Greening the way

Navigating environmental and climate risks in insurance due diligence

HOWDEN

The impact of climate change is expansive and transcends sector boundaries.

Global economic losses resulting from weather events surged by 57% between 2010 and 2019. Looking ahead, the top 215 companies are predicted to face a staggering $1 trillion (£760bn)[1] worth of financial risks over time. These risks encompass higher operating costs, asset write-offs and diminishing demand.

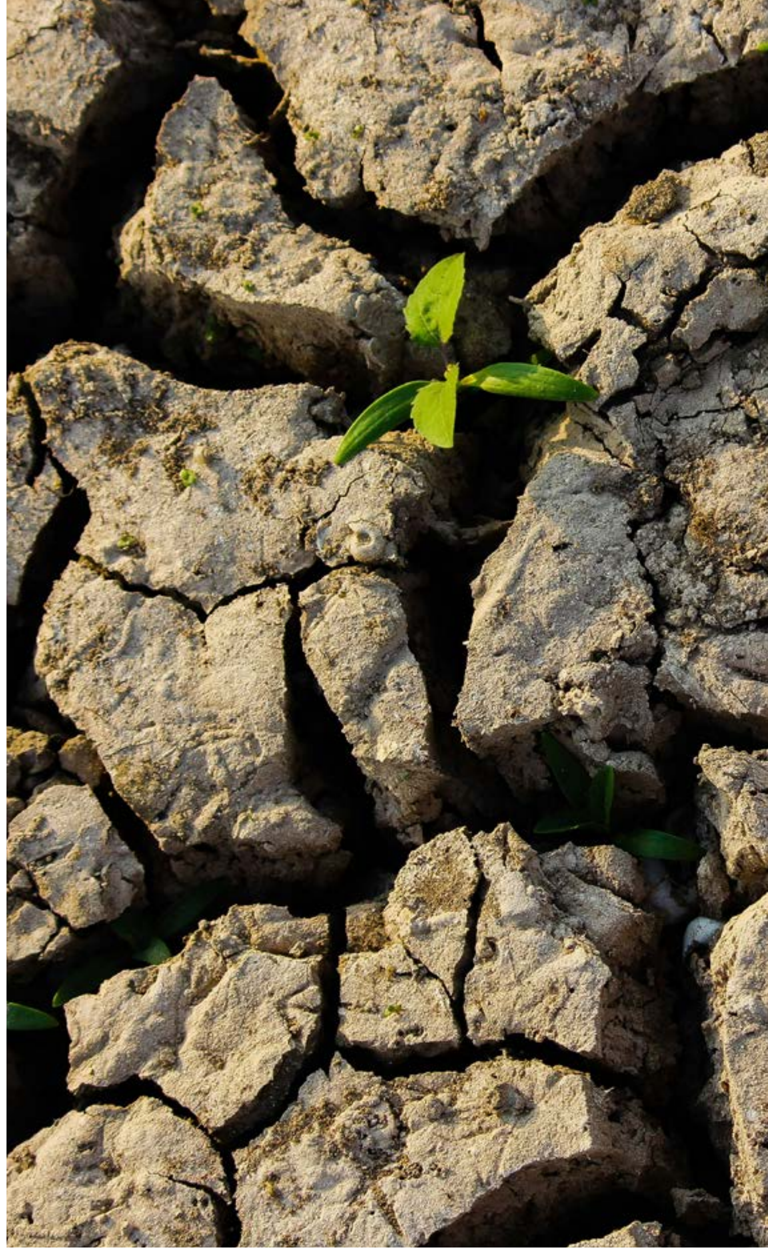
The insurance industry, like many others, has been forced to adapt to environmental and climate risks. Notably, Howden M&A's Transactional Diligence team has taken to the forefront in addressing these challenges.

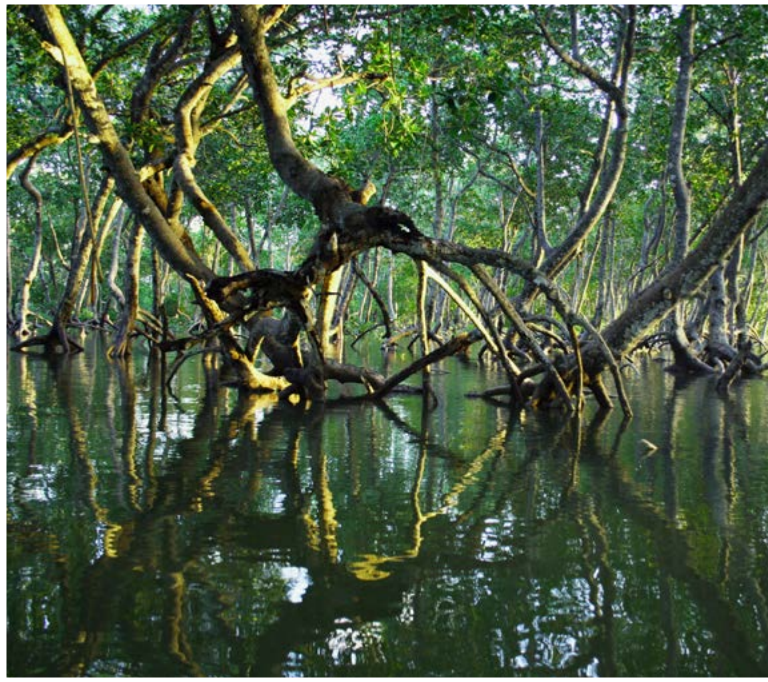
57%

Surge in weather events between 2010 and 2019.9

$1 trillion[1]

Worth of financial risks predicted for the top 215 companies.





1. Raconteur, (2022) https://www.raconteur.net/sustainability/climate-change-risks-and-the-future-of-insurance/#:~:text=Stress%20testing%20for%20climate%20risks,as%20200%25%20over%2030%20years

Environmental and climate risks – - the challenges ahead

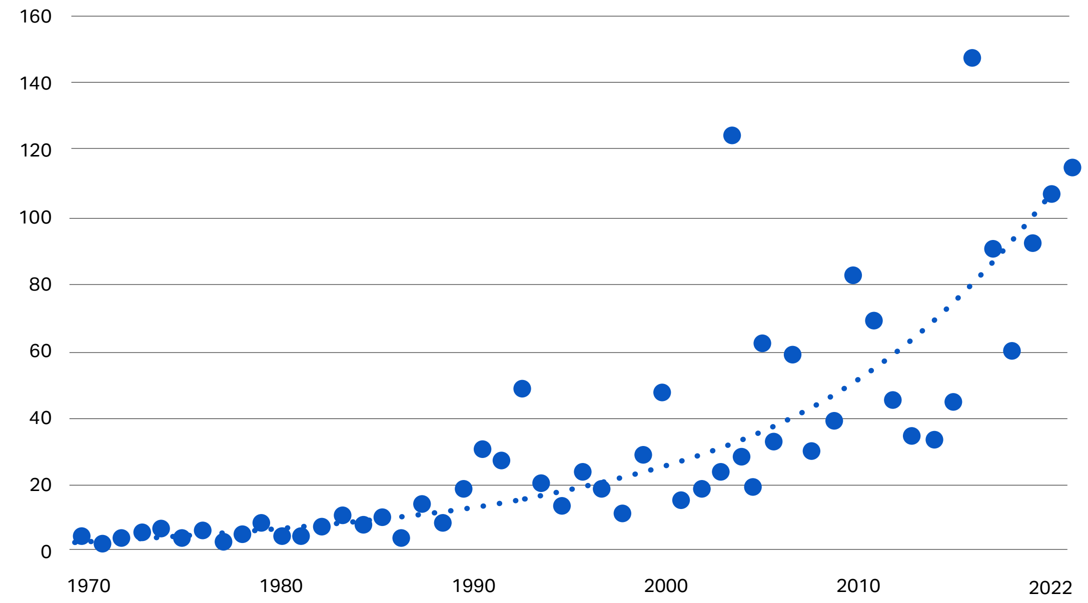
The spectrum of environmental and climate related risks is broad, encompassing natural disasters, instances of extreme weather, wild fires, rising sea levels and rising temperatures. Each risk poses a complex challenge to the insurance sector, and to investor clients engaging in mergers and acquisitions.

The graphs opposite illustrate how insured weather related losses from climate change are exponentially increasing when compared to losses from man-made events. This underlines the importance of understanding the impact climate risks will have on all company assets and operations, as well as the need to insure against these risks.

Weather related

USD billion

(Inflation adjusted)



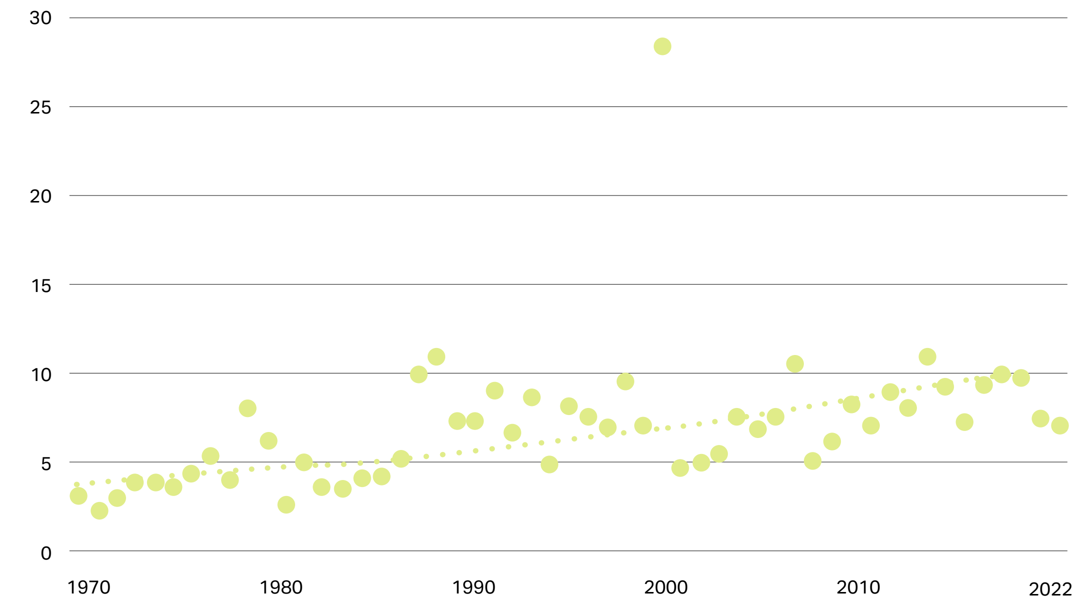
Distribution of insured losses

For weather events vs man-made events - 1970 to 2022*

Man-made events

USD billion

(Inflation adjusted)



Distribution of insured losses

For weather events vs man-made events - 1970 to 2022*

* (Source: Swiss Re, HX Nova Portal)

Insurance due diligence: changing climate leads to changing cover

As part of the transactional diligence process, We are able to offer unique insights into relevant climate risks.

This is in collaboration with our market leading Climate Risk and Resilience team at Howden. The qualitative and quantitative assessments of physical assets and exposures can provide an invaluable view of both current and future climate risks. Once our assessment is complete, we support you to interpret the results of the review as well as arranging market leading solutions that address any issues highlighted.

Our comprehensive review process is designed to ensure that you can address points raised at the earliest opportunity, protecting investments appropriately as well as streamlining the acquisition process with clear reporting and appropriate mitigation measures.

The burgeoning climate crisis undoubtedly poses a novel challenge for the insurance industry and its clients. Remarkably, 66% of weather-related risks worldwide were uninsured from 1990 to 2020. Unsurprisingly therefore, related insurance premiums are rising. A 2021 report by France's central bank projected that claims relating to natural disasters could rise fivefold in its most affected regions, accompanied by a soaring 200% premium increase over 30 years. [2]

Against this backdrop, Howden has access to the most up-to-date market data on premiums, coverage and policies, and can therefore play a crucial role for buyers and sellers alike. Our teams can offer your business insight on the most cost-effective policies specified to your business' needs. This proactive approach ensures that our insurance due diligence not only considers immediate risks but also anticipates and addresses evolving challenges, such as those posed by the climate crisis.

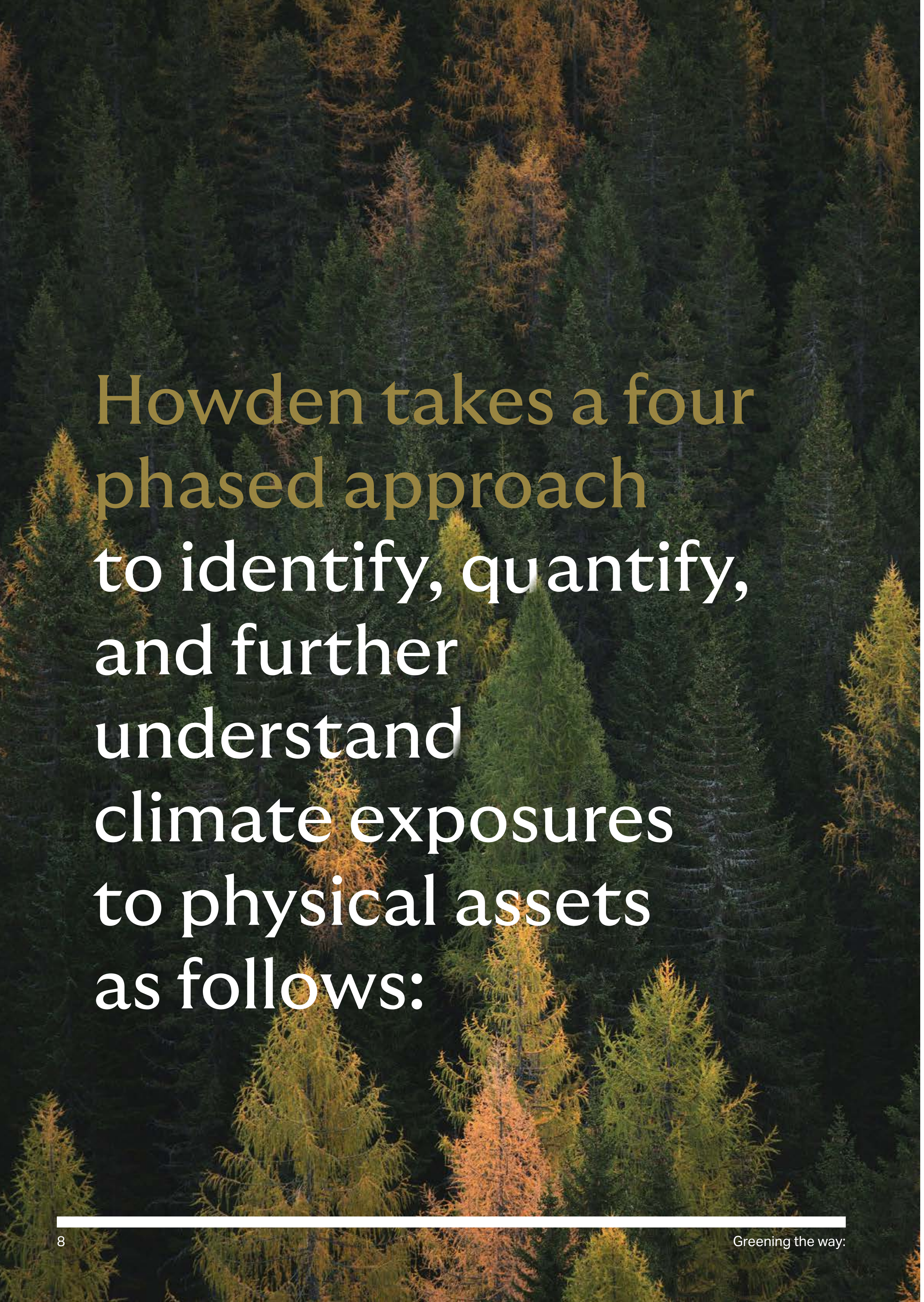
2. Racouteur, (2022) https://www.raconteur.net/sustainability/climate-change-risks-and-the-future-of-insurance/

Climate analytics

The relationship between data analytics and climate change continues to evolve. As clients request forward thinking climate analytics to be incorporated into insurance due diligence scopes, we are proud to offer specialised data-analytics, which have advanced our capabilities in predicting risks to exact locations.

The below are some central questions that we aim to answer through our advisory services:

- How can we efficiently **transfer risks** associated with climate exposure?
- What do our climate risks look like **today** and how will they change in the **future under different climate scenarios?**
- Where are our **asset hot spots** under different climate scenarios, hazards, and time horizons?
- What is the **financial impact** of climate risks to our investments?
- How will climate change impact the insurability or valuation of our assets and investment portfolios?
- Could these risks further affect our wider **supply chain** (upstream / downstream)?
- How do we address emerging **regulatory disclosures** (e.g. TCFD, EU Taxonomy etc)?



Howden takes a four phased approach to identify, quantify, and further understand climate exposures to physical assets as follows:

Phase 1

Portfolio hazard analysis

Diagnostic analysis of global and regional hazards across your business, for current and future climate risks.

Helps to pre-screen a portfolio and identify 'hotspots'. Supports strategic decision making.

Phase 2

Portfolio loss modelling

Incorporates asset vulnerability to evaluate the financial impact across the portfolio.

Helps to evaluate changes in losses and valuations over time. Supports insurance and investment decisions.

Phase 3

Single risk deep dive analysis

In-depth climate scenario assessment for individual critical assets (desktop or on-site engineering evaluation).

Helps to determine insurance requirements and climate adaptation solutions.

Phase 4

Supply chain analytics

Identifies exposures within the upstream and downstream supply chain networks.

Helps identify critically exposed suppliers and enhances business continuity.

Parametric Insurance solutions

What is it?

Parametric (or Index based) insurance is an objective form of protection that pays out based on a pre-defined index, as opposed to traditional insurance that pays out on a measured loss.

This form of insurance is highly liquid, with claims potentially paid out from 48 hours after the event parameters are met. The index is also customizable based on the spread of risk that needs to be covered, or around a budget.

This index is usually structured to match financial losses with the magnitude of an event, such as weather or natural catastrophes.

Material damage

Covers direct damages to property

Business interruption

Covers interruption to business operations:

- Direct: As a result of property damage
- Non-Damage: Catastrophes or changes in weather that may not cause direct damages, but still cause revenue losses
- Contingent: Business interruption to suppliers that spills over

Energy generation

Protects volumetric output for renewable energy generation

Agricultural yield

Hedging against a poor crop yield due to sub-optimal weather conditions

The benefits of a climate conscious insurance advisor

Engaging with a transactional diligence advisor who understands the risks and potential for opportunity of climate risk in a merger or acquisition offers a number of advantages for clients:

1 Enhanced understanding:

It enables more accurate risk evaluation and future cost analysis, reducing the potential for post-transaction surprises.

2 Resilience:

It encourages businesses to adopt climate-resilient practices, protecting their assets and continuity.

3 Adaptation to market changes:

Insurance service providers that proactively address climate risks are better prepared for changing market dynamics and regulatory shifts.

Wider implications for your business

Our analytics can also provide valuable insight to a wider range of stakeholder groups within an organisation far beyond insurance and risk management such as those shown in the summary below.

Insurance/ risk management

- Understand the suitability of the current insurance program for ongoing and future climate risks.
- Anticipate future changes to inform business continuity planning.
- Identify emerging health and safety risks.

Strategy and investments

- Support portfolio management and strategic decisions around investments for both existing assets and new acquisitions.
- Incorporate expected impacts and changes into the investment due diligence process.

Operations

- Identify factors likely to impact the normal functioning of business operations.
- Plan for long term changes in chronic climate risks such as heat and drought stress which could impact operational processes and worker productivity.

Finance

- Anticipate material losses to physical assets that could impact the valuation of the company.
- Plan for changes in risk management expenditure as a result of changing climate risks.

Compliance

- Support disclosure requirements in line with relevant frameworks (e.g. EU Taxonomy, TCFD).
- Meet standards on reporting financial impacts of climate change to a business or portfolio of investments.

To conclude

One of the key initial benefits of engaging in this process is to help identify any gaps in your current insurance program. Following the Transactional Diligence review, our Climate Risk and Resilience team at Howden is able to model and structure bespoke parametric policies across a variety of weather perils.

Parametric insurance provides the insured with the comfort that their claims will be paid rapidly once the pre-defined thresholds are hit, protecting investors.

Get in touch with our team for more information.

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