

“From Virus to Vitamin”, Newsletter

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**Turning up the heat:
can private insurance alone mitigate
climate change damages?**



“From Virus to Vitamin”
Newsletter n°20

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QUESTION UNDER DISCUSSION

"Insurance companies play a key role in pricing, transferring and managing damage-related risks. Yet, in 2015, just before the UN Climate Change Conference (COP 21), the then CEO and Chairman of global insurance company AXA - Henri de Castries - warned that "a four degrees' rise in global average temperature is not insurable." According to Intergovernmental Panel on Climate Change (IPCC), we are today aiming at four degrees. In fact, De Castries poses the question of how uncertainty will be priced and mitigated in our world which is off track of net-zero greenhouse gas emission target. Would public authorities become by default the only available shelter against some risks, and what would this imply for financial markets, insurance companies and public finances?"

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EDITORIAL

Turning up the heat: can private insurance alone mitigate climate change damages?

As a consequence of climate change, extreme weather events such as floods, droughts, heat waves and storms have increased in frequency and severity. As recalled by Domingo Sugranyes: “global losses from natural disasters in 2020 came to US\$ 210bn of which US\$ 82bn was insured. To cover the gap and manage catastrophic risk accumulation, the role of insurance and reinsurance pools is key, often drawn by traumatic events themselves.” This being said, the gap of uninsured damages is huge, which means a growing burden on public budgets, but also directly on the most exposed and on the directly hit. These situations will impact access and credit conditions for these populations.

Insurers’ concerns are no longer individual catastrophic events but their global and systemic effects on human societies. Andrew Cornford explains, “the problems posed to insurers will be due to the increased scale of the actual occurrence of events associated with these risks, to their sometimes geographically uncertain incidence, and to increased correlations between them.” In Cornford’s view, “the resulting problems can, to some extent, be handled through better designed and increased capital requirements, public-sector reserves, and precautionary arrangements suggested by stress testing - for which recent experience with Covid-19 may be helpful.” However, the underlying hypothesis is that the level of premiums will remain affordable to those seeking cover.

Nevertheless, indeed increased property claims as a result of extreme weather events are forcing insurers to re-evaluate underwriting

strategies, including rebalancing their premiums and pricing strategies. Against this background, regulators have expressed concern that climate change could make it increasingly difficult for insurance companies to provide affordable financial protection. Rising premiums could indeed make cover unaffordable, especially for the disadvantaged communities more likely to live in regions prone to disaster.

Rather than burdening local populations with additional costs of prospective damages that occur because of climate change generated largely by the wealthy North, there is urgency to work out international burden sharing underwriting strategies that would transfer a substantial portion of the climate related insurance costs from the South to the North. Otherwise, the most exposed regions of the world may well become impossible to insure by market mechanisms, which would leave only the public guarantee option open, as stressed by Etienne Perrot.

[Virgile Perret & Paul H. Dembinski](#)

“... pass the cost to policyholders through increased insurance premiums ...”

Unlike randomness, which allows a probability calculation on a statistical basis, uncertainty arises from facts that are emerging, unique or too few to give rise to a stochastic calculation. Randomness is the basis of prevention and insurance systems. On the other hand, uncertainty can only be covered by contingency reserves, it's a precaution. (The IPCC forecast, insurance's prevention and precaution are the three forms of the virtue of prudence, which is the intelligence of concrete situations.) Henri de Castries therefore hypothesizes that the damaging meteorological phenomena induced by a global warming of four degrees are phenomena, if not unique, at least too few to enter into an insurance system. **This involves the States, either directly when they compensate for the damage by compulsory levies (in France, we have known “the drought tax” in the 1980s) or by obliging the insurance companies to compensate the damage, which will pass the cost on to policyholders through increased insurance premiums.**



Etienne Perrot

Jesuit, Dr. Economics sciences, editorial board of the magazine Choisir (Geneva), editorial adviser of the journal Études (Paris)

“... public-private partnerships can be developed ...”

According to Munich Re, global losses from natural disasters in 2020 came to US\$ 210bn of which US\$ 82bn was insured. To cover the gap and manage catastrophic risk accumulation, the role of insurance and reinsurance pools is key, often drawn by traumatic events themselves. **Public-private partnerships are nothing new (eg US National Flood Insurance or the Spanish Consorcio) and can be developed. Insurance plays an essential role towards mitigating damage from climate change through underwriting, prevention, disseminating knowledge and as investors. Large players have recently committed to the UN-convened Net-Zero Insurance Alliance (July 2021). Artificial Intelligence and big data analysis research, also supported by insurance, will increase natural disaster predictability.** Insurance and reinsurance markets are efficient, though unpretentious!



Domingo Sugranyes

Director of a seminar on ethics and technology at Pablo VI Foundation, past Executive Vice-Chairman of MAPFRE international insurance group

“... capital requirements, public-sector reserves, and precautionary arrangements ...”

Individually most of the risks associated with a substantial rise in temperature due to climate change can be quantified owing to past experience. The problems posed to insurers, other private financial institutions, and the public sector will be due to the increased – and sometimes unpredictably increased - scale of the actual occurrence of events associated with these risks, to their sometimes geographically uncertain incidence, and to increased correlations between them. **To some extent the resulting problems can be handled through better designed and increased capital requirements, public-sector reserves, and precautionary arrangements suggested by stress testing - for which recent experience with Covid-19 may be helpful. These arrangements will entail institutional innovations, training of people to handle the consequences of the new risks, and enhanced multilateral cooperation, the absence of any of which will reduce the effectiveness of the potential contribution of finance to control of damages and mitigation of their effects.**



Andrew Cornford

Counsellor, Observatoire de la Finance; past staff member of UNCTAD, with special responsibility for financial regulation and international trade in financial services

LIST OF CONTRIBUTORS

Andrew Cornford (Counsellor, Observatoire de la Finance; from 1977 until 2003 staff member of UNCTAD, latterly with special responsibility for financial regulation and international trade in financial services)



Paul H. Dembinski is the initiator and Director of the Foundation of the Observatoire de la Finance. In parallel, he is partner and co-founder of Eco'Diagnostic, an independent economic research institute working for both government and private clients in Switzerland and elsewhere. Paul H. Dembinski is also Professor at the University of Fribourg.



Dr. Virgile Perret holds a Ph.D in Political Science from the University of Lausanne and he is specialized in the study of monetary innovation from an interdisciplinary perspective. He collaborates with the Observatoire de la Finance where he is responsible for managing the global Prize "Ethics & Trust in Finance for a Sustainable Future".



P. Etienne Perrot, Jesuit, Doctor in Economics sciences, member of the editorial board of the magazine Choisir (Geneva), editorial adviser of the journal Études (Paris).



Domingo Sugranyes Bickel, KCSG. Graduated from the University of Fribourg, Switzerland. Secretary General of UNIAPAC, Brussels, from 1974 to 1981. With MAPFRE international insurance group from 1981, Executive Vice-Chairman until 2008. From 2009 to 2019, Chairman of Vatican-based Foundation Centesimus Annus Pro Pontifice. Knight Commander of the Pontifical Order of Saint Gregory the Great (April 2019).



“FROM VIRUS TO VITAMIN” – JOIN THE DISCUSSION

The **Observatoire de la Finance** intends to seize this period of pandemic to step back and take a fresh look at our global economic system, dare to ask new questions which the current crisis brings to the fore and propose innovative ways to rebuild a more resilient and sustainable economy and society. In brief, we want to turn the virus into a vitamin for the future.

Our Discussion Board “From Virus to Vitamin” focuses on commenting issues relevant to finance and economy in relations to society, ethics and the environment from a variety of perspectives, of practical experiences and of academic disciplines. It has been designed to share and discuss information and opinions expressed in a short and concise manner.

Contributors ([Discover the list of contributors](#)) are invited to react on a question/issue that is submitted in parallel to a limited group of experts. This happens on a regular basis, through a dedicated mailing list. After the deadline for submission, the reactions are edited and published with signatures in one document on the website of the Observatoire de la finance and on its Linkedin page. If you would like to join the discussion, you may send an email to the editor, Dr. Virgile Perret <perret@obsfin.ch>.

OF Discussion Board – Questions addressed so far

- Question 19 : [From the gold window to the global casino](#)
- Question 18 : [Turning point for the planet: can the G7 be trusted?](#)
- Question 17 : [Sustainable Finance: Hype or Hope?](#)
- Question 16 : [Universal basic income – an idea boosted by the pandemic?](#)
- Question 15 : [Multi-polarity: the best guarantee against falling \(again\) into the Thucydides Trap](#)
- Question 14 : [Special Drawing Rights: a drop of liquidity in an ocean of needs](#)
- Question 13 : [Trump's economic heritage: false promises setting the stage for populist disruption](#)
- Question 12 : [Will America drive the world again? A whish list for Biden's economic agenda](#)
- Question 11 : [Rush for Covid-19 vaccine: bottle-necks require public-private worldwide](#)
- Question 10 : [Does robotisation trigger redistribution?](#)
- Question 9 : [Scaling up industrial policy at regional level](#)