Managing Insurance Cost and Business Risk

Executive Summary

Many experts anticipate that commercial insurance policies, pricing, and availability are set to undergo major shifts in the coming years due to increased climate and resilience risk. This fact sheet discusses the role that the insurance and re-insurance industries play in mitigating resilience risk and offers best practices for building owners to work effectively with insurers. It also reviews the types of insurance coverages relevant to resilience as well as efforts by the insurance industry to respond to increased risk.

This fact sheet was developed as part of a Better Buildings Financial Ally roundtable including partners, allies and stakeholders.

Overview

The insurance and re-insurance industries are increasingly incorporating climate- and resilience-related risk into property insurance pricing and availability, subject to a time lag because insurance rates are largely based on historical data. Many experts anticipate that insurance policies and pricing are set to undergo major shifts over the next few years as recent natural disasters are taken into account. However, some insurance companies are actively working with building owners to help them take steps to mitigate risk and improve premiums—often a win-win for both parties.

Insurance plays a key role in protecting commercial building owners from many of the financial risks associated with natural disasters and a changing climate. In 2017 and 2018, building owners in the U.S. experienced a combined 101 catastrophes (defined as causing $25+ million in insured property losses) that caused estimated insured property losses of over $150 billion, a significant increase in losses over previous years. While it is difficult to predict future losses, the number of yearly loss events has been steadily increasing for the past few decades, and many expect this trend to continue with increased climate volatility, the threat of sea-level rise, and other natural stressors.

According to a survey from the Society of Actuaries in 2018, climate risk was both the top current risk and top emerging risk based on 267 total responses. Insurers are factoring this increased risk into pricing, and experts agree that building owners may see a rise in premium costs in the near-term. This is especially pertinent for assets in risk-prone areas such as coastal cities where premiums may become particularly burdensome for building owners. Because insurance policies are typically priced annually or every few years, locking in favorable rates in risky markets may be difficult. Insurers may also outright decline or reduce climate-related coverage limits (e.g. flood, wind, wildfire, named storm) for extremely risky assets. It is important to note that while insurance can provide coverage for losses from catastrophic climate events, it cannot protect an asset from a reduction in liquidity, depreciation in asset value, or many of the transitional risks outlined in the Building the Financial Business Case For Resilience Fact Sheet.

Relevant Insurance Coverages for Resilience

Insurance products are available to cover most—but not all— resilience risks. These include:

- **Property and Casualty Insurance:** Often grouped together, these insurance types cover physical assets from damage incurred from climate and weather events and any costs resulting from accidents.
- **Flood Insurance:** This type of insurance covers damages incurred to a property through flooding. While some commercial property insurance policies cover flood damage, many do not.
- **Equipment Breakdown Insurance:** These policies cover losses due to mechanical or electrical breakdown of many types of equipment.

- **Business Interruption Insurance:** This type of insurance covers lost income while a business is unable to operate in the aftermath of a covered loss such as a hurricane (e.g. extra expense, supply chain).
- **Insurance Coverage Gap Products:** This type of insurance protects owners from limitations or restrictions in policy coverages. For example, MunichRE developed a commercial flood coverage endorsement for small business owners.

Insurance Industry Perspective and Efforts

The insurance industry is responding to increased climate and resilience risk across customer portfolios in several ways:

- **Improved catastrophe modeling:** Catastrophe modeling is the process of using computer-assisted calculations to estimate the losses that could be sustained due to catastrophic events. Factoring climate risk into catastrophe modeling is now standard practice for most insurers, and industry collaborations such as the Oasis Lost Modeling Framework are encouraging advancements and standardization in modeling. More accurate modeling can help insurers and customers identify and quantify exposures to make more informed decisions, reducing premiums and losses.
- **Advocating for advanced building standards:** Some insurers are using standards such as the Insurance Institute for Business & Home Safety (IBHS) FORTIFIED Commercial and the Envision rating system as benchmarks to assess areas of vulnerability for customer properties. Properties that meet a certain set of standards (which may depend on location) may be eligible for premium discounts.
- **Coverage for resilience improvements:** Some insurers like Chubb offer policies that cover the costs of implementing energy efficiency and resilience measures in the event of a loss at an existing property.
- **Location risk scoring:** Access to specific location data has dramatically improved due to geospatial technology like GPS, satellite imaging, geographic information system (GIS) maps, and internet of things (IoT) devices. This granular-level detail allows insurance companies to more accurately underwrite climate related risks. One example of a data source is MunichRE's NATHAN (Natural Hazard Assessment Network) which helps to assess the risks of natural hazards like floods, storms, and earthquakes.
- **Parametric coverages:** Unlike traditional insurance policies that insure assets for actual losses incurred, parametric insurance instead covers the probability of an event such as a major hurricane occurring and then pays policy holders according to a predefined scheme.

How Building Owners Can Mitigate Insurance Risk

While the insurance industry is working to improve climate risk management, building owners also have an opportunity to work directly with brokers and insurers to mitigate risk, prevent losses, understand coverage gaps, and cut premiums by taking preventative steps. Whether or not a building owner has experienced increased premiums, it is often possible to proactively engage with insurers to ensure assets are best prepared for the uncertainty of the future. Considerations for working with insurers include:

- **Understand risks:** Building owners can engage with their insurer to understand which assets are perceived as the riskiest. Many insurance carriers have risk engineering groups that may be able to provide certain risk assessment services to customers.

- **Identify opportunities:** There are typically actions that building owners can take to improve the resilience of assets and reduce premiums—including structural improvements, equipment upgrades, and changes to management practices. Insurers may require certain resilience features or building code measures to qualify for discounts.
- **Assess policy options:** Some insurers are providing innovative risk-mitigating insurance solutions to better address climate risk. Building owners planning to be proactive on resilience can contact their current provider to assess policy options, or shop around for alternative insurance providers that offer resilience-friendly options.

Next Steps

For building owners looking to assess and manage insurance risk, below are some suggested next steps and additional resources:

- Engage internal risk management leadership to understand current insurance policies across the building portfolio
- Work with insurers using the suggested steps above
- Consult with insurance brokers and attorneys regarding risks and opportunities associated with resilience

Additional Resources

- MunichRE NatCatSERVICE
- IBHS Disaster Safety
- Envision Rating System
- FM Global: Master the Disaster