INSURERS: THE ADULTS HAVE ARRIVED

BY

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I'm used to people looking at me sideways like dogs sometimes do. If rolling eyeballs made a noise, I'd have my own leitmotif: a swell that foreshadows another eventual truth. Because "I told you so," doesn't matter for my mental well-being, there's no satisfaction when what I said comes to pass. Just sadness.

20-odd years ago, when it became evident the well-meaning would NEVER convince enough people (and business corporations) to act on climate change—known then as *global warming*, I took to loud consolation by saying, "It's OK. The insurance companies will save us. There will be no rally to the barricades. We'll slip quietly into compliance."

It was glib and superficial. It was also the end of a decidedly capitalist logic chain *and* not especially opaque. Yet even today, I have to explain it.

Signs and indisputable evidence I will neither quote nor cite formally feed chat room rants and reveal the hypocrisy of political leaders and the wealthier classes. A sampling:

- The US Federal Emergency Management Agency (FEMA) recently announced a risk-based change to subsidizing flood insurance premiums and coverage:

insurance on properties in riskier areas will be higher. It's a reasonable, market-based approach that prompted angry blowback from affected state and federal senators and representatives, and (wealthy) coastal property owners.

- Because of the higher likelihood of repeat, avoidable payouts, premiums will go up for coastal municipal governments and property owners around the world *if an insurer even agrees to insure at all*.
- Wildfires ravaging the North American West are causing insurers to reevaluate the likelihood of their winning over time. Payouts are too high, too often, and rising too fast.
- Heating of the Pacific Northwest threatens core infrastructure that was formulated for cooler, wetter conditions. Who's to replace it?
- Reinsurers—the financial houses that cover the derivative risk for the insurers that write your policy—are also no longer comfortable with how well their risk can get spread about.
- Insurers are beginning to balk at insuring carbon-based resource endeavors—like Canada's oil sands.
- It's only a matter of time before hotter, thinner air starts widely impacting (commercial) aircraft lift. One way or another, life and property insurance will be affected.

I could go on. But to what end? Too many still deny and politicians still dither.

The business of insurance is essentially that of casinos, venture capital, and other odds-playing endeavors. Like casinos, insurer profit is based on pricing just over the expected outcome *on average* over a very large number of transactions. Optimally, the small gains on the multitude of very high probability events will also cover the inevitable very few, very big payouts on very low probability events. "Over time" is a key concept for businesses that depend on the law of large numbers because—and this is critical—vanishingly small changes in the probabilities (odds) have outsize effect.

There is more science—calculus, specifically—to it than we need to get into here. What we absolutely need to know is that too many payouts in too short a time portends one of three outcomes:

1. Change in the odds (i.e., a price rise).
2. Exclusion from the game (i.e., ejection from the floor or not getting a policy).
3. The end of the business (e.g., Trump Taj Mahal).

The FEMA situation is simple subsidization of "one-percenter" (coastal, quake- or fire-zone) insurance policies by everyone else. Premiums on expensive coastal properties are kept artificially low—relative to the risk—by being lumped together with policies on many more, "safer" properties. In a non-subsidized world, when the "safe" property owners get tired of price hikes for no good reason, they force the insurer to reassess who pays what.

Nobody wants price rises, but they are among other things in economics, a corrective mechanism. Higher risk is higher (insurance) cost. The correction: for a lower premium, move from the flood zone, hurricane path, tornado alley, or fault line.

More people and businesses are waking up to a new reality: their risk simply cannot be insured. Nobody will take the bet. Or, to take the bet, the price is too high (see 1). If forced to stick to a lower price—a price that does not have adequate risk premium—without the public's account as a hedge, sane capitalists get out of the business. That is the penultimate corrective.

Without insurance on the property, a mortgagor is likely to call and not rewrite a loan. (If your mortgagor is willing to maintain/write the loan on an uninsured property, start writing puts on the mortgagor.) That's about the end of market forces to encourage moves from fire zones and the seaside. After that it's back to Mother Nature.

By example, Lloyd's (of London) has been in business since the turn of the 18th-century. Over 300 years, they have plenty of practice recognizing risk, and climate change may be the single-broadest risk humanity has faced. So, this must be serious now.

As I projected, there is no charismatic call to arms. Insurance executives are not known for that. But if anyone will provide the nudge—or hard shove/kick in the butt—needed for idiots (read: us) to save themselves, it's them. Yes, they are boring. But the adults in the room are usually (seen) that way. Obviously it's time the adults to joined the party.

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