3.6: Sustainable Insurance

The insurance industry is particularly interested in sustainability, given the impact that climate change has had on this industry's profitability. In fact, climate change is the number one risk to the insurance industry.Ernst & Young (2008). According to an Ernst & Young study,Ernst & Young (2008). climate change could result in increased mortality and health problems, increased environmentally related litigation, increased conflicts over control of resources, and negative impacts on capital markets.

According to a 2005 study by the Association of British Insurers, if carbon dioxide emission levels are doubled, the capital requirement for insurers could increase by $76 billion, which is an 80%–90% increase due to the increased risk of tropical cyclones in the United States and Japan.Association of British Insurers (2005). Allianz, Europe's largest insurer, estimated that losses due to climate change could be as high as $400 billion. In addition to property loss, insured companies may face carbon-regulatory risks governing its investment and insurance policies on green projects. Given these challenges, the industry is addressing the concept of sustainability and is taking notice of social, environmental, and economic impacts.

Many insurers have increased their focus on financial risk management. Yet proactive insurers are making progress in developing both investment strategies to "participate in the 'green' revolution in the financial markets" and in creating new climate-friendly products to address climate change risk.Mills (2007). Many of these financial products deal with green building, hurricane-resistant design, promotion of alternate fuels, and sustainable driving practices to reduce carbon emissions. Proactive insurers encourage the insured to participate in the insurance sustainability effort.

Insurance companies play an important role in social, economic, and ecologically friendly sustainability. Swiss Re has sold weather-risk products to 320,000 small farmers in India. For renewable energy-related insurance products, Willis Holdings covers potential power underproduction of wind farms. As a pioneer in offering green-building policies, Lexington Insurance Company's new policies will pay the insured to rebuild a home using environmentally friendly and energy-efficient materials after it is destroyed by natural disasters.Tergesen (2008).

In Japan, Sompo Japan Insurance and Tokio Marine Nichido Fire Insurance Co., Ltd. have given premium discounts to 10 million policyholders who drive low-emitting cars. Travelers and Farmers cut 10% off the policy premium for hybrid cars. Progressive and GMAC insurance companies offer pay-as-you-drive (PAYD) policies in parts of the United States. In the U.S., automobiles account for 25% of all GHG emissions and it is anticipated that implementing PAYD policies and hybrid vehicle incentives could reduce emissions by 10%.Bordoff (2008).

Increasingly, insurance companies have utilized exclusion clauses—tightened conditions to foster the right decisions by customers. Some insurance companies limit liabilities for emitters of greenhouse gases and for companies that do not have a climate mitigation plan in place. "Development and establishment of business-continuity management (BCM) procedures [is used as] a prerequisite for adding on business interruption coverage to a company's property insurance."Ross, Mills, and Hecht (2007). As one of the world's largest re-insurers, Swiss Re, Munich Re requires disclosure of a company's climate strategy in their directors and officers insurance application.Makower (2005).

As this chapter has demonstrated, the finance function, as well as the finance industry, is greatly impacted by sustainability considerations. Every aspect of finance, from investments to banking and from trading to insurance and risk, requires new thinking when we consider the social, economic, and environmental impact of business.

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