W+K UPDATE

Rushing the Australian transition to renewable energy adds risk for all players

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At a glance

- Australia is committed to becoming a renewable energy superpower.
- Minister Bowen recently announced: "Australia's energy supply will be assured by a faster transition to renewables".
- For energy stakeholders, including insurers, there are risks as Australian operators in the renewables sector rapidly move from being nascent to operational.
- These risks include extreme weather risk zones and supply-side risks.

The Minister for Climate Change and Energy, Chris Bowen, recently addressed the National Press Club to declare: "We won't just be powering Australia with renewable energy – we will be powering the world" and "we have not a second to wait."

The urgency for the transition to renewable energy, a key part of the Albanese Government's climate change agenda, has been parlayed into Australia's recent east coast energy crisis. The crisis was caused by a combination of factors that increased energy demand (an unseasonably cold winter) at a time of decreased supply available from traditional generators (offline for repairs or maintenance). A perfect storm of inputs and outputs culminated in the Australian Energy Market Operator (AEMO) suspending the national electricity wholesale spot market because energy prices were exploding out of control. In a charged political response, Minister Bowen said: "Australia's energy supply will be assured by a faster transition to renewables".

The case for transitioning to renewables

The case for transitioning to renewable energy in Australia is logical – it will be cheaper, cleaner and more sustainable than fossil fuel-based energy generation in the long-term. But, for energy stakeholders, including insurers, there are risks as Australian operators in the renewables sector rapidly move from being nascent to operational. For example, AEMO has not included offshore wind in its blueprint for Australia's energy transition on the basis the sector is insufficiently mature. That is in stark contrast to newspaper headlines, which announce that various offshore windfarms are being constructed 20km off the Australian coastline.

Extreme weather risk zones

One of the key risks for Australian players is the renewables industry's catch 22 – the locations that are ripe for harnessing renewable energy (because of high wind or solar exposure) are logically more exposed to extreme weather events.

Solar assets are exposed to extreme weather events, including hail. For example, most solar installations in the United States are in Texas, California and Florida. While their locations are well-suited for generating solar power, these states are also prone to natural catastrophes – specifically, wildfires (California), hail (Texas) and tropical storms (Texas and Florida) – which, ironically, are increasing in frequency and severity due to climate change. This leads to more insurance claims from renewable energy asset owners each year. In July 2022, *Insurance Business America* reported: "In the second quarter of 2022, there were multiple catastrophic hail events that all caused losses in excess of $50 million in the solar industry." These near-record losses all occurred within a span of 60 days, leaving the insurance market reeling and cautious of further risk accumulation.

To avoid these losses in Australia, players will push for a renewables sector that is resilient, diverse, and to a standard that will withstand Australia's unique climate of high temperatures and proximity to the sea.

Supply-side risk

The speedy transition is taking place in the context of developing technologies and specialist equipment that braces in the wind of supply chain challenges. While the cost of the technology is generally decreasing as new suppliers continue to enter the market, market forces naturally introduce other difficulties around reliable supply and quality control. The industry will be relying on local and international suppliers for steel, concrete, engineering and labour – all predicted as tight markets for the next two decades.

The shortage of technical expertise in the Australian market will rub against those market forces. Infrastructure Australia predicts an expected shortfall of 105,000 roles in infrastructure-connected labour by 2023, which will compound due to an aging Australian population – as 40% of the infrastructure workforce is expected to retire in the next 15 years. Transitioning to renewables at the same time as Australia grapples with an aging population and skills shortage may impact the cost, delivery and reliability of the renewables sector – particularly as operators will need to rely on competitive international markets to source the majority of the necessary technical expertise.

Insuring losses in the sector

All of these challenges, rising claims, and untested technologies are escalating insurers' perceived risk of the sector. This is leading to increased premiums to underwrite risks and an inevitable hardening of the insurance market for renewables.

As the renewables sector marches on and continues to attract significant investment, some key milestones will make renewables in Australia a more mainstream insurance proposition.

The renewables industry will establish a track record of losses, which will make the Australian market more predictable and easier to insure. "Move fast and break things" might work in Silicon Valley, but it's an unhelpful mantra for those investing in and developing the next turbine prototype for an offshore wind farm in an Australian climate. In this space, insurers probably prefer that insureds "move slowly and get it right".

In the longer-term, Australian renewable technology will become proven, certified and governed by clearer standards, making it easier for insurers to price risks.

Increased investment and uptake of renewable energy assets will inevitably produce economies of scale that will eventually make equipment cheaper to produce and source, even though an easing of global supply chain issues around specialist equipment is based on macro factors outside the Australian market's control. These factors should combine to reduce the quantum of material damage losses – all things being equal.

Australian players will have to adapt faster than other markets

The exciting transition to renewables has felt inevitable for some time. But, the sudden push to transition quickly has led to the Australian sector outpacing all expectations. On a per capita basis, Australia has been adding four to five times more renewable energy annually than the European Union.

Australian players are racing against the clock to understand mid to long-term patterns of risk while the industry transforms in front of their eyes. It is a fascinating time for insurers, brokers and insureds in the Australian market as they eye each other upon the dance floor looking for not only a quick waltz, but the promise of a happy and fruitful marriage.

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