AN INTERNATIONAL OVERVIEW OF EXISTING CLIMATE-RELATED INSURANCE INITIATIVES: FINDING THE RIGHT PATH FOR CANADA

Posted on June 30, 2021

Categories: Insights, Publications

Climate change is transforming the world at an unprecedented rate and is leading to a significant rise in natural disasters. In 2020, the Americans saw a significant rise in hurricanes, while Europeans dealt with a rise in flooding across the continent[1]. Canadians are no strangers to dealing with disasters and the resulting losses. The effects of climate change are far reaching, but one industry that has been put under significant pressure as a result of these changes is insurance. The rise in severe weather events has created significant challenges for managing exposure to environmental risks. Experts harbour concerns that climate change will continue to lead to an exponential rise in natural disasters, with insurers potentially responsible for paying more claims than they can afford[2]. Because the insurance sector also typically acts as an investor in the financial market, real concerns exist about the possibility of one large natural disaster bringing down the whole of the financial sector. As the insurance market adapts to these risks, concern then turns towards consumers who may be priced out of insurance premiums or may not be able to obtain sufficient coverage and, as a result, left to carry significant uninsurable risks themselves.

To address these newer, climate related risks, governments at all levels have begun working with insurance companies to implement measures to protect both consumers and the insurance and financial sectors as a whole. Globally, several western nations have passed initiatives relating to flood and earthquake coverage. These initiatives have often been done in consultation with insurers and many have been created through targeted government legislation. While Canada has been slow to act with respect to national initiatives, there are signs that some are on the horizon. In particular, the government appears to be exploring national initiatives relating to the cost of flood insurance. In 2019, the Prime Minister, in conjunction with the Minister of Public Safety, announced that they were undertaking consultations to create a low cost national flood insurance program. The goal of the national flood program would be to protect homeowners who are at a high risk of flooding and to ensure that they have access to low cost flood insurance[3]. In the recent federal budget, 63.8 million dollars was earmarked to work with provinces and territories to update flood maps, which experts have interpreted as being preparation for future initiatives. Public Safety's consultations and subsequent report, however, are not expected to be completed until 2022[4]. Canada could also soon see an earthquake insurance initiative. The Property and Casualty Insurance Compensation Corporation ("**PACICC**") (which is industry-funded and not for profit) recently held discussions with the Insurance Bureau of Canada about the possibility of expanding the compensation fund to cover major losses resulting from earthquakes. The PACICC's compensation fund, since its inception more than twenty years ago, has focused primarily on its ability to respond to claims from policyholders in the event of the insolvency of a property and casualty insurer.[5]

Although Canadians will have to wait to see exactly what kinds of initiatives the government will introduce, existing initiatives in the United Kingdom, the United States, Australia and New Zealand may provide hints as to the kinds of flood risk and earthquake programs Canada may develop. These initiatives, together with suggestions for the types of programs that may be most successful in Canada, are discussed in this article from McMillan's ESG initiative.

International Flooding Initiatives:

Recently, in the United Kingdom, scientists hypothesized that flooding was becoming far more prevalent as a result of climate change. One-sixth of British homes are at a higher risk of flooding than ever before and scientists predict that by the year 2100, 'once a century' rainfall would become a yearly occurrence[6]. Due to the enhanced risk, consumers living in high-risk flood areas started finding it difficult to afford flood insurance. As a result, in 2016, the UK passed legislation to create FloodRE, a program with two goals. First, the government aimed to keep costs low for consumers. Second, they hoped that by introducing this initiative, the market would correct itself over time. The hope is that by 2039, market prices will come down on their own, to the point where the initiative is no longer required[7].

The operation of the program is fairly simple. Insurance companies came together to provide the 20 million pounds in start-up costs and signed up to participate in the program[8]. Consumers receive coverage with their insurance companies as they normally would, but when a participating company writes a home insurance policy, they have the option of passing the liability for the flood component of the policy to FloodRE. The insurance company then pays a small fee to the program, resulting in a yearly revenue of 180 million pounds for FloodRE. The money goes into a fund, which is later used to pay claims. When a consumer makes a claim with a participating insurer, the insurance company pays the claim out to the insured and is later reimbursed through FloodRE[9]. More than fifty British insurers currently participate in the program, including Barclays, AIG and Lloyds Bank[10]. As the program is publicly accountable and not for profit, the cost of flood insurance is lower than it would be on the open market. However, to avoid incentivizing the building of homes in high-risk areas, no homes built after 2008 are eligible to participate[11]. The main criticism of the program is that it does not do enough to incentivize protection against, and prevention of, flooding itself, unlike the

National Flood Insurance Program in the United States[12].

The Americans have also developed a plan to keep the costs of flood insurance low. While it does have some key similarities to FloodRE, it also has some significant differences. First introduced in 1968, the National Flood Insurance Program ("**NFIP**") is funded in part by the Federal Emergency Management Agency ("**FEMA**") and in part by the premiums collected from policies[13]. Like FloodRE, the NFIP's goal is to provide lower cost flood insurance to homeowners and to ensure everyone has access to insurance (a pre-requisite to qualify for a mortgage). Some of the revenue from the NFIP is also reinvested into participating communities, which incentivizes participation, while allowing for increased prevention and protection. For example, the NFIP will work with local officials on mitigation initiatives, such as flood proofing structures[14].

Unlike FloodRE, entire communities at risk of flooding may apply to participate in the NFIP. For communities to be eligible, they must plan and develop to meet a certain standard of floodplain development. As part of this, communities will often work in conjunction with FEMA to manage and produce flood risk maps. Once the communities meet the requisite standards, individuals are given access to subsidized flooding insurance provided through the program. Individuals from communities that go beyond the minimum standards given greater discounts. The intent of the preventative incentives is for fewer claims to be made, which eases the burden on the financial sector as a whole[15]. One of the major criticisms attached to the program is that unlike for FloodRE, the insurance coverage provided often does not provide enough coverage for the entire contents of a consumer's home. As a result, homeowners generally also have to apply for separate insurance, which can be a major impediment to qualifying for a mortgage. The hope is, however, that, due to the measures to protect and prevent homes from being flooded, the market insurance price will also decrease[16].

On the other hand, Australia's initiatives differ quite a bit from FloodRE and the NFIP. Australia recently established the National Recovery and Resilience Agency ("**NRRA**"), with the goal of aiding communities in the wake of disasters, while also helping communities build homes that can better withstand such natural disasters. The program combines both flood and wildfire relief and involves scientists who can offer insights into ways of improving access to climate data (which can then be used for prevention and protection efforts)[17]. Australia's government also created a 10 billion dollar reinsurance program to protect insurance companies from going bankrupt in the event of a large natural disaster. Some of the money is also earmarked to build stronger infrastructure across the country[18]. Just as with Canada, however, Australia has also recently launched consultations to explore ways to bring insurance costs down for consumers[19].

Earthquake Exposure

Although Canada has not had a 'big shake' in some time, Canada sits on a few significant fault lines, particularly in British Columbia and in Quebec and is at risk of experiencing an earthquake that could severely cripple the insurance sector[20]. As a result, many experts strongly believe that Canada's financial sector should be better prepared.

The State of California developed an earthquake initiative in 1996. In 1994, California suffered a quake that caused twenty billion dollars in losses, only half of which was insured. At the time, California law mandated that companies that sold home insurance had to sell insurance that included coverage for earthquakes. Reeling from losses, the market responded by limiting the number of policies they wrote. By the following year, 93 percent of the market had stopped writing homeowners insurance policies or had severely cutback the number of policies they were writing. To respond to this, the California Legislature created the California Earthquake Authority ("**CEA**"). The goal of the program is to ensure consumers have access to coverage. Beyond that, the program aims to keep insurance costs affordable for all consumers[21].

As with FloodRE, the CEA is privately run but publicly overseen. As the fund is not for profit, premium costs are lower. In fact, by law, only six percent of the CEA's budget is allowed to be used for operating costs. As a not for profit entity, the CEA pays no federal taxes, which helps keep premiums lower. Because the CEA is not profit driven, the premiums it collects are reinvested to protect those who hold policies. Homeowners, the only people eligible for the program, access the lower cost insurance through participating insurance companies, just as with FloodRE. Every year, the program receives approximately 890 million dollars in revenue. As a result, the CEA currently has nearly 19 billion dollars in claim paying ability[22]. Should the next large earthquake hit Californians soon, the insurance industry should be able to withstand it as a result.

New Zealand is another jurisdiction with a government created initiative relating to earthquake insurance coverage. Established in 1945 but redeveloped in 1993, the goal of the New Zealand Earthquake Commission ("**EQC**") is to protect the insurance sector while also providing New Zealanders with access to lower premiums. The EQC is part of the country's Natural Disaster Fund, which funds claims through levies that are paid by New Zealanders as part of their home insurance policies. Every year, the Natural Disaster Fund also purchases reinsurance, with a portion of that money going towards fulfilling claims made under the EQC, if necessary[23]. Similar to the California Earthquake Authority, the EQC only offers protection to residential properties, which has allowed the EQC to be more efficient. The EQC is also publicly overseen and is not for profit, ensuring that its main goals are always to protect consumers and to ensure financial stability. The EQC's obligations are set out in legislation, which further enhances the regime.[24]

As is the case with many of the other initiatives described, consumers receive insurance coverage from private insurers, but when a resident purchases home insurance, they automatically receive coverage from the EQC as well. Although the EQC does not cover homeowners fully, they do assume a significant portion of the risk. Because the EQC assumes such a significant portion of the risk, the insurance policies from private insurers can be purchased at lower rates than they otherwise might be.[25] In order to enhance efficiency, claims made under the EQC program or under the policies purchased from private insurers (or both) are processed by the private insurers.[26] As with other government initiatives, the EQC also prioritizes funding for research on how to better protect homes from natural disasters with the goal to reduce the number of claims made in the future[27].

Wildfire Exposure:

Experts recognize that in addition to flood and earthquake initiatives, Canadians would also benefit from a similar wildfire initiative. The 2016 Fort McMurray fires in particular brought this issue to light. As a result of the tragedy, insurance companies paid out nearly $4 billion in insurance claims.[28] Although first responders and the community were praised in how the fire was handled, climate data suggests that large wildfires will become far more frequent, and insurers will need to be prepared. While wildfire numbers in Canada were lower as a whole in 2019, some regions in Canada saw a large increase in the number of fires. For example, Northern Alberta experienced four times more fires than the ten-year average in May and June of 2019 alone. Yukon, on the other hand, experienced a very dry winter and spring, and saw the number of fires as compared to the ten-year average double in July 2019[29]. Unfortunately, our review uncover no successful international insurance programs focusing on wildfires that could serve as an example.

Conclusion:

Moving forward, there are three important considerations for Canada in the development of efficient and workable climate-related insurance initiatives. First, such initiatives must not only ensure that consumers can access low-cost sufficient coverage, but should also incorporate measures to further protect communities from losses due to natural disasters. Communities that are better equipped to deal with natural disasters may be less likely to submit claims when a disaster strikes (or at least submit claims for lower amounts), allowing the market to correct itself over time. Second, in order for communities to better protect themselves and for individuals to make more informed decisions about, for example, where they live, they must have access to advanced climate and seismic data allowing them to predict and assess risks due to climate change and severe weather. Although seismic activity can be more unpredictable, climate change data has shown that the landscape can change within a matter of years, not centuries. Therefore, preparation is crucial. Finally, a not for profit initiative would appear to be the best alternative for keeping the costs of weather-related insurance low and for focusing on delivering what is best for consumers.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.