurers regard 'small' events as those with under \$25 million in insured losses.)

Weather losses are also becoming more unpredictable, especially as insurers from the U.S. and other industrialized countries are moving aggressively into rapidly emerging markets such as China and

India, which pose additional weather risks. With growth rates triple those in industrialized countries, premium volume from the developing world will represent half of the global total in the next few decades. Lack of building codes and other factors make these markets vastly more vulnerable to the costs and other impacts of climate change.

The report cites numerous studies predicting that rising global temperatures from higher emissions of greenhouse gases (GHG) will create additional financial burdens for insurers globally and in the U.S. A recent report by the Association of British Insurers (ABI) and two of the "big-three" U.S. catastrophe modelers stated that under a high GHG emissions scenario (where carbon dioxide levels double from today's levels, as predicted by many leading climate models), wind-related insured losses from extreme U.S. hurricanes could jump to \$100-\$150 billion, an increase equivalent to two to three Hurricane Andrew in a single season in 2004 dollars. Such losses would require insurers to boost their capital requirements by 90 percent, resulting in substantially higher premiums and other adverse consumer impacts. Losses under a low-emissions scenario (carbon dioxide levels 40 percent above today's levels) were only one-fifth those of the high emissions scenario.

Yet, despite these rising insurance risks, climate change has received little attention to date from U.S. insurers, regulators and governments. Among the problem areas highlighted in the report:

- Only a small fraction of U.S. insurance companies have seriously examined the business implications of climate change and fewer still work closely with climate scientists or present their analyses publicly.
- Insurers and regulators currently do not have a comprehensive capacity to assess the cumulative weather-related risks from both catastrophic events and the growing number of small-scale events.
- The U.S. government's full financial exposure from insurance programs (flood, multi-crop insurance etc), disaster relief and other forms of weather-related assistance has never been assessed.

The report recommends the following actions, among others:

Insurers need to: collect more complete data on weather-related losses; incorporate climate modeling into their risk analyses; analyze the implications of climate change on their business and investments and share the results with shareholders; and encourage policy action to reduce greenhouse gas emissions.

Regulators need to: include climate risks in company solvency and consumer-impact analysis; review the "standards of insurability" to identify new challenges, including climate-related hazards in the US and abroad; encourage insurers to collect more comprehensive data on losses; elevate standards for catastrophe modeling; and assess exposure of insurer investments and adequacy of capital and surplus to extreme weather events.

Government needs to: foster and participate in public-private partnership for insurance risk spreading; comprehensively assess the government's overall financial exposure to weather disasters; reduce vulnerability to disaster losses through improved early warning systems, land use planning and other measures; and take policy action to reduce greenhouse gas emissions.

Joel Ario, Oregon Insurance Administrator and Vice President of the NAIC, said the report makes clear that insurers need to do more to assess their growing risks and financial exposure from climate change. "The insurance industry plays a vital role in identifying and quantifying catastrophic risks so that appropriate loss prevention and risk-spreading measures can be put into place," Ario said. "Reinsurers who provide a backstop on large losses are engaged on the climate issue, but much more work needs to be done by the primary insurers who consumers rely on when catastrophes hit."

Jack Ehnes, chief executive officer at the California State Teacher's Retirement System (CalSTRS), one of the country's largest pension funds, said a growing number of institutional investors are pushing insurance companies to focus more attention on climate change. "Investors are increasingly more concerned about the financial risks posed by climate change and our interest is especially strong for an industry that is so directly exposed to the physical impacts of global warming," Ehnes said, "Insurers must take active steps to understand and assess these daunting tasks."

The report was written by Dr. Evan Mills, a scientist with the U.S. Department of Energy's Lawrence Berkeley National Laboratory; Richard Roth Jr., former chief property and casualty actuary and assistant commissioner at the California Department of Insurance who now works with a leading U.S. actuarial consulting firm; and Eugene Lecomte, president emeritus at the Institute for Business and Home Safety in Boston and 50-year veteran in the insurance industry.

Ceres is a national coalition of institutional investors and environmental organizations working with companies to address sustainability challenges such as climate change. Ceres directs the Investor Network on Climate Risk (INCR), a network of more than 50 institutional investors in the U.S. and Europe, which collectively manage over \$2.7 trillion of assets.

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