

The challenge of insuring against climate change

All the effects that climate change can have are related to the insurance and reinsurance industry in the coverage of risks to people and things. Extreme precipitation, increased flooding, drought, fire and sea level rise are just a few examples of the effects of climate change, and in turn, **new challenges for the industry** that will have to advance the adoption of new solutions and combine financial protection with prevention services and new risk transfer schemes.

In 2022 alone, according to Swiss Re's 1/2023 Sigma report, **insurance covered nearly 45% of the \$275 billion in global economic losses from [natural disasters](#)**. Only the annual average of insured losses due to natural disasters exceeds \$100 billion and only the industry estimates for the most significant loss in 2022 –Hurricane Ian– place insured losses at \$65 billion.

Accurate analytics

No more data is needed to highlight the importance of these risks and their complexity in trying to predict and protect against them. **The current predictive models appear to be insufficient** in the face of new and unexpected increases and situations. It will take the use of more accurate analytics and artificial intelligence to try to understand the impact of climate change and mitigate, to the extent possible, its economic impact on goods and business disruption. As said models are being developed, lack of knowledge of weather trends or patterns translates into:

- **lack of experience in the markets** in the event of a possible increase in climate change-related claims;
- **higher premiums and greater technology** in the exercise of the underwriting (higher franchises, limits, sub-limits, etc.).

Since 2017, demand for catastrophe-related insurance has increased due to the increased activity of said risks. At the same time, **climate change exclusion clauses have proliferated** because, as is often the case, in the face of certain systemic risks, there are few or no options between reducing coverage or excluding it. However, it is the lack of clarity in the wording of the aforementioned clauses that has been triggering global litigation with direct repercussions on insurers, reinsurers and clients, affecting the industry's reputation.

Lower risk appetite

Almost every day, we wake up to headlines highlighting new **greenwashing cases and complex climate activist litigation** against governments and large corporate corporations for their allegedly inadequate management and failure to meet their environmental commitments. That being said, the industry, as it cannot be otherwise, shows a **lower risk appetite**.

In light of this, the insurance industry must take measures to ensure that there is an affordable supply against the risks arising from climate change and prepare to mitigate or undermine, as much as possible, the insurance protection gap.

The European Retirement Pension and Insurance Authority (EIOPA) in the Supervisory Statement on **Exclusions in Insurance Products** related to risks arising from systemic events 22/419, August 2022, supports a statement on exclusions in insurance products relating to systemic risks – including pandemics and cyber risk – and aims to provide best practices that translate into clarity and transparency for customers and reliability in the industry.

Burden of proof

EIOPA's reproach is to indicate that these clauses are often not introduced into insurance products in accordance with the control and governance processes relating to products (POG), that is, in accordance with the processes indicated in Directive (EU) 2016/97, of the European Parliament and the Council of 20 January 2016, on the distribution of insurance (DDS). Therefore, among the highlights of EIOPA, the most prominent is the **burden of proof**. It is in any case the underwriter's responsibility to provide the customer or the insurance distributor with clear information about its content, which allows **for well-informed decision-making** and to warn of the existence of exclusion according to its wording.

“Industry estimates for the largest loss in 2022 –Hurricane Ian– put insured losses at \$65 billion”

In this regard, clause LMA 5570 of the Lloyd's Market Association Model Climate Change Exclusion, **for [Civil Liability insurance](#)**, excludes, without any specifics or examples, the loss, liability, cost or expense, derived from any claim for which a “contribution to climate change and its consequences” is attributed to the insured or reinsured party.

The clause takes as a definition of “climate change” that given by the United Nations Framework Convention on Climate Change (1992, Article 1 (2)) which defines it as “the change of climate attributed, directly or indirectly to human activity, which alters the composition of the global atmosphere and that adds to the natural variability of climate observed during comparable periods of time.” That is, a “contribution to climate change” **could be considered a collection of everyday acts and situations**, for example, driving our vehicle or using heating in our homes and businesses, implying, in a very simplistic way, that any action that could contribute to climate change would be excluded.

Clauses

The aforementioned clause does not accurately determine its scope and does not establish parameters or criteria that would delineate the “environmental compliance or action framework” of the insured or reinsured party that, if violated, would cause the exclusion to be activated. Furthermore, it seems reasonable to think that there **should be a prior resolution of an**

authority, public or private, with the capacity to certify and prove the existence of an activity that has contributed to the change of climate, and even **an administrative or judicial resolution**, which warns it, for the denial of coverage, but none of that is observed in the clause.

It could also not be considered that the non-inclusion of the aforementioned clause would cover without more all the risks associated with climate change. **Hence the importance of delimiting the risks covered well and of clearly defining and writing the clauses.** In the meantime, as the industry advances in research and knowledge of catastrophic phenomena, **the insurability of these risks must be addressed** with transparency and clarity and be able to provide sustainability and profitability guarantees to the (re)insurance industry.

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