

September 12, 2024 | [Read Online](#)



Climate Risks Are Undermining Insurance. Is Personalization The Solution?

InsurTech experts debated the merits of more tailored solutions for closing the insurance protection gap



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TL;DR

- ‘Insurability’, the ability of individuals and/or properties to access insurance, is under pressure from escalating climate risks
- Insurance carriers are jacking up prices or pulling out of certain markets to stay solvent, accelerating a growing climate protection gap
- The hyper-personalization of insurance may be one way to combat this trend, whereby policyholders are assessed based on their idiosyncratic risks and associated adaptation and resilience efforts
- However, this may create problems of its own. The erosion of broad insurance risk pools shifts the burden of risk management more on individuals, not all of whom have the resources or capabilities to mitigate their climate risk exposures
- Community-based resilience, and the forging of new public-private-philanthropic partnerships, offer ways to address the insurability crisis and embrace personalization at the same time

Climate change is fueling an insurability crisis in the US. Banner stories from the [New York Times](#) to [The Economist](#) can tell you that much. Take a cocktail of insane climate-related risks, add a pinch of inflation and a dash of misguided public policy, and you have a recipe for spiraling costs and a [yawning protection gap](#).

The obvious question is: what can be done to fix this? A less obvious follow-up is: how could possible solutions to the insurability crisis unleash problems of their own?

It was the second of these questions that rattled round my head on the journey back from [The CleanTech Group’s adaptation and mitigation event](#) in Boston earlier this week. An expert panel on InsurTech unfolded in a way that left me wondering whether the “traditional” model of insurance dating back to [Lloyd’s Coffee House](#) was in danger of fragmenting completely under a triple-whammy of climate risks, market shifts, and cutting-edge technologies.

[Christopher Lowell](#), managing director of nonprofit insurance innovation hub [Innsure](#), laid out the stakes from the get-go: “How do you create new insurance products and constructs that actually allow communities to continue to be insured, but at an appropriate threshold [in a world of worsening climate risks]?”

The answers offered by fellow panelists [Valkyrie Holmes](#), CEO of InsurTech startup [Faura](#), and [Peter Ortez](#), principal at [Munich Re Ventures](#), offered answers that riffed on “better data” and “more transparency.”

However, all three glommed onto the idea of hyper-personalization as a potential solution: essentially, the tailoring of insurance products and coverage to very specific locations, asset types, and circumstances.

Wave of the Future

It's a concept that's fundamental to Holmes' startup. Faura produces property and climate risk assessments that help insurers and homeowners reduce their natural disaster risk. By empowering individuals to capture risk information about their properties and send it to insurers, Faura makes it possible for carriers to better price risks and policyholders to take actions that protect their homes and lower their insurance costs.

"A big thing that we think about at Faura is this idea that property insurance, in a lot of ways, is eventually going to follow the same way of hyper-personalization that something like health insurance has and auto insurance has now with telematics. Previously, we haven't really needed to as much in property, because climate was not this hyper-personalized variable that it is today, or it wasn't as much of a factor that we really needed to take into account," said Holmes.

Her theory of the case is that climate and catastrophe models used by the insurance industry are a little too clunky to provide the fine grain insights that allow for hyper-personalization. "The big problem with a lot of those models is that they're taking into account a general area of risk — as opposed to pinpointing a specific property — and [are focused] more in terms of 'a disaster is going to hit in this area', as opposed to 'these properties are actually going to survive when a disaster does hit,'" she said.



Source: David Aughenbaugh / Getty Images

Why is hyper-personalization desirable? From the policyholder side, it allows for price differentiation. If I manage the vegetation around my property and install ignition-resistant decking, I would like to be able to reap the benefits through lower insurance premiums against wildfire risk. From the insurer side, it shines a light on those little pockets of risk that may be too discrete or complicated for a major carrier to bother with — but which a swashbuckling firm may want to scoop up.

“When State Farm and Liberty leave California, it makes all the newspapers,” Innsure’s Lowell explained. “When a small wildfire MGA [Managing General Agent] picks up some of those pieces in the excess and surplus markets no one writes about that necessarily, but it does help. It creates innovation in a way that is slowly shifting value from the large incumbents and insurance to the more innovative ones.”

Personalization vs Pooling

Hyper-personalization is an attractive solution to insurability on its face. Certainly, it speaks to our desire to have services tailored to our unique circumstances, and is made possible thanks to all the cool technologies that have investors jazzed: Big Data, remote sensing, and —of course — AI.

However, insurance is about the pooling of risks — lots of risks — so that the exposure of a carrier to any one risk type is mitigated via diversification. From the consumer perspective, pooling also makes the cost of premiums to the average policyholder lower than the cost of managing their risks solo.

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Christopher Lowell, Innsure

Hyper-personalization threatens this model. As Lowell explained:

“One of the challenges is insurance was invented to pool homogeneous risks, and the more data and technology that we have separates the people who are riskier versus those who are not. So in the past, we were all subsidizing each other, and we were all comfortable because we didn’t know which way that subsidization was flowing. Now the insurance carriers and our data is telling us which way that is flowing,” he said.

It’s the dark side of transparency: elimination of the enforced ignorance that underpins the risk pooling approach. This development is going to lead to “hard conversations”, according to Lowell. After all, why should you have to pay higher premiums because your safely-located home is insured by the same company that’s underwriting wildfire bait in the [wildland urban interface?](#)

“Everyone has made choices. The real estate industry has made choices. Homeowners have made choices. There’s sometimes a cost to that choice, and insurance sometimes gets, unfortunately, to play the bad guy in telling you the cost of that choice, but it’s real,” said Lowell.

But the thing is, we’re not always able to pay these costs. Moreover, often our choices made good sense (and were low risk) back when we first made them. It’s runaway climate change that now makes those

choices look risky — five, ten, twenty years after the fact. I'm thinking here of Kevin Jordan, one of the plaintiffs in a [landmark case against the UK government](#) over the failings of its national adaptation plan. When he bought a coastal property 14 years ago, he was told by experts that it would be 80-100 years before climate risk-related erosion would cause him any trouble. In reality, climate impacts [forced its demolition](#) last year.

There is a danger, then, that the hyper-personalization of insurance foists intolerable costs on those who own high-risk properties today not because of their own choices, but because of our collective failure to address global warming. Broad risk pooling socializes the costs in a way that acknowledges this collective failure.

New Partnerships

Of course, carriers don't offer insurance for the public good. These are for-profit entities we're talking about. Hence why Lowell believes the future of climate risk insurance will involve the public sector. After all, governments manage vast portfolios of risk already, and have a responsibility to protect the governed. Specifically, Lowell said the public sector could help bear the risk of new insurance technologies, like parametric insurance products. These payout in the event of a specific climate-related disaster, rather than on the basis of damage incurred. While favorable to policyholders, they represent a greater risk to insurers.

"I think we're going to need to see a blend of government funding to come in and take some of the early losses in some of these spaces, as well as potentially philanthropies. This insurance-as-a-financing mechanism and as a platform to enable private capital to come in and to support these technologies is absolutely critical," he said.

For his part, Munich Re's Ortez suggested localization is the way forward. This approach recognizes that when it comes to building adaptation and resilience, there's only so much individual homeowners can do. Actions on a larger scale are often more effective, and only possible if they have broad community buy-in. Insurance data that captures local resilience, rather than just individual resilience, may therefore help with the insurability effort.

"When a house is on fire often one of the first things done is spraying the other houses so it doesn't spread. And it's kind of the same idea, that you can have the insight that's more than just a single home, [it's] a localized area, that's also specific enough to be valuable. Often you see a lot of climate modeling or innovations that are... almost too big to make business decisions around it," he said.

Lowell agreed, and suggested that climate risks could force new data and technology partnerships at the local level that then feed into insurance product development.

"It's very difficult to harden just your home. You need to harden the homes around you. That type of technology where you share sensor data with a broader community in a way that the communities can understand and engage with — [and is] also in the same language of insurance and underwriters — that is a technology concept challenge that we have to overcome over the next few years, because Mother Nature is forcing us to do so."

I'm confident that insurance personalization will continue to gather steam as climate risks to people and property escalate, at least in the US. The gospel of personal choice and rugged individualism — however overstated — remains deeply ingrained in American society. Moreover, the frantic pace of technological development makes it possible to salami-slice risks and parcel them up across all kinds of carriers. If we can do it, we will do it.

However, the disintegration of traditional risk pooling that hyper-personalization could bring about cannot go unanswered. It requires bold action and the forging of new partnerships. It also necessitates a recalibration of the relationship between insurers and the insured. If insurers increasingly price individual policies based on their idiosyncratic risks, the insured will want to have more of a say in how those risks are measured.

It's like Holmes said: "If people have the knowledge to be able to say: 'Okay, I've done X, Y and Z on my property', and not just the knowledge but they have the actual route to take a benefit from that change, we can see a lot more progress in people reducing their risk."

Thanks for reading!

Louie Woodall

Editor

