'Superpower' of Insurers Curbs Energy Transition Risk

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Insurers have a "superpower" essential for the energy transition, helping to limit risks involved in new technologies and strengthen climate modeling, according to Rakhi Kumar, head of the Liberty Mutual Climate Transition Center.

"Insurers are risk experts. We are very good at risk identification, risk mitigation and risk transfer," she told BloombergNEF in an interview. "That is the superpower of insurers, and there's a lot of risk in technology as we are transitioning to a low carbon economy."

Risk assessments vary substantially, however, depending on the climate modeling and data used. Kumar, who is also the senior vice president of sustainability solutions and business integration at the company, makes the case for "a cross-sector, public-private conversation of what the future of climate data and models looks like. Because it's in everyone's best interest that we get it right."

She sees "significant gaps" in the tools and data used to understand and translate climate risk. The Liberty Mutual Climate Transition Center aims to collate data around climate models and risk in order to understand the opportunities in new decarbonization technologies and improve the climate resiliency of infrastructure.

Mitigating the threats posed by increasingly frequent hurricanes and severe storms in the US is just one example. As much as 26 gigawatts of electricity-producing capacity was within Hurricane Milton's expected trajectory, according to BNEF, including gas-fired generators and solar and coal-fed plants. Shoring up power plants against severe weather events will likely become a key part of the design and operations strategies of these assets.

"There's a growing realization that on the way to a low-carbon economy, we're going to have more physical climate risk."

Rakhi Kumar, Head, Liberty Mutual Climate Transition Center

The Boston-headquartered Liberty Mutual has been in business since 1912. It had $165 billion of assets and $49 billion in revenues in 2023.

The following transcript has been lightly edited.

Q: What is the ambition of the Liberty Mutual Climate Transition Center and what has been the progress so far?

A: We announced the founding of the Liberty Mutual Climate Transition Center in 2022 because we felt there was a need to bring the insurance-reinsurance perspective to the climate transition. There is a very clear and distinct perspective that financial institutions, like investors and banks, have based on the role they play in the economy. But the perspective of insurance was not being articulated clearly.

We identified three core areas to support the transition: collate data around climate models and risk, understand the risks and opportunities in the new decarbonization technologies, and help improve climate resiliency of infrastructure.

We have started publishing papers and materials on these areas. We spent the first two years building up and sharing information we have on the data behind climate models as well as on climate transition. You are going to see a lot more thoughts around physical risk, transition plans as well as climate resiliency coming out of the Climate Transition Center. We also hold events that bring together cross-sector stakeholders to talk about the different aspects of the climate transition, focusing on the system-level change needed.

Q: So the Climate Transition Center fills a gap in the market?

A: Yes, absolutely. Insurers can help the rest of the financial sector and companies understand and manage physical risk. Not all weather-related events will create loss. You need to identify those events that will create loss, and then you want to manage that loss. We don't have perfect science or perfect information.

Take tornadoes. There is an increase in tornado reporting. Is that caused by climate change or is that because we have more people living in areas that were prone to tornadoes and now have phones that can take pictures?

Q: Insurance companies have been modeling climate for over 100 years. How do you leverage that?

A: We use the climate scenario models to understand transition risk, whereas for physical risk we use catastrophe models (often referred to as cat models).

Cat models help to understand and price the physical risk, but they have a shorter time horizon. The larger climate models can tell you, for example, directionally that there will be more hurricanes, but they cannot tell you which of these hurricanes are going to be category 4 or 5 – which means loss generating – or of a milder variety.

The third type of models are called integrated assessment models, which duct-tape climate models to economic models. We are adapting these models, which were built originally for policymakers to help inform policy decision-making around climate, for investment decisions.

Having access to different types of models and understanding what they can be used for gets you to the right kind of conclusions and helps with decision making.

Q: Bloomberg News recently wrote about the risks of proprietary opaque climate models which often yield contradictory results, but can impact business worth billions. One option is for the US government to create a "public prediction engine" of its own, or force transparency in existing models. What do you think is the best approach?

A: Significant gaps remain with the tools and data we use to understand and translate climate risk – both physical and transition risk – which presents a challenge as the world seeks more and better information to make decisions.

The insurance industry sees the downstream effects of climate resiliency decisions made by others based on the data they have on hand. This is especially true for critical infrastructure, which is a "climate risk multiplier." A failure in infrastructure, for example a flooded sewer system, is going to make the impacts to lives and property worse.

Communities, governments and companies need to make informed decisions, based on accurate data, leveraging the latest science. If they are making investments inaccurately, the people holding the bill are the insurance industry, and ultimately, communities and individuals.

We think there needs to be a cross-sector, public-private conversation of what the future of climate data and models looks like. Because it's in everyone's best interest that we get it right.

Q: You mentioned how insurance has a larger role to play in energy transition investments, and how it

can improve the risk-return profile of projects. Could you elaborate?

A: Insurers are risk experts. We are very good at risk identification, risk mitigation and risk transfer. That is the superpower of insurers, and there's a lot of risk in technology as we are transitioning to a low-carbon economy.

Not all risks are insurable risks. That’s why we worked with The Geneva Association, a think tank of insurers and reinsurers, to help develop an insurability readiness framework. I do believe that insurance needs to go from being an afterthought to being part of the initial discussion.

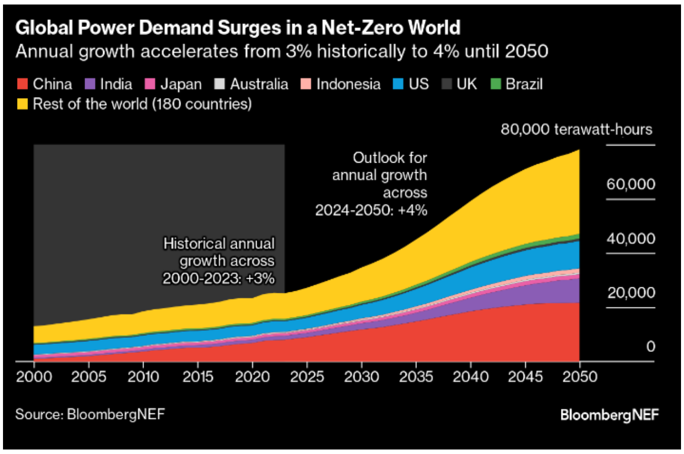
We are trying to provide insights to early-stage developers, private equity/venture capital firms, and others putting money into clean technology. We want to highlight the characteristics of an insurable risk. Engaging with insurers early can really help.

We found that people will sometimes build everything, fund everything and then come to us. They could have mitigated some part of the risk through design – that will save money and improve returns. In some cases, they are asking for coverage they may or may not need. Insurers can actually help in the transition in a very different way than they typically have.

Q: How is the climate transition universe responding to this overture from insurers?

A: The idea of insurance as a risk signaling mechanism is really coming into focus now. Is there a good system in place to make sure that insurers are engaged early on in the conversation? I would say no. There is more work to be done. But there's a growing realization that we need to have insurers *be more*. The risk advisory aspect of insurance is very helpful in policy and in the early design stage.

For us as an insurer and for the insurance sector, climate resiliency and resilient infrastructure is extremely important. There's a growing realization that on the way to a low-carbon economy, we're going to have more physical climate risk. We need to shift our thinking when it comes to climate transition plans and planning. How are you going to future proof your revenues in the transition?



Q: How many people do you have at the climate transition center now?

A: We don’t have a separate, dedicated Climate Transition Center team but are pulling in subject matter expertise from across our business. If we’re talking about physical risk, it’s coming from our climate scientist. If it’s transition risk, it’s people that are breaking down economic models.

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