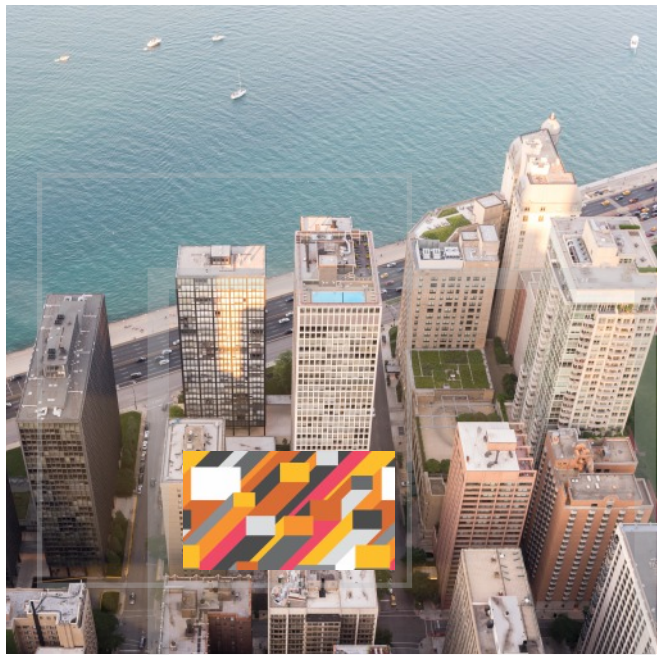




## Impact of climate change on the Nigerian insurance sector

Climate change is increasingly becoming an area of growing interest and engagement for many developing countries as a result of how it affects different sectors across the globe. The insurance sector which is a market-based mechanism for the transfer and management of the risk of an individual or organisation is one of the sectors that will be impacted by climate change. Indeed, Climate change is ranked as the second most urgent threat to business by reinsurers, and as the third most urgent by property and casualty (P&C) insurers, according to 2019 Insurance Banana Skins report from PwC and the Centre for the Study of Financial Innovation (CSFI)<sup>1</sup>.

This article will cover how the Nigerian insurance sector will be impacted by climate change, which is diverse, uncertain, and complex. We also identify the three primary channels (risk factors) through which such impact might be expected to arise according to the 2015 Bank of England Prudential Regulation Authority report<sup>2</sup>. These factors can be grouped into physical, transitional, and liability risks.



### Physical Risk

The physical risk arises from weather-related events, such as floods, earthquakes, volcanic eruptions, cyclones, hurricanes, storms, etc. This comprises impacts directly resulting from such events, such as damage to property, and those that may arise indirectly through subsequent events, such as disruption of global supply chains or resource scarcity.

In the case of Nigeria, no earthquakes, volcano eruption, cyclone, or hurricane have been documented, however, rainstorms and floods usually wreak havoc during the rainy season resulting in loss of farm products in the north, death, and displacement of persons arising from damages to property. Concerns have been raised by short-term insurers over the increasing frequency and severity of flooding and landslides in the north.

In developed economies, the use of catastrophe modeling for underwriting and pricing as well as sophisticated risk transfer mechanisms suggests general insurers are reasonably well equipped to manage the current level of direct physical risks. Currently in Nigeria, most insurers do not incorporate catastrophe modelling in the pricing of insurance products and as such do not transfer the required premium on this risk to the policyholders. Some proactive insurers however manage this risk through reinsurance arrangements.

The impact of changing climatic conditions, if not widely considered, can cause disruption in established

insurance business models as well as affect large parts of portfolios indirectly through real-economy effects and have a material impact on the value of the stock of manageable assets.

It is, however, important to note that irrespective of the potential impact on the insurance business that may arise as a result of physical risk, the Nigerian insurance sector should start taking deliberate steps towards mitigating the impact of this risk.

### Transition Risk

Transition risks are the financial risks that are likely to arise for insurance firms due to the adoption of a low-carbon economy. In Nigeria, the government looks forward to adopting a low-carbon economy in line with the global climate change goal of keeping within a '2oC carbon budget' and have established a strategy as contained in the 'Nigeria Climate Change Policy Response and Strategy'. The strategy is to foster low-carbon, high growth economic development and build a climate-resilient society. The Nigerian insurance sector is most likely to be impacted by this risk and must become aware of the extent of its impact on their business and investments.

This policy formulated by the government of Nigeria in response to adopting a low carbon-economy will reflect on carbon-intensive assets. Assessing and managing carbon-intensive assets risk may be more challenging due to the substantial amount of uncertainty about future changes in the current policies on the low-carbon economy and climate change. Thus, insurance businesses cannot afford to be in oblivion as government policies can and will greatly impact the operations of insurance businesses in Nigeria.

There are certain risks the policies will pose to insurance firms such as market and economic risks (which affect the financial profile of carbon-intensive assets), reputational risks (which impacts the direct or indirect association with carbon-intensive assets), and technological risks (which relates to changes and development in commercial availability of alternative low-carbon assets). In the face of these risks also exists opportunities, such as; writing new businesses, re-pricing of carbon-intensive business such as the oil and gas class business, and re-strategising their investment portfolios.

The insurance firms stand to benefit if they accept to play a major role in working to reduce the uncertainty around the low-carbon economy, through regular and consistent engagement with government policies on the low-carbon economy and climate change.

The National Insurance Commission (NAICOM) being the regulatory body for the insurance sector in Nigeria, can foster the awareness and potential impact of a low-carbon economy and climate change policies on insurance businesses. This will tend toward achieving her objectives around the safety and soundness of Insurance Institutions, optimal development of the Nigerian insurance market, protection of policyholders and public trust and confidence in the insurance system.

### Liability risk

Liability risk is not a new business in the Nigerian insurance industry. The underwriting of liability risks by insurers is to provide coverage for a policyholder (the insured) who is legally liable to pay compensation to a third party due to some forms of actions, and the extent of any legal liability is highly dependent on the prevailing legislation. There exists a possibility that climate change will show off liability risk as a significant threat to Nigeria's insurance sector.

Liability risk must be high on the radar of all insurance firms. In the case where climate change happens to be very severe, there will be increased liability claims and sometimes it takes a little longer time than expected for claims to be settled. Nigeria's insurance firms will continue to be challenged by the uncertainty around the timing of climate change occurrence, the degree of damage that will be caused, and the number of claims that will arise simultaneously. This will be a big dilemma for them because historical events have shown that over time liability claims can be more disruptive to the insurance industry than losses caused by individual extreme weather events. More so, when new sources of claims arise, they may fall under the following aspects of liability risks such as public liability, professional indemnity, third party, and product liability.

Insurance firms in Nigeria may need to re-evaluate how they underwrite the liability risks business and probably expand the scope of coverage or include exception clauses. Also, they may have to put measures in place to strengthen their capacity of handling claims that emerge based on court verdicts, thereby safeguarding the stability of their financial position.

### Conclusion

The Nigerian insurance sector will definitely be impacted by climate change. We note that the potential effects are diverse, uncertain, and complex. Insurance players and regulators therefore need to consider these three key "risk factors" we have highlighted in this article and ensure that they are adequately addressed in their strategies.

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