Swiss Re: Progress and Contradictions on Climate Change and Fossil Fuels

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Introduction

Along with Munich Re, Swiss Re is the world's largest reinsurance company, and thus one of the ultimate managers of risk in our society. Swiss Re stands out from the rest of the business world by being almost on the same page as scientists regarding climate change. Swiss Re first identified the potential mid- to long-term impact of climate change on their natural catastrophe business almost 30 years ago.

When it comes to taking climate action, Swiss Re has so far only taken modest steps. The insurer divested from the coal sector in 2016, yet it continues to insure coal companies in which it would no longer invest. Conversely, Swiss Re no longer insures greenfield tar sands projects, yet it continues to hold $110 million in bonds of highly controversial tar sands operators and the developers of pipelines associated with their operations.

Scientists have concluded that no more coal plants can be built and existing plants need to be retired early for the goals of the Paris Agreement to be achievable in a cost-effective way.[1] Like all enterprises insurers have a moral obligation to align their business with the goals of the Paris Agreement.[2]

The insurance industry also has a self-interest in avoiding runaway climate chaos. "Left unchecked", the British insurer Aviva spells out this threat most bluntly, climate change will "render significant portions of the economy uninsurable, shrinking our addressable market."[3]

This briefing paper summarizes the financial risks arising from climate change for insurance companies, analyzes Swiss Re's continued involvement in fossil fuel sectors as an investor and underwriter, and summarizes the initial steps Swiss Re has taken to reduce its involvement. It concludes with a set of recommendations to the Swiss Re management.

Financial risks from insuring fossil fuels

While the economic costs of natural disasters have seen a steadily increasing trend over the past three

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[1] See Climate Analytics, Implications of the Power Sector for Coal Use in the Power Sector, November 2016, p. 12
[2] See Swiss Re's communication and commitment related the the Paris Agreement: http://www.swissre.com/climate_action/Climate_negotiations_in_Paris_Why_success_is_the_only_option.html
[3] Aviva's strategic response to climate change, July 2015, p. 14

decades, the first half of 2017 was marked by rather low costs from natural disaster. Such disasters caused global economic losses of $53 billion – less than half the 10-year average of $122 billion for the semester. Of these losses, $22 billion were insured, compared with a 10-year average of $34 billion.[4]

According to a recent Swiss Re Sigma study, weather-related catastrophes consistently cause the highest amount of annual insured losses worldwide. Floods in Europe, the U.S. and China, earthquakes in New Zealand, Ecuador, Japan, wildfires in Canada, and hailstorms in the U.S. caused the most severe economic damages over the last few years.[5]

Interestingly, Swiss Re has been reducing its exposure to natural catastrophe insurance business, and has been reviewing its corporate-insurance portfolio after deterioration in pricing and claim experience hit its 2016 margins. Financial analysts[6] expect underwriting results for the first half of 2017 to be less challenging than those seen over the last few quarters.

Yet over the medium and long term, the more climate change manifests itself, the harder it will become for reinsurers to have a profitable natural catastrophe business, however good their models are. And as natural catastrophe losses continue to rise, their models will gradually reflect this trend, and premiums will rise, making «nat cat» insurance less affordable.

Furthermore, investments in and insurance services for fossil fuels carry increasing financial risks for Swiss Re and other re/insurers. **Re/insurers are exposed on multiple fronts to climate related financial risks.**

First, the transition to a low-carbon economy reduces the value of coal, oil and gas companies. **Investments which insurance companies hold in such companies can quickly turn into stranded assets.** Lloyd's of London warns that climate change, and society's response to it, "could potentially strand entire regions and global industries within a short timeframe, leading to direct and indirect impacts on investment strategies and liabilities".[7]

The Bank of England's Prudential Regulation Authority warns that **liability claims against companies causing climate change may pose the greatest threats to insurance companies**. *"Historical events have shown that over time liability claims can be more disruptive to the insurance industry than losses caused by individual extreme weather events, especially when new sources of claims emerge"*, the Authority stated in 2015.[8] By this time, it noted, liability claims against asbestos companies in the U.S. had caused estimated losses of $85 billion to insurance companies.

Several cases against fossil fuel companies claiming damages from climate change are currently pending in U.S. courts and in other countries. Three coastal Californian counties and cities for example recently brought cases against 37 fossil fuel companies, including coal companies such as Peabody Energy, Arch

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[4] See The Actuary Magazine, July 21, 2017, and Insurance Journal, July 20, 2017. It should be noted that economic losses are biased towards losses in developed countries, and don't necessarily reflect the human suffering caused by natural disasters.

[5] https://www.bloomberg.com/news/articles/2017-03-28/insured-losses-from-catastrophes-at-a-4-year-high-swiss-re-says

[6] See JP Morgan Cazenove research piece *"Swiss Re: Model Update"*, 7 July 2017

[7] Lloyd's, Stranded Assets: the transition to a low carbon economy, Overview for the insurance industry, February 2017, p. 4

[8] Prudential Regulation Authority, The impact of climate change on the UK insurance sector, September 2015

Coal and Rio Tinto. **Once such lawsuits become successful, the insurance companies which have covered the liability risks of fossil fuel companies may well end up holding the bag.**[9]

Overview: Swiss Re and climate change

Swiss Re has for a long time played a leading role in identifying climate risks. *"Climate change has the potential to develop into our planet's greatest environmental challenge of the 21st century "*[10], states a Swiss Re position paper. Therefore climate change has been designated a Swiss Re *Top Topic*, which means that it is recognised as an issue of Group-wide strategic importance.

Swiss Re claims to pursue four climate change objectives:

- Advancing their understanding of climate change risks and integrating them into risk management and underwriting frameworks where relevant.
- Developing products and services to mitigate or adapt to climate risk.
- Raising awareness about climate change risks through dialogue with clients, employees and the public, and advocating a worldwide policy framework for climate change.
- Tackling their own carbon footprint and ensuring transparent, annual emissions reporting.

By the end of 2016, Swiss Re had advised 26 sovereigns and sub-sovereigns on climate risk resilience and offered them a total of USD 3.9 billion in re/insurance protection.[11] However, what is not clear is whether the world's top reinsurer uses its position to engage these sovereigns to urgently transition to low carbon and sustainable economies.

Swiss Re as a fossil fuel investor

In July 2017, Swiss Re shifted its $130 billion big investment portfolio to track ethical indices[12]. It also announced that it has been integrating environmental, social and governance considerations into its investment process since the start of 2017 and expects to complete this reallocation by the end of the third quarter in 2017.

Taking ESG criteria into account, Swiss Re says, "makes economic sense and reduces downside risks especially for long-term investors."[13] The company's release says that it has selected the MSCI ESG Index "family" and the fixed-income Bloomberg Barclays MSCI Corporate Sustainability Index "as part of their ESG investing needs." Although Greenpeace encourages ESG-integrated investment approach as a minimum for all investors, This is not sufficient on its own.

This new approach doesn't mean that Swiss Re will have zero fossil-fuel exposure. According to data analyzed by the research firm Profundo for this briefing paper, Swiss Re holds very limited assets in bonds of coal companies such as Duke Energy. Yet the insurer holds major assets in other highly controversial

[9] In 2009, Swiss Re expressed the expectation that "climate change-related liability will develop more quickly than asbestos-related claims and (…) climate change-related litigation could become a significant issue". See Swiss Re, The globalisation of collective redress: consequences for the insurance industry, 2009, p. 3

[10] http://www.swissrecom/rethinking/sustainable_energy/our_position_and_objectives.htm

[11] http://reports.swissre.com/2016/servicepages/downloads/files/2016_financial_report_swissre_ar16.pdf

[12] https://www.reuters.com/article/us-swissre-ethical-idUSKBN19R22Y

[13] *Reinsurers Find Sense in Ethical Investing* by Nathaniel Bullard, 21.07.2017

fossil fuel companies such as the Canadian tar sands operators Cenovus Energy and Husky Energy. Swiss Re also has bond holdings in Kinder Morgan Energy Partners, Energy Transfer Partners and Enbridge Energy Partners – the developers of the contested TransMountain, Keystone and Dakota Access pipelines respectively. All these projects violate indigenous rights and will or may be used to export oil from Canada's tar sands.

Swiss Re's investment in tar sands and associated pipeline projects is all the more disturbing since the insurance company has taken a principled decision not to offer insurance services to greenfield tar sands projects. The climate policies of insurers tend to be inconsistent when they continue to insure fossil fuel companies from which they have divested. In the case of Swiss Re this inconsistency apparently also works the other way around.

Applying the MSCI Corporate Sustainability Index to Swiss Re's full investment portfolio will hopefully weed out destructive tar sands and pipeline companies. Yet even a portfolio fully compatible with the index is not necessarily free of fossil fuels. The new ESG bond benchmark for example includes Total SA, the French oil major, who is planning to drill for oil dangerously close to barely explored Amazon Reef.[14]

In addition to the sustainability index, Swiss Re has also adopted a policy to exclude investments in companies where a substantial part of their revenues is stemming from thermal coal (30% threshold).[15] However it is still unclear whether this investment approach aligns Swiss Re's investment portfolio with Paris Agreement climate goals.

Today we urgently need fossil free, human rights violations free investments, which exclude carbon majors and industries, which are inherently unsustainable, and put us all at risk of not reaching the Paris Agreement. Some asset owners are already acting: Denmark's biggest commercial pension fund announced last week that it will start tracking its investments' carbon emissions and divest from companies violating the Paris climate accord.[16]

Swiss Re as a fossil fuel underwriter

For better and for worse, insurance companies play an essential role in underwriting the development of industrial society. No highrise could be built, no factory operated without insurance. The same is true for climate-destroying coal mines, pipelines, mega dams and thermal power plants.

Data on market shares and specific underwriting contracts in the insurance sector is not available. However, it is known that more than half of Swiss Re premium income comes from Property & Casualty reinsurance, with 33% of that coming from EMEA, 45% from Americas, and 22% from Asia Pacific. **Profundo considers Swiss Re a leading reinsurer in the construction and operation of oil, gas, petrochemical, power and mining sectors.**[17]

Swiss Re claims that it integrates environmental, social and governance (ESG) criteria into the decision-making process for underwriting contracts, e.g. in the risk assessment of major infrastructure projects and

[14] http://www.greenpeace.org/international/en/press/releases/2017/BP-and-Total-risk-oil-spill-with-30-chance-of-reaching-Amazon-Reef/
[15] http://reports.swissre.com/2016/servicepages/downloads/files/2016_financial_report_swissre_ar16.pdf
[16] https://www.reuters.com/article/us-climatechange-investment-denmark-idUSKBN1AB1M6
[17] Profundo, The involvement of European insurance groups in the fossil fuel sector, May 2017

apparently provides no insurance cover for mining in protected areas, offshore drilling in the Arctic, fracking with undisclosed information, and greenfield tar sands project.

In April 2017, AXA decided to no longer offer insurance services to coal companies in the interest of a consistent climate policy. In contrast, Swiss Re has so far not taken any steps to rule out underwriting new coal projects. **The company is, in other words, prepared to still insure the coal projects of companies from which it has divested, and this marks a blind spot of the insurer's climate policy.**

Conclusion and recommendations

As an investor and underwriter of coal companies, Swiss Re has taken initial steps but need to do more to match the activities some of its leading peer companies have taken to address their responsibility for averting catastrophic climate change.

In June 2017, Greenpeace Switzerland and 12 other member organizations of the global Unfriend Coal coalition **asked Swiss Re to take the following actions on fossil fuels and climate change:**

- By October 2017, Swiss Re needs to adopt a policy to stop underwriting and divest from coal companies (broadly defined as companies deriving at least 30% of their revenues or electricity generated from coal);
- Beyond October 2017, Swiss Re will also need to stop underwriting and divest from other fossil fuel companies;
- As the company withdraws from the coal and fossil fuel sectors, it needs to increase its support for clean energy sources accordingly.

In November 2017, the Unfriend Coal coalition will publish a scoring exercise which will analyze and rank the positions of 25 leading insurance companies, including Swiss Re, on coal and climate change. **By following the above recommendations, Swiss Re can protect its long-term self-interests and contribute to its ultimate mission in society: to provide protection for its customers from catastrophic risk.**

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