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Economic Insights

Climate resilience: how insurance can contribute to a new, "green" dawn

Key takeaways

- Tackling climate risks could lift G20 GDP growth by 4.7% by 2050.
- Insurers can contribute to climate resilience through environmental-friendly underwriting guidelines.
- Incorporating ESG criteria to investment process supports long-term economic growth.
- Green bond issuance is at record highs but is still just 0.5% of global bonds in circulation.
- A harmonized "taxonomy" of what is green and sustainable is needed to further advance climate resilience.

About Economic Insights
Analysis of key economic developments and their implications for the global re/insurance industry.

Managing Editor
Jérôme Haegeli
Swiss Re Group Chief Economist

Author
Jessie Guo
Economist

We welcome your feedback. For any comments or questions, please contact: institute@swissre.com

In a nutshell

Re/insurance is at the front line of mitigating climate risk and facilitating sustainable growth. Re/insurers can contribute to the UN's 1.5°C target from both sides of the balance sheet and help drive a unified policy framework for green transition.

Climate change is a systemic risk that impacts the financial industry also. The Economist Intelligence Unit estimated that USD 4.2-13.8 trillion of the world's financial assets in 2015 were at risk from the impact of climate change.[1] Calls to address climate risk and build a robust green financial system are becoming ever louder. According to OECD estimates, if a "decisive transition" to a low-carbon economy is effectively implemented, climate-change associated damage to economic value will be reduced to the tune of 2% of the gross domestic product of the G20 nations.[2] It will also boost long-run output by up to 2.8% by 2050, resulting in a net growth benefit of 4.7% across those countries (see Figure 1-1). Driving this value creation will be investments in sustainable infrastructure, supportive fiscal initiatives, structural reforms and green innovation, like a capital market for green securities. Insurers can contribute to the new green dawn by applying climate adaptation underwriting measures and environmental, social and governance (ESG) criteria into their investment portfolios.

The risk to financial and economic assets from climate change comes as physical and transitional risks. Physical risks include, for example, property damage and trade disruption emanating from climate shocks (eg, the more frequent and severe weather events like storms, floods and drought). Transition risks refer to how adjustment towards a low-carbon economy could change the way society deploys resources, uses techonology and rolls out new regulation. This will prompt reassessment of the value of assets and generate "stranded" assets such as in fossil fuel deposits or coal reserves.

Re/insurers are at the front line of managing climate risk and transitioning to the low-carbon society under the UN's goal, offering risk protection services to help businesses minimize earnings volatility resulting from adverse weather conditions. Beyond refraining from insuring high CO_2 emission sectors and firms, insurers can also include climate adaptation measures in their underwriting processes. This will also raise people's awareness and reduce adverse selection against climate risks. In addition, by embedding insurance into climate-resilient infrastructure projects, insurers can facilitate availability of associated financing by collaborating with multilateral banks and government agencies.

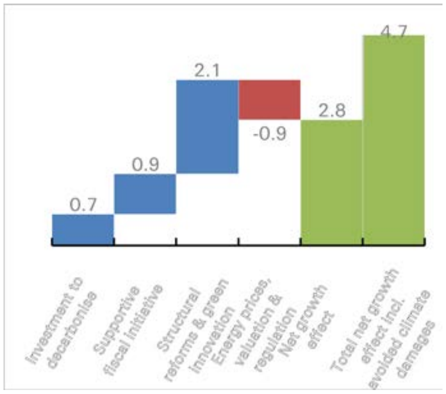
On the asset side, re/insurers can apply well-defined ESG criteria into their investment portfolios. ESG or responsible investing benefits a company from

[1] "*The cost of inaction: Recognising the value at risk from climate change*", The EIU, 2015.
[2] "*Investing in Climate, Investing in Growth*", OECD, 2017.

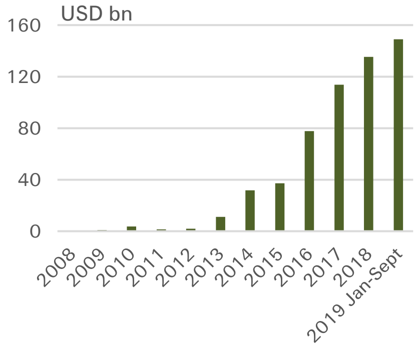
a reputation perspective. It also makes economic sense and can generate better long-term risk-adjusted returns.[3] There is already some evidence that in certain asset classes, ESG investments outperform benchmark indices.[4] In alternative investment, asset managers can contribute to invest through green bonds, infrastructure renewables and sustainable real estate projects. All told, much more can and should be done. For instance, after the record high volume of green bond issues in the first three quarters of 2019 (see Figure 1-2), the total USD 500 billion green bond universe is still just 0.5% of global bonds. As long-term investors, global re/insurers can advocate for better disclosure in financial reporting and promote financial securitization for infrastructure as a tradable asset class, according to the Principles of Responsible Investing.[5]

Figure 1-1 (LHS)
Impact of climate action on G20 GDP growth by 2050

Figure 1-2 (RHS)
Global green bond issuance



Source: OECD



Source: Bloomberg

Swiss Re implements its climate change strategy based on four pillars: 1) advancing our understanding of climate change risks; 2) developing related products; 3) raising awareness; and 4) tackling our own carbon footprint. In the future, we will focus more research on the implications of climate change for economic modeling. Faced with the global challenge that lacks a harmonized definition of what "green" and "sustainable" is and thus hinders a broad-based climate risk regulation, we strive to work with multiple stakeholders to push forward the green transition within a unified policy framework and to achieve the UN's Sustainable Development Goals (SDGs).[6]

[3] "*Responsible investments: the next steps in our journey*", Swiss Re, 2018
[4] As the IMF's *Global Financial Stability Report* from October 2019 says, however, due to the short time horizon of available data, it is too soon to conclude that sustainable funds consistently outperform conventional funds across different asset classes.
[5] See Principles of Responsible Investment website: https://www.unpri.org/pri-in-person
[6] Find out more about the UN's SDGs at: https://www.unglobalcompact.org/sdgs/about