# Climate’s unsolicited payout

Down to Earth

Rising weather extremes is destabilising the insurance industry, driving up premium prices and pushing insurers out of high-risk markets. The crisis is also spurring re-invention of insurance sector

Probability is business-critical for the insurance industry. The insurer applies the “probability” factor to assess and value the risks, and sets the premium at a rate that earns them a profit even after paying out claims. When a large number of individuals or businesses subscribe to insurance policies, the risk gets shared by all, which makes the insurance premium affordable. But what happens when “probability” loses its meaning—or, the “how likely something is to happen” becomes the “all likely to happen”? The business of insurance collapses. In the face of high payouts, insurers increase the premiums. This makes insurance unaffordable for individuals and businesses, even discouraging them to buy policies. After sustained losses, insurers also quit the business. At present, the insurance industry is experiencing a similar downturn because of a new risk pattern that has redefined the game of probability: climate change.

In a rapidly warming world, extreme weather events such as storms, cyclones or hurricanes, floods and wildfires have become not just frequent and ferocious but also highly damaging. Probability of a disaster hitting a region is no longer once-in-decades but an annual occurrence. This has hit the insurers that offer coverage or financial protection against losses caused by weather-related events. One could even argue that the insurance is the unconventional tipping point of climate change. “We have the reality of climate change, the inconvenient truth that it’s not just some conceptual political debate. It’s having an impact and insurance is one of the places where we are starting to feel the pain,” says Amy Bach, executive director of United Policyholders, the US-based insurance consumer advocacy group.

The wildfires this January in Los Angeles county of California, US are a sombre reminder of the insurance crisis brewing in a changed climate.

As goes California so goes the US

A dozen major insurers, accounting for 80% of California market, have dropped out or restricted issuance of new policies.

For over three weeks since January 7, multiple wildfires ripped through the neighbourhoods in and around Los Angeles, burning 23,000 hectares of land, killing at least 29 people, destroying 16,000 structures, including homes, offices, shops and public utilities and displacing tens of thousands of residents. While coastal southern California is no stranger to catastrophic wildfires, the January fires have been an outlier both in terms of rarity and severity.

The wildfire season in coastal southern California typically starts with dry June and continues through October; the period from January to March is rainy and cold thus not conducive for fires. But this year, shows an analysis by global research non-profit World Resources Institute, over 200 fire alerts were detected in Los Angeles between January 7 and 22—more than 130 times the average for the first four weeks of the year during 2012-2024. World Weather Attribution (WWA), an academic collaboration that analyses the possible influence of climate change on extreme weather events, estimates that human-induced climate change fuelled the hot, dry and windy conditions that made the Los Angeles fires about 35 per cent more likely.

While it is too early to determine the magnitude of the damages, Insurance Information Institute, a New York-based industry association, estimates that the Los Angeles wildfires are likely to rank among the 10 costliest natural disasters in global history. On January 14, as the fires were still raging across southern California, private forecaster AccuWeather estimated the damage and economic losses to be between $250 billion and $275 billion—surpassing the numbers for the entire 2020 wildfire season. The projected insured losses—financial damage caused by an event that is covered by insurance—are estimated to range between $35 billion and $45 billion, said CoreLogic, a risk modelling company. Soon stocks of leading insurers in the region tumbled, exposing the crisis building over the past several years. The fact is that the wildfires broke out across Los Angeles, just as California officials were working to stop insurance companies from fleeing the state.

According to the California Air Resources Board, that aims to reduce air pollution, “Since 1950, the area burned by California wildfires each year has been increasing, as spring and summer temperatures have warmed and spring snowmelt has occurred earlier.” Of the 20 largest fires in California’s history, eight occurred during 2017-2020. The 10 most expensive wildfires in the world, based on insured losses, have all taken place in the US. Regular wildfires have changed the landscape of risk for house insurers, while growing claims from homeowners have wiped out profits for the insurers, crippling them in California, and in the US in general.

This has led to an exodus of insurers from California. At least a dozen major insurers, accounting for 80 per cent of the market, have either dropped out or restricted the issuance of new policies. Between 2020 and 2022, insurance companies declined to renew 2.8 million homeowner policies in the state … READ MORE