THE SHARD

Climate Change Risks for South African Insurers

Understanding Climate Change

Climate change refers to long-term shifts in temperatures and weather patterns, mostly due to human activities. South African insurers face a unique spectrum of challenges brought by climate change, which pose significant risks to their financial stability and long-term resilience. As extreme weather events like droughts, heatwaves, and floods occur frequently and become more severe, insurers must adjust quickly to these changing conditions. For South African insurers, understanding and managing these risks is essential to keep their business stable and successful.

What Climate-Related Risks Do South African Insurers Face?

The main risks that insurers face include physical risks, transition risks, and liability risks. A dditionally, insurers face reputational risks and operational risks. These categories are explained below.

Physical Risks

Physical risks come from the increasing damage caused by extreme weather events, such as storms, floods, and heatwaves. South Africa has already seen severe flooding, especially in areas like KwaZulu-Natal, which damaged buildings, roads, and other infrastructure and caused huge financial losses totalling R54 billion. Of this, the insurance industry absorbed about R27 billion, as highlighted in the Santam Insurance Barometer 2022-23. When events like these happen, insurers often face more claims for property damage, business interruptions, and even loss of life. If insurers don't account for these risks in their pricing, they may struggle to cover these costs.

Insurers also face challenges with underwriting—the process of assessing risks for life, health, and property insurance. For example, climate change can worsen health problems, particularly in vulnerable communities, leading to higher health and life insurance claims. Studies indicate that climate change can increase mortality and morbidity rates due to factors like rising temperatures and worsening air quality, which in turn raise the number of climate-related health and death claims. South African insurers may need to update their risk models and study how climate change affects mortality and health to price policies more accurately.

Liability Risks

Liability risks refer to the risk that insurers could be financially responsible for climate-related damages. For example, companies may face lawsuits for contributing to environmental damage, and insurers who cover these companies may also be exposed. Insurers could also face lawsuits themselves if they fail to address or disclose climate risks properly, putting their financial health at risk.

Transition Risks

Transition risks come from the shift to a low-carbon economy, which can change the value of assets and the costs of doing business. For example, new laws and taxes related to carbon emissions, stricter environmental standards, and changing consumer expectations may affect companies in carbon-heavy industries like mining and energy. Insurers that cover these industries or invest in them may face financial losses if these industries decline.

Transitioning to sustainable practices also requires upfront costs. South African insurers must find a balance between these costs and the long-term benefits of being part of a sustainable economy.

Reputational Risks

Reputational risks are the risks to an insurer's image if they do not address climate concerns openly or lag in adopting sustainable practices. Customers, investors, and regulators are paying closer attention to how insurers handle climate issues. South African insurers may need to reduce their investments in high-carbon industries, set green policies, and clearly report their climate-related risks. Showing a commitment to sustainability can also help attract customers who prefer companies with strong environmental practices.

Operational Risks

Operational risks refer to the ways climate change can affect an insurer's own operations. Climate events, like floods or heatwaves, can disrupt an insurer's office operations, data centres, and other key infrastructure. In areas prone to extreme weather, insurers may also struggle with staff availability, as employees' safety and ability to travel may be impacted. To manage these risks, South African insurers need to plan carefully for these disruptions to keep their business running smoothly.

Preparing for the Future

To manage these rising climate risks, insurers must be proactive and build resilience throughout their business. By improving their risk models, insurers can use climate data and technology to predict losses from extreme weather more accurately. Creating new insurance products, such as "green" insurance and parametric coverage (which pays out quickly after specific weather events), can help insurers respond better to climate impacts. On the investment side, insurers can move towards environmentally friendly investments, which helps them avoid potential losses as regulations tighten and customer preferences change. Regularly stress-testing their investment portfolios for climate risks can also help insurers identify weaknesses and protect against sudden financial impacts. Within their own offices, insurers can adopt sustainable practices to reduce their carbon footprint and show their commitment to a greener future.

Working with government agencies and industry groups can help insurers stay updated on best practices and support policies that improve climate resilience. By staying connected to these efforts, South African insurers can help build a stronger response to climate change while also securing their own future.

A way forward

Climate change is changing the types of risks that insurers in South Africa face. By recognizing and managing these risks—whether they are physical, transition-related, liability, or reputational—insurers can be prepared for a challenging future. With smart strategies, insurers can turn climate challenges into opportunities, building resilience, stability, and sustainability in a fast-changing world.

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