The scientist's view: Insurers making up for lost time on climate change

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Although insurers have been slow in responding to climate change, they have come a long way in the past few years. Reactions talks to a leading scientist to find out what more needs to be done.

Evan Mills is a member of the international body of scientists known as the Intergovernmental Panel on Climate Change (IPCC), which collectively shared in the Nobel Peace Prize for 2007 with former US vice-president Al Gore. Mills is a staff scientist at the US Department of Energy's Lawrence Berkeley National Laboratory, one of the world's leading research centres on energy and environment.

His research covers both the impacts of climate change and the means of mitigating those impacts through reduced emissions and loss prevention. Specifically, Mills studies the linkages between changes in natural systems and economic systems, particularly with respect to the insurance and financial services industries.

Last year he authored From Risk To Opportunity: 2007 -Insurer Responses To Climate Change, a Ceres report released last November. Ceres is the largest coalition of investors and environmentalists in North America.

That report charted the progress insurers had made on addressing the climate change problem. It identified 422 real-world examples of progress made to develop new products and services related to climate change from 190 insurers, reinsurers, brokers and insurance organisations from 26 countries (see chart). This was a big increase on the 192 examples identified in the 2006 report.

Nearly half of the products identified in the 2007 report came from US companies, including services such as green building design, hurricane-resistant construction, carbon emissions trading, sustainable driving practices and renewable energy.

The report said that many of these products could have a big effect on reducing greenhouse emissions in some of the most energy intensive parts of the economy. An example is that Ceres believes pay-as-you-drive motor insurance policies and incentives for hybrid vehicles could reduce the more than 25% of US greenhouse gases that motor vehicles account for by more than 10% if broadly implemented.

Another example is microinsurance offered in the developing world by Munich Re and Swiss Re. In 2007, Swiss Re created the Climate Adaptation Program that uses climate models and satellite data to determine when up to $2m in weather-related claims are to be paid in response to severe drought causing flood shortages in Kenya, Mali and Ethiopia.

But the 2007 report noted there was still a long way to go. Only about one in 10 of insurers in the report were doing anything noticeable to understand the mechanics or implications of climate change, while only a third were offering innovative products and services. These figures would be much lower across the whole industry.

Here, Mills talks to Garry Booth about the progress being made by insurers towards sustainable business practices and provides a preview of his 2008 Ceres report.

Your 2007 Ceres report identified insurers incorporating sustainability into their businesses. Since it was published do you detect any further signs of progress?

Evan Mills: Things are evolving at breakneck speed. There is significant progress in virtually every area we have looked at in the past as well as some new and different angles. Previously unaddressed insurance lines as well as customer segments are also being targeted. We are still processing the data for our upcoming 2008 update of the report, but some preliminary highlights are:

* Creating cross-cutting climate change business support units;
* Supporting studies on vulnerabilities to extremes and ways of managing those risks, and making efforts to incorporate climate change into their catastrophe models;
* Rolling out new products linked to the proliferation of green buildings;
* Launching GPS-based [global positioning system-based] mileage-based insurance products as well as discounts for fuel-efficient cars;
* Attaining carbon-neutrality in their own operations;
* Scaling up microinsurance initiatives in the emerging markets;
* Increasing investments in climate-friendly technologies and services;

* One of the new and different initiatives is that Progressive has partnered with the X-Prize Foundation to offer a $10m prize for development of a more fuel-efficient automobile

Some commentators are concerned at the lack of urgency shown by the insurance industry over climate change? Do you share their concern that too many insurers and reinsurers are in denial?

Evan Mills: Yes, the industry could be more engaged - much more - but it deserves a lot of credit for how much it has ramped up the due diligence and product development on climate change. A lot of cynical misinformation about climate change is circulating in the insurance world and beyond, but I find most insurance professionals to be willing to listen to and consider the facts if they are presented in a way that is accessible and understandable.

The confusing information environment has no doubt contributed to the industry's slow start, at least in the US, but I run into fewer and fewer deniers and am seeing more and more companies constructively engaged. There are so many things that can be done that even highly-motivated companies understandably struggle with where to start, and then to overcome the inertia that exists in any large company and industry. It is becoming clearer that we do not have time on our sides and it would be quite prudent to move faster.

What message would you send out to reinsurance CEOs meeting in Monte Carlo in September?

Evan Mills: The physical climate is changing, and in ways that will increasingly affect reinsurers. The climate is changing faster than the scientific community had previously estimated, and in unexpected ways. Even for those who have doubts, the fact that the business climate is changing as well is plain as day. Carbon markets are here, with more than $30bn traded in Europe last year, and the creation of a potentially even larger market in the US is inevitable, irrespective of the outcome of the upcoming presidential elections.

Customers are using new technologies, which pose new risks as well as new insurance opportunities, and are expecting new green products and services from their insurers. Meanwhile, investors are increasingly concerned about the climate-sensitivity of their insurance investments and are seeking more disclosure. Regulators and rating agencies are engaging. The green-tech investment explosion promises to parallel the lucrative biotech explosion and asset managers in the reinsurance business stand to gain by riding that wave.

For these reasons, climate change has become an integral consideration in customer retention, corporate governance, portfolio management, reputational risk, and regulatory risk. Any reinsurance CEO serious about enterprise risk management would be wise to look at climate change through that lens and incorporate it in their approach to the market.

Reinsurers could more effectively educate their direct insurance customers about the risks and opportunities. They are in an ideal position to have a lot of positive impact and promote replication of new business practices that contribute to solving the climate change problem.

Getting started on sustainability

Insurance and reinsurance companies who want to respond to climate change have to juggle their aspirations with the press of everyday business and the need to develop revenues in the near term. Yet, while strategic thinking can be dismissed as a luxury, it is in reality critical to remaining competitive, says Evan Mills. You have to start somewhere. Here, Mills offers a checklist of initial steps that insurers can take to establish a corporate platform from which longer-range best practices can be pursued:

Approach climate change as an enterprise risk management (ERM) issue. ERM improves decision-making and creates value by managing hazard, financial, operational, and strategic risks and opportunities across business units and stakeholder groups. ERM provides a portfolio framework for managing risk in a holistic manner, and elevates the practice to higher levels within organisations. For insurers, ERM includes issues such as physical risk, regulatory risk, competitive/market risk, asset management, implications for liquidity, capital needs, and reserves. ERM provides a ready framework for thinking about climate change and assessing risks and risk-management opportunities.

Establish a champion from the board. This will help mobilise internal resources, keep the issues on the company's radar, and enable a cross-cutting effort including underwriting, operations, and asset management rather than a piecemeal approach limited to specific silos within the company.

<u>Appoint a point-person on climate.</u> This person collaboratively authors the corporate position paper, assists with internal fact-finding and education efforts, tracks climate change issues, and serves as liaison to the board. The climate champion should also track trends and developments in the outside public policy domain, and make the

company visible as deemed appropriate. This person can also take the lead on voluntary or mandatory climate reporting. Ideally, this person will be resourced to assemble a broader climate management team.

Develop a written corporate position on climate change. These can be so-called evergreen documents that evolve along with the company's strategy. Such statements prove useful for internal education and communicating with external stakeholders.

Prepare an annual environmental report. Reports can be used to establish and benchmark baseline performance, set and track progress towards goals, catalogue activities from across the organisation, and communicate corporate initiatives to potential employees, shareholders, and other stakeholders. This may be integrated into a broader corporate social responsibility report (if the company produces one).

Model better. Catastrophe modelling firms are now beginning to incorporate forward-looking climate variables and their customers – insurers – should seek continuous improvement in this area. Risks not captured in catastrophe models should be modelled or analysed using other methods. Models should be used to conduct hypothetical stress tests to determine the implications of a wide range of plausible scenarios.

Listen to and support customers. Customers are increasingly embracing green and climate-friendly technologies and practices, and are actively seeking insurance that fits these activities. In addition to meeting these stated needs, insurers can extend their traditional role in supporting customer-side risk management to incorporate existing and emerging climate risks, for example through improved construction technology and business-continuity planning. Meanwhile, insurers can add value by supporting customer desires to reduce their greenhouse-gas emissions.

Set priorities. There is an overwhelming array of possible responses. Based on due diligence conducted in the preparation of the corporate position paper, assessing company-specific risks, interactions with trade allies and other potential partners, and listening to customers, companies should identify and rank likely early measures and focus on doing a few things well rather than adopting a shotgun approach. Build on successes to expand the effort.

Forge partnerships. Insurers needn't operate in a vacuum or otherwise reinvent the wheel. In particular, insurers can play a role in educating and enlisting the support of their agents and brokers on the issues, while at the same time listening to what brokers have to say about customer needs with respect to climate change. There are many natural allies outside the insurance arena as well – such as energy utilities, non-governmental organisations, state and local agencies – with years of experience in this domain. These entities are constantly looking for partners to help deploy new initiatives.

Walk the talk. Companies attempting to mount a climate-change initiative should learn through first-hand application of appropriate responses within their own organisations. This should include assessment of greenhouse-gas emissions and implementing an emissions-reduction plan. All stakeholders will look to insurers to lead by example.