



Risk Management: Next Step for Insurers on Climate Change

Introduction

In our previous articles, we were able to establish how climate change will affect the Nigerian insurance sector and how insurers should stand up to the roles they will have to play in the coming years. However, responding to the impact of climate change on the insurance space; insurers, regulators as well as other stakeholders will need to design an adequate approach to help manage the risks that might arise.

The Climate Change Risks

According to the 2015 Bank of England Prudential Regulation Authority report¹, climate change will lead to three primary risks. These risks, though well discussed in one of our past articles titled, “*Impact of Climate Change on the Nigerian Insurance sector*”², are briefly highlighted below:

Physical Risks: These are risks that are caused as a result of weather-related events such as storms, floods, earthquakes, hurricane, cyclones etc. The most relatable events in the case of Nigeria are rainstorms and floods. These risks have a large direct impact on insurance businesses.

Transitional Risks: These are financial risks that are likely to be imposed as a result of the adoption of a low-carbon economy and there exists a global climate change goal of keeping below a ‘2°C carbon budget’. This goal has caused the government of various countries to set up policies to align with the global goal and insurance firms tend to have participated in discussions on such policies.

Liability Risks: These are risks where an insurer tends to provide coverage for a policyholder who is legally liable to compensate a third party due to any form of damage or injury caused. Having to indemnify any types of liability risks can cause business disruption for insurance businesses.

This article focuses on our first step considerations in responding to the identified climate change risks. The focus is on risk management from the regulator's and the insurer's approach.

Regulator's Approach

The risks posed to insurers as a result of climate change is an ongoing discussion between insurers, regulators and other stakeholders. In dealing with these risks; regulators, insurers and other stakeholders need to collaborate immensely in order to establish a structure in dealing with climate change risks.

Our last article “*Climate change: Roles of Insurance Businesses in Nigeria*”³ highlighted some instances in which the insurers and regulators could collaborate to address some of the risks encountered by insurers as a result of climate change. As a result of this collaboration, regulators should create a structure to help insurers ease the process of adapting to the impact which will be caused by climate change risks.

Regulators in managing the impact of climate change risk could consider the following approach to reduce or eliminate the risks posed by climate change;

- Regulators should mandate insurers to integrate climate change risks into their existing enterprise risk management. It is necessary for regulators to ensure that every insurer embeds climate change in their existing principles-based risk management framework. This is to show how they want the insurance sector to be prepared for future climate change and mitigate against its negative effects on insurance businesses at large.

- Introduction of codes of practice, which could be used to ensure that climate change risks are accounted for by insurers as part the process of writing insurance products. The aim of this code of practice is ensure that insurers are aware of the climate change risk as well as other risks while writing an insurance product.
- Regulators should facilitate a clear, comparable and consistent disclosure by insurers on risks and opportunities presented by climate change. This could be in the form of a mandatory disclosure about the impact of climate change on insurance risk and climate change risks to motivate entities to assess risks and provide information to consumers/users about those risks.

Insurer's Approach

The ravaging effects of climate change on the society today has seen insurance as a panacea for managing the risks that the society itself would be unable to manage. For instance, the property of people situated in areas where floods and rainstorms are very prevalent, might leave the owners without hope of recovery if insurance coverage is not in place. The society tends to rely on insurers to help salvage their loss situations and bring them back to their initial position. This therefore means that insurers are the risk management tool for the society in tackling climate change effects.

In our last article “*Climate change: Roles of Insurance Businesses in Nigeria*”³, we clearly explained what roles insurers are positioned to play since the society relies on them in mitigating the above identified risks. However, insurers will need to design a risk management process that will help them to begin to adapt to climate change in order to use it to their advantage as failure on that part can potentially wreck their long-built businesses.

This section focuses on the risk assessment process that can help insurers to plan their steps for them to begin to adjust, adapt and prepare for future climate change. Some insurers will only be short-changing themselves if they ignore the existence of climate change and fail to take steps towards it.



Risk assessment for climate change adaptation

Insurers have been able to understand the potential impacts climate change will pose on their business but now, they need to develop a solution-based approach that will assist their adaptation planning in addressing climate change. Their risk management objective for climate change will be essential in the planning phase. We will focus on three risk assessment layers.

The first layer is about gaining a prefatory understanding of the climate change risks faced by their organisations: It is quite necessary for each insurer to develop a research and knowledge based centre on climate change within their system of operations. This will help workers develop a high-level understanding of climate change risks. Enlightening each unit will help to generate ideas on what product types can be developed, what should be adjusted in their current products policies, how underwriting certain products should change, what assumptions should be factored in when reviewing products prices, what assets should investments be channeled towards etc. All of these will only be beneficial when insurers take it upon themselves to enlighten every unit in their organisations.

The second layer is about conducting an in-depth risk analysis: Insurers should identify and evaluate the specific climate change risks that they are more susceptible to (from the knowledge of the state of their businesses), assess the possible immediate and future likely occurrence and how each unit of their business will be affected. The use of scenario testing and sensitivity testing analysis will aid their assessment and conducting these analyses will require professionals such as actuaries, risk experts etc. This way, the business operations and strategy decisions of insurers at the top management levels will be heightened and help price related products appropriately.

The third layer is about understanding the vulnerability of various business units to climate change hazards: Part of the risk management process is for insurers to understand the extent to which each business unit will become vulnerable so that measures can be put in place for them to continue to have a smooth ride. For instance, the investment unit will need to become aware of the investment assets that will have to change in order to match the liabilities(claims) that will be incurred as a result of climate change occurrence. Also, underwriting oil & gas lines of business may require some drastic changes as transitioning into a low-carbon economy will greatly impact the energy sector. A broad risk assessment from the second layer will be required because the risks that each business unit will be exposed to should be known early in this risk management step.

Conclusion

It is not enough to just identify risks and its effects on businesses and society at large regarding climate change. There are expected steps that should be taken to show the responses given to the identified risks. A proactive conversation should be initiated by either the insurers, regulators as well as other stakeholders as regards managing the risks originated by climate change to aid proper capturing of all the risk exposure of an insurer. The regulators and insurers should begin with what we consider as the first step in managing the risks that exist as a result of climate change.

References

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