

Sustainability Now Podcast

“Pricing the Unpredictable”

Transcript, 27 March 2026

Bentley Kaplan

Hello and welcome to the weekly edition of Sustainability Now, the show that explores how the environment, our society and corporate governance affect and are affected by our economy. I'm Bentley Kaplan, your host for this episode. And on today's show, we're going to talk about an industry that most people only think about when something goes wrong, even though it quietly underpins just about everything in the global economy. And that is insurance.

Because right now, that industry is being forced to rethink one of its core assumptions — that the past is a reliable guide to the future. And as that assumption starts to break down, it's not just insurers that have a problem. It's anyone who relies on prices, risk, or, frankly, the ability to keep doing business in a world that's getting harder to predict. Now, my guests on today's show have had some pretty unique access. They surveyed more than fifty insurers globally and spoke to a number of them in depth. And what they heard paints a picture of an industry that knows things are changing, but isn't entirely sure if it's keeping up. So, the question we'll be getting to the bottom of is this — is the insurance industry really adapting to physical risk, or is it still playing catch up? Thanks for sticking around. Let's do this.

Before we get into whether insurers are changing the way that they price and manage risk, it's worth zooming out for a second because insurance doesn't sit quietly in the background of the economy. It enables it. If something can't be insured, it becomes a lot harder to finance. And in some cases, it becomes very difficult to justify building, investing or operating at all. Data from the research team at MSCI Sustainability and Climate estimate that annual physical risk-related losses were at around USD 1.2 tril. in 2024, spread out across around 9,500 companies. And that's a big chunk of change. But that cost is projected to nearly quadruple by 2050. And that's why physical risk, things like floods, fires and storms, isn't just an insurance problem. It's a problem for the whole financial system. In the survey that we're about to get into, concern about this systemic risk was nearly universal across the insurers that responded.

Now here comes a little plug. You can get hold of the research paper written on the back of these interviews. It's called What the Market Thinks: How Global Insurers are Responding to Rising Physical Risk, and it's published by the MSCI Institute. One thing that I want to stress is when you're reading that paper or listening to this podcast, which you should absolutely be doing first, just keep in mind that when we talk about whether insurers are adapting, we're also really asking whether the broader economy is going to be ready for what's coming.

My first guest is David Carlin, one of the co-authors of the research that we'll be covering. David is the founder of D.A. Carlin and Company and the former head of risk at the United Nations Environment Programme Finance Initiative, or the UNEPFI for those in the know. And David first focused on the significance of the shift that's taking place, about how an industry that has traditionally relied on historical data to price future risk can no longer count on the past to be a stable guide.

David Carlin

Yeah, this couldn't be more fundamental. This is really about, as you said, the past no longer being a good guide to the future. That's what climate change is about. It's all about our expectations needing to move, to be updated. How do we recognize that there's continuity with the past but also differences? And so insurers today are thinking about how they calibrate their catastrophe models,

not just to be backward looking, but to anticipate some of the increasing effects of climate change. In addition, we're seeing hazard patterns changing in different places, and some of this isn't always knowable in the long term. So we need to be able to adjust our models, adapt what we're doing and recognize that. And finally, it's seeing that there's a clear climate signal. But once we get down to the very specifics, we see more and more variability, volatility. So, dealing with not just a changing world, but in some cases a less well-behaved world in the modeling sense. These are really the key things to recognize that as we consider climate change and insurance, it's not just about increasing losses, it's about fundamentally changing the architecture of what you need in order to be risk-ready in the future.

Bentley Kaplan

Right. So what David's describing, there isn't just a tweak to how insurers are thinking about risk. It is a fundamental shift. Because if your entire business model is built on predicting the future, using the past. And suddenly the past isn't behaving like it used to. Well, you can't just recalibrate a hazard model. You've almost got to overhaul it. And that helps explain why insurers are starting to layer in new types of data and new models. But "starting to" is the operative phrase here because the shift is not happening evenly. Parts of the industry may have already moved ahead and started integrating new risk models into their underwriting, but others find themselves still figuring out how to take that next critical step.

David Carlin

Climate risk is definitely a topic that insurers are taking an ever closer look at. It's impossible to ignore with the massive disasters in California, with fires, with floods in different parts of the world and of course, with increasing climate-related damages from storms, heat and many other factors. So where we're seeing this begin to be integrated is looking at coverage. So where we're seeing coverage be offered, where we're seeing pricing in some parts of the US that are higher risk, we're seeing premiums that have increased nearly 80, 90% over the past decade. So a really good example in pricing. However, a lot of the forward-looking tools that are going to be so critical as we uncovered in our report, a lot of those are still earlier stage. So using forward-looking scenario analysis, many insurers are talking about this but are trying to find the appropriate scenarios, trying to get information that is going to align to their operational horizons. We're seeing that big challenge between we need to know what will happen in the near term, because that's how our policies are written and renew versus, yes, some big climate models may tell us about change over decades. How do we bring that down? How do we make that an operationally relevant window? But we're seeing more and more both in the modeling, in the tools being used, but it still remains a little bit more peripheral on the pricing side. Even as I said, a lot of that pricing I mentioned is still retrospective. A disaster happens, we change the price. What we're beginning to see, which is really promising and really interesting, is more exploration of what forward-looking pricing could look like. And that obviously offers a new avenue for, uh, for organizations, um, and opportunities as well. So I think it's key to recognize that insurance is the canary in the coal mine, as people often say when it comes to climate risk, but the industry itself is still working through the paces when it comes to using scenarios, considering forward-looking pricing, and really integrating this into its overall strategy rather than responding retrospectively to disasters.

Bentley Kaplan

That gap that David is pointing to, between understanding climate risk and actually pricing it, is really what's at the heart of the story. Because while insurers are clearly reacting, a lot of that reaction is still retrospective. A disaster happens and prices go up. But moving to something more forward-looking, pricing risk before it fully materializes, that's much harder. A challenge that brings on a lot more wincing and squinting. And it's one of the reasons why, across the industry, integration still feels incomplete. Which brings us to one of the more interesting things that David and the team learned through speaking to these global insurers. Because when asked how prepared they feel for

rising physical risk, many respondents said, you know, we're actually doing okay for the most part. But when asked about the industry as a whole, well, confidence dropped off pretty quickly. That gap between individual confidence and system-wide concern shows up very clearly in the data, which is what brings me to my second guest, Pam Palena. Pam is based in MSCI's Zurich office and covers both sustainability and climate research for the insurance industry. And so, I asked, Pam why we're seeing this gap. Why do we see individual respondents saying they're prepared but flagging concerns about the system more broadly?

Pam Palena

Yeah. So I think this gap reflects how insurers assess themselves versus the system they operate in. So at their own level, insurers can see the steps they've taken to invest in climate tools, refine their underwriting and embed climate considerations into decision-making. Many insurers have made progress on that front. So this makes preparedness more tangible. But when they assess the industry, they're judging whether the industry as a whole can continue to function properly, underwriting physical risk. And this is where the structural constraints become clearer. The key point is that the industry resilience depends on how consistently risk is understood and managed across the market. So in practice, we see that some insurers have deeply integrated climate analytics into risk selection and pricing, but we also see that others rely on less granular data or less mature models. This creates important dispersion in how the risk is managed and in a context of rising and sometimes correlated losses. Unprepared or underprepared firms are more likely to misprice risk come under stress when losses occur and amplify market stress. So even if insurers feel confident about their own capabilities, they can still conclude that the market is constrained by the least-prepared participants.

Bentley Kaplan

Okay, so what Pam is getting at there is something quite subtle but really important. Because even if individual insurers are improving how they manage risk, the system itself is only going to be as strong as its weakest parts. And in a world where losses are becoming more frequent, more severe, and sometimes more correlated, well, that unevenness starts to matter a lot more, especially when risk doesn't stay neatly contained within one balance sheet. But allow me, if you will, to just park this existential threat for now. Try and ignore the specter of looming systemic risk because some insurers are pushing the envelope. Laying out markers on not just how to survive this changing future of risk, but how to create new opportunities. As David said, insurance is the canary in the coal mine, but it's a canary that can be both resourceful and sharp. Indeed, more than 70% of insurers in the survey said that they see large sector-wide opportunities ahead. So, I asked Pam to tell me more about how companies are doing this finding opportunity amid new challenges. Because if enough insurers can make that sort of thing work, there's a better chance of de-risking the whole system.

Pam Palena

Yeah. So I think that the ones that will successfully adapt are not necessarily the ones with the most advanced tools or the most granular data, but I think it's the one that will really turn climate awareness into something that has a real impact on their business decisions today. Analytical capabilities have improved, but they do not necessarily translate into consistent action. And one area where this gap becomes very visible is incentives. In most firms, climate considerations are still not linked to executive performance. And this really matters because this creates weaker accountability that can then influence how climate risk is ultimately integrated into day-to-day decisions, especially when it becomes mixed with other commercial pressures. But at the same time, adaptation is also about taking advantage of new opportunities. And in our study, we asked insurers where they see the largest commercial opportunities that come with rising physical risk, and resilience advisory services clearly emerged as the most interesting one. So here we're talking about insurers using their risk assessment capabilities to help clients identify physical risk exposures and invest in resilience measures. And the real benefit for insurers lies in the fact that this helps, obviously, clients stay insurable. And for insurers, this also protects their addressable market over the long run. So to

answer your initial question, I think the leading firms will be the ones that integrate climate consideration holistically into every aspect of their business faster than the competition. |

Bentley Kaplan |

Right. And in some ways, it's that idea – turning awareness into action that might be the simplest way to think about what separates those leading the pack to those trying to keep up with it. Because the tools, the data, even the models, a lot of those already exist, but actually embedding them into underwriting, pricing and incentives, that's where things get harder.

And it's also where the industry still has some way to go. Which brings us back to the question that we started with – is the insurance industry adapting? And the answer seems to be yes, albeit unevenly, and nowhere near fast enough to remove the risk entirely. So, expect to see some action in the near future. Because for insurance, as a system that helps the rest of the economy manage uncertainty, well, figuring this challenge out isn't optional, it's foundational. |

And that is it for the week. A massive thanks to David and Pam for helping us unpack what is admittedly not the lightest topic, but definitely one of the more important ones. And a special shout out to Rumi Mahmood, a serial guest on the show, and alongside Pam and David, one of the co-authors of this research. A reminder that the full paper is available free to download on the MSCI Institute's website. And a reminder on the title – “What the Market Thinks: How Global Insurers are Responding to Rising Physical Risk”. And as usual, if you like what we're doing, let us know. Leave a review, rate the show or share it with someone who probably hasn't thought about insurance this much in a while. Thanks again for tuning in, and until next time, take care of yourself and those around you.

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