Insurances: The increasing pay-outs from climate-related disasters?

In recent years, Global natural disasters have seen an increase in frequency and severity due to the global climate crisis. Weather events such as floods, heatwaves, and storms have occurred across the world destroying homes and businesses putting lives at risk. How does this affect the insurance industry worldwide? In 2021, Insurers paid out the largest compensation in the last 10 years with a staggering total of 120 billion.[1] This figure is also projected to only increase in the next ten years.

With this rise in catastrophic events, it may appear to be beneficial for insurance providers to take into consideration the risk and charge a premium for their policies. The issue arises when realizing the volatility and threat that climate change poses. Due to the nature of climate change, its effects are "systemic; climate risk is likely to stress local economies and—more grimly—cause market failures that affect both consumers and insurers" (McKinsey)[2]. As a result, stakeholders like customers, shareholders, and regulators are going to want to demand changes in insurance solutions since the risk will become too unaffordable at some point. The way to mitigate these risks for insurance company business models? Companies should mitigate and adapt by developing products that take into consideration climate risks and take into consideration carbon-intensive investment strategies. This way their portfolio will be rebalanced with the consideration of the global climate crisis.

Case Study: Florida Flooding

Currently in Florida, the 10% of citizens who live less than five feet above sea level now are more at danger of storm surge destruction as sea levels rise. The 2.9 million dollar properties that are under danger are expected to be worth $581 billion in 2020. Additionally, sea levels are predicted to increase 2.5 feet from 2000 levels in some areas of the state by 2050. These unprecedented effects of tidal flooding in the state might grow from a few days in 2019 to more than 200 by 2050. The effects of these annual floods for the insurance industry is an increase in losses of 1.98 billion in 2019 to 2.94 billion in 2050.

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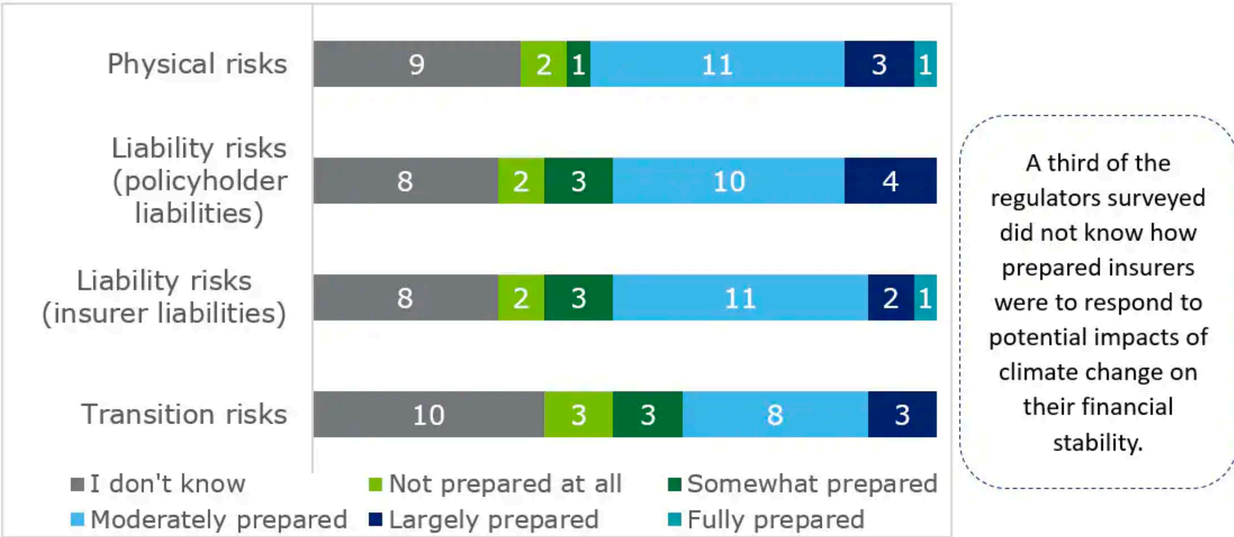
[1] https://www.reuters.com/markets/commodities/natural-disasters-cost-insurers-120-billion-2021-munich-re-says-2022-01-10/

[2] https://www.mckinsey.com/industries/financial-services/our-insights/climate-change-and-p-and-c-insurance-the-threat-and-opportunity

According to a Deloitte survey on insurance companies' preparedness for climate change[3]:



- "One-third of responding regulators said they didn't know how well the insurers are prepared to deal with the potential impacts of climate-related risks on financial stability."
- "Among those who were aware, only up to four respondents answered that insurers were largely or fully prepared."
- "One-third of the regulators surveyed didn't know whether current insurer risk models were up to the challenge of capturing and testing climate-related risks."

Two conclusions can be gathered from this. First, this demonstrates the fact that insurers should better disclose and showcase the efficacy of the changes they are making to adjust for risk. This transparency allows for customers and regulars to better understand how insurance companies are accounting for climate change. Secondly, more could be expected of insurers in terms of taking action to prevent the worst effects of climate change. Further adaptations to mitigate risks associated with climate-related losses would benefit all stakeholders.

[3] https://www2.deloitte.com/us/en/pages/financial-services/articles/insurance-companies-climate-change-risk.html