Sustainable Finance for Insurance Undertakings

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Agenda

• 1. Sustainability and the Financial Sector

• 2. The specific role of the insurance industry

• 3. Risk assessment of the shift towards a more sustainable and lower-carbon future

• 4. Opportunities on the horizon
Sustainability and the financial sector: Where is the link?

- Current economic activities reached levels incompatible with sustainable economic growth, quality of life, while also threaten financial stability.
- The transformations needed generate investment needs, to be channelled through the financial sector – in particular, large institutional investors, such as insurance companies and pension funds.
- The relevant label is ESG (Environmental, Social and Governance), whereby one or a combination of the underlying aspects must be embedded in strategic, business and investment decisions.
- Practical examples are green bonds, clean/renewable energy infrastructures, more sustainable transportation and food production systems.
- Investments tend to occur, predominantly, in the form of bonds, loans or equity.
Sustainability and the financial sector: From niche to mainstream

• Ambitious objectives to fight climate change were set through, amongst others, the Paris Agreement (2015). Sustainable finance is currently a paramount aspect in the political and strategic agendas (e.g. UN, EC, national governments).

• The European Commission’s action plan on financing sustainable growth listed three goals explicitly involving the financial sector:
  - Reorient capital flows towards sustainable investment, in order to achieve sustainable and inclusive growth;
  - Manage financial risks stemming from climate change, environmental degradation and social issues;
  - Foster transparency and long-termism in financial and economic activity.

• The EC is currently developing an EU taxonomy, which should foster a common understanding for green investments.

• European and national financial supervisors are involved, focusing on ensuring an orderly-fashioned transition into the new paradigm.

• Organic embedding of ESG factors into the governance, commercial and operational practices of financial institutions is required.
What exactly is the insurance sector looking into?

- The insurance industry’s core activity is to sell risk coverage, and acts also as a large institutional investor.
- Multiple insurance coverages correlate largely with sustainability challenges and climate change (e.g. catastrophic events, demographics, health insurance).
- Insurance companies are thus in a delicate place, as climate change can negatively hit - simultaneously – both sides of their balance sheets.
- The sector must seek an integrated perspective of climate and social impacts, ensuring that investment choices on the asset side do not contribute to stress the frequency/severity of claims experiences.
Going greener and more sustainable: Does the balance sheet become less risky?

The underlying risks can be split into two main dimensions:

- **Physical risks** – resulting from the exposure to increased frequency and/or severity, due to climate change, or, more generally, CAT events, causing economic disruption or destruction of value.

  How extreme can the insurance risks in portfolios become? Will insurability of risks be at risk?

- **Transition risks** – deriving, on one hand, from the negative externalities caused by economic activities, affecting the underlying financial assets (e.g. equity prices, yields, credit ratings). On the other hand, also reflect the entrance of the insurance sector into a new and complex area, encompassing the political and technological transition to a sustainable and low-carbon economy.

  Will the transition occur in orderly or disorderly fashion? What will be the appetite and how will asset valuation evolve?
# Going greener and more sustainable: Brainstorming some risk drivers

## Physical risks | Liabilities

*Protection gap* still a core challenge

- Physical risks may no longer be captured within the usual approaches to measure liability patterns and dynamics
- Further improvements on data quality and granularity are needed
- Are some risks, or areas, becoming uninsurable?
- Stress on multiple LoBs or coverages (CAT, auto, health, business interruption)
- Larger (or previously inexistent) correlations are emerging between perils and zones, in the occurrence of climate episodes
- Future shape of the reinsurance market (soft or harder)?

## Transition risks | Assets

- Difficulties in a common language between financial practitioners and ESG experts
- Know-how and data constraints. Critical to avoid overreliance on external sources of expertise
- Which technologies, or services, will actually shape economic activity transformation?
- Brown assets - Rushing to be out first? Fire sales? Systemic potential and cross-sectoral effects!
- Green assets are not necessarily a safe investment space: high technological and policy volatility
- Low IR environment stimulates appetite towards different investment alternatives
- Complex concentration risk – Larger exposures per technology, service, provider, or economic activity to be transformed
- Potential second layer effects on assets such as Government Bonds and Property
- Green-washing
Opportunities underlying the ESG transition

- A complete overhaul of the company’s system of governance, which can foster better efficiency, performance and also add value to stakeholders and clients.

- Areas such as the Prudent Person Principle (PPP) on investments and the ORSA are suitable to embed ESG appetite, mission and values.

- Investment portfolios can become more diversified, and contribute to relief on the liability side (holistic approach).

- A company’s ESG mission/values can function as an effective competitive advantage, enabling, for instance, reputational gains and better matching of clients’ needs.

- New business opportunities, for instance linked to filling the protection gap, to reflect the future risk coverage needs of the technologies and services assuring the economic transformation, or even through issuing coverages on the scope of ESG investments.
Thank you