



ESG and the Insurance Industry: The role of control functions

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Agenda

1

Market trends

2

Insights from the “EY European Insurance CRO Survey”

3

Insights from the “EY European Insurance Survey on Climate Risk Practices in the ORSA Process”



Sustainable Finance Regulatory Framework – Main impacts on the insurance sector



EU Reg. 2019/2088 (SFDR) and EU Reg. 2022/1288

Transparency ESG themes at entity and product level through various channels (web, pre-contractual/periodic doc.). Key topics: integration of sustainability risk, key negative impacts, ESG approaches. Marketing must be in line with regulations; New classification of ESG products.



EU Reg. 2020/852 (Taxonomy)

Classification framework for environmentally sustainable activities
The activity must meet three tests (e.g., Substantial contribution / DNSH)
Climate change mitigation and adaptation to climate change currently explained



EU Reg. 2021/1256

Integration of sustainability into risk assessment for insurers and reinsurers.
Integration of ESG factors in key areas: risk management and document framework that includes Underwriting and Reserving policy, Investment policy, risk management policy, actuarial function, remuneration



EU Reg. 2021/1257 and EIOPA Guidelines

Integration of sustainability preferences into the POG process of investment products (IBIP)
Integration of sustainability preferences into the suitability assessment



CSRD

Amendment of Dir. 2014/95/EU in the area of transparency obligations on non-financial information. The Reporting becomes «of sustainability» (from NFRD to CSRD): extension of the reporting purpose and inclusion of the sustainability disclosure in the Management Report, which will also include information useful for the application of the SFDR

24 October 2022: launch of IVASS public consultation N.9/2022 for amendment to IVASS Regulations nn. 24/2016, 38/2018, 40/2018 and 45/2020 to implement a first step of alignment and adaptation of national regulatory rules to the new European provisions adopted in the field of sustainable finance, relating to the insurance sector and directly applicable from 2 August 2022

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Impacted areas



Source: EY European CRO survey 2022 (118 European Insurers involved)

The development of **risk management frameworks** incorporating **sustainability issues** is the **main priority for 2023** activities, with a particular focus on

- monitoring **physical risks**
- definition of **scenario analyses** that include climate risk aspects
- development of **dedicated reporting** for top management

Other development areas are related to the adoption of **increasing automation** in risk management and capital calculation processes (Operational Resilience).

Lastly:

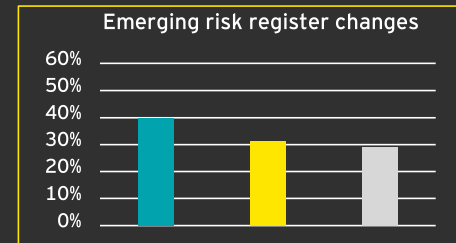
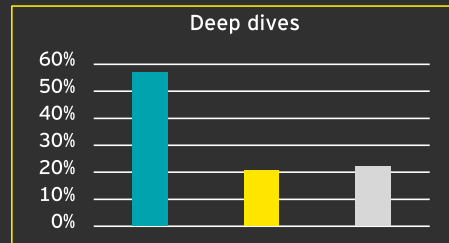
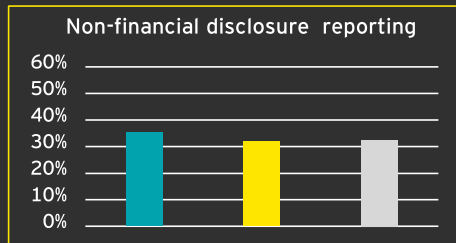
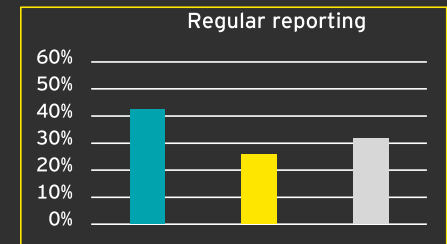
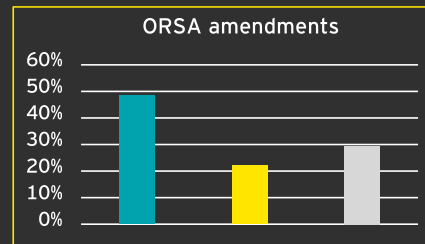
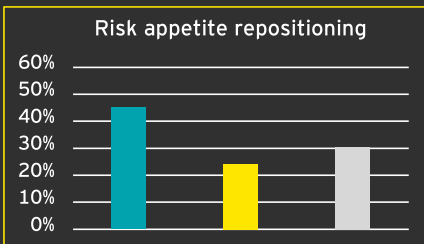
- those Groups that have not yet completed their internal models will **devote part of 2023 to this purpose**
- the **strengthening of controls** that risk management must have within the product governance system is one of the topics considered crucial for the current year, also in view of the developments in European legislation on this subject

Commitment with the Board Risk Committee



In what ways are you engaging with the Board Risk Committee ?

■ Environment ■ Social ■ Governance

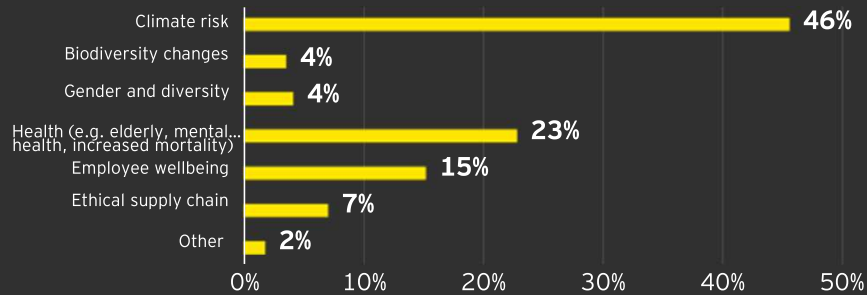


- Board Risk Committees are much more engaged on the 'E' part of ESG rather than 'S' or 'G'.
- Many are addressing the environmental aspects as part of "ORSA amendments" and "deep dives".

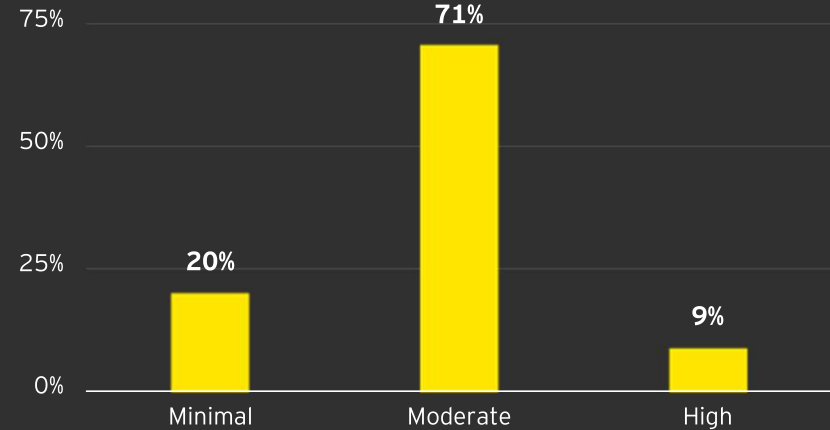
Risks arising from climate change and social awareness



Which of the following risks have you incorporated into your risk scenario analysis as a consequence of increased climate change and social awareness?



How well developed is your approach to monitoring physical risks arising from climate change?

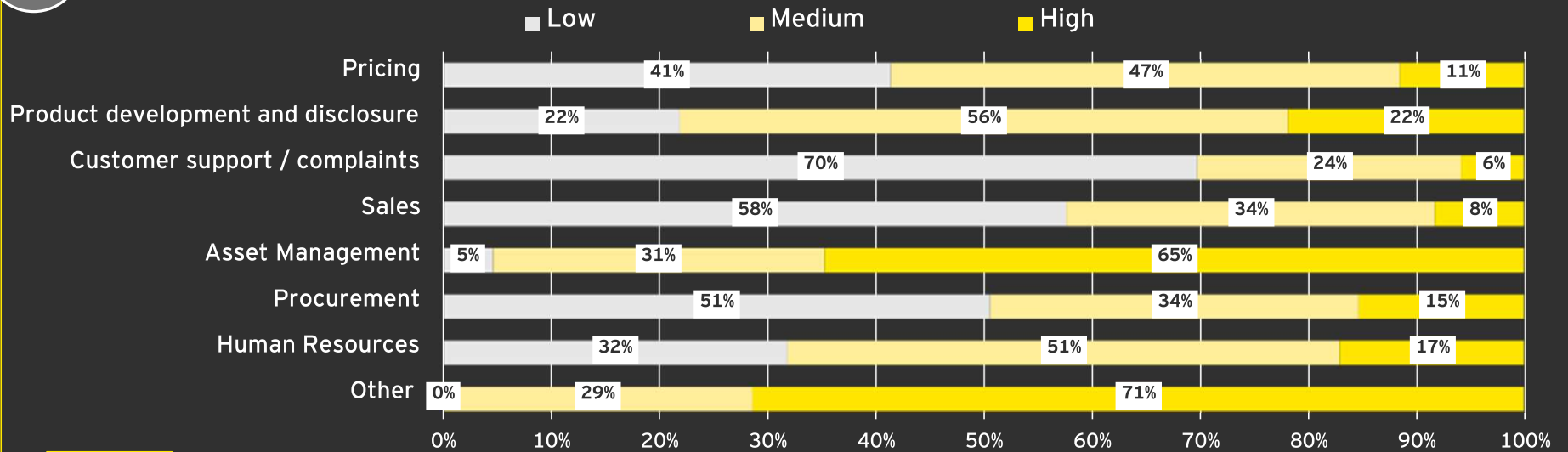


- Many respondents felt the need to incorporate "Climate risk" (46%) and "Health"(23%) into their risk scenario analysis, whilst others have incorporated "Employee wellbeing" (15%) or "Ethical supply chain" (7%).
- Furthermore, majority of the respondents consider their approach to monitoring physical risks as moderately developed (71%).

Commitment with the stakeholders on environmental and social issues



To what extent do you currently engage with the following stakeholders on environmental and social issues?

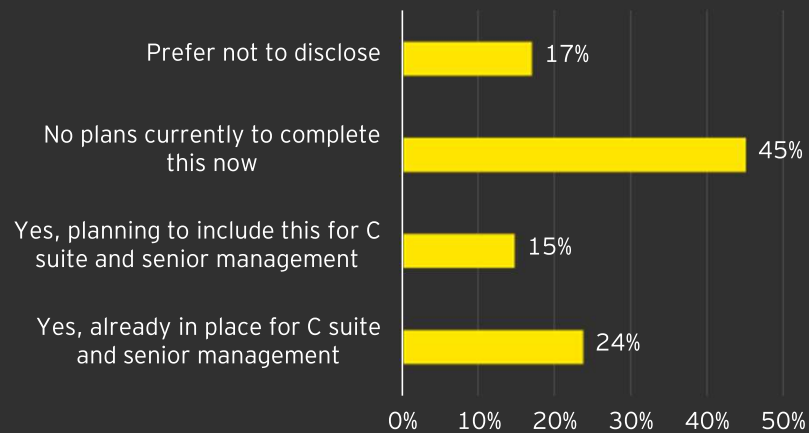


- Most insurers are highly involved in "Asset Management" (65%), Financial Reporting (internal disclosures), Actuarial, Compliance/Legal (71% - categorized under "Other") when dealing with environmental and social issues. They have medium level engagement with "Product development and disclosure" (56%) and "Human Resources" (51%).
- For several topics, the level of engagement is "Low" especially when it comes to "Customer support / complaints".

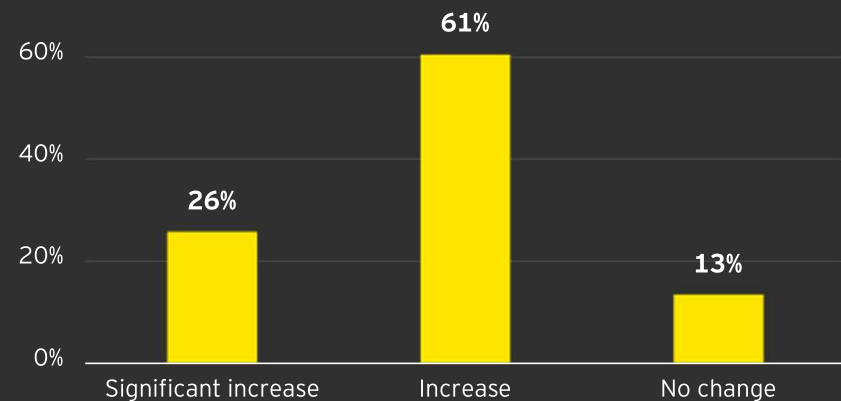
Risks considered as a consequence of increased climate change and social awareness



Does your company plan to incorporate ESG into the appraisal and compensation plan for senior staff?



How much did the impact of COVID-19 in 2020/21 shift your company's focus on social issues and the wellbeing on your people?

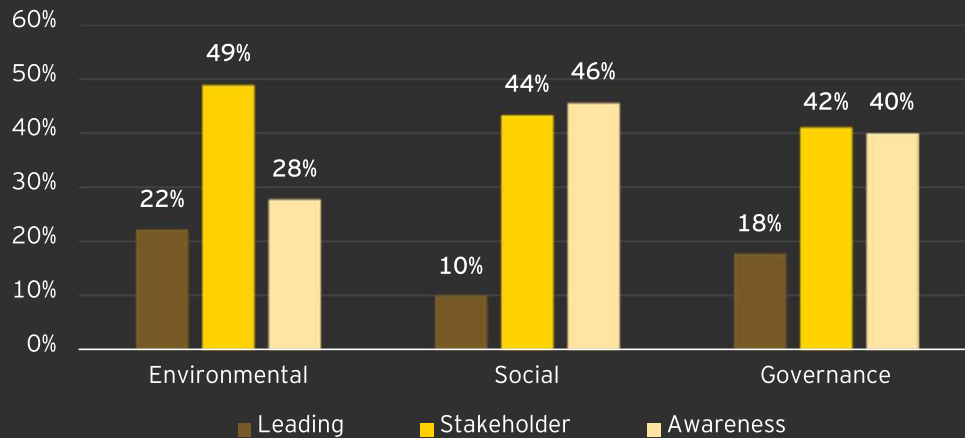


- Most respondents currently have no plans on incorporating ESG (45%) into their appraisal and compensation plan for senior staff. Insurers who have already incorporated ESG for senior staff (24%) have mentioned KPIs such as "Citizenship" and "Net Promoter Score" (NPS); Core sustainability goals for Group; in performance agreements; in business scorecards as a strategic KPI which contributes to the overall BU performance rating.
- Over half of the respondents claim that Covid-19 has increased the focus on social issues and the wellbeing of their people (61%).

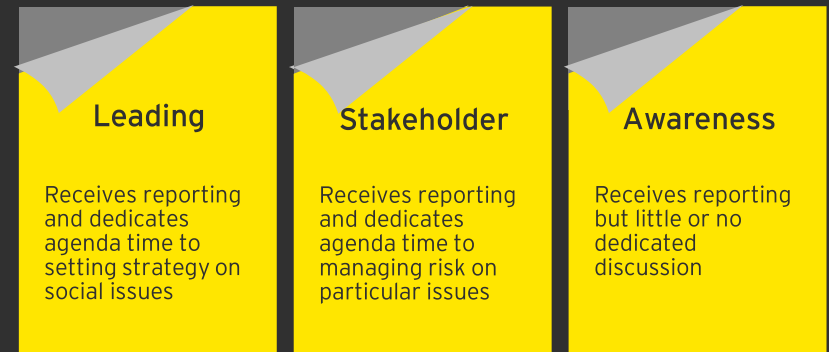
The role of the Board Risk Committee in managing ESG issues



What role does the Board Risk Committee take in managing ESG issues?



The role of each criteria:

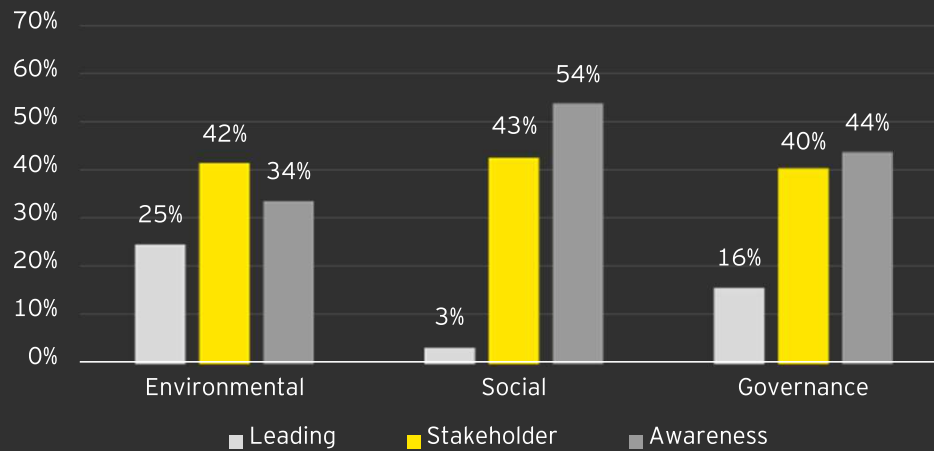


- The "Stakeholder" and "Awareness" role of the Board Risk Committee (BRC) is evenly distributed between "Governance" and "Social" issues contained in ESG. As for environmental issues, half of the insurers answered that the BRC plays a stakeholder role.
- Despite the important role of "Leading", it scores the lowest in all fields related to the management of ESG issues by the BRC.

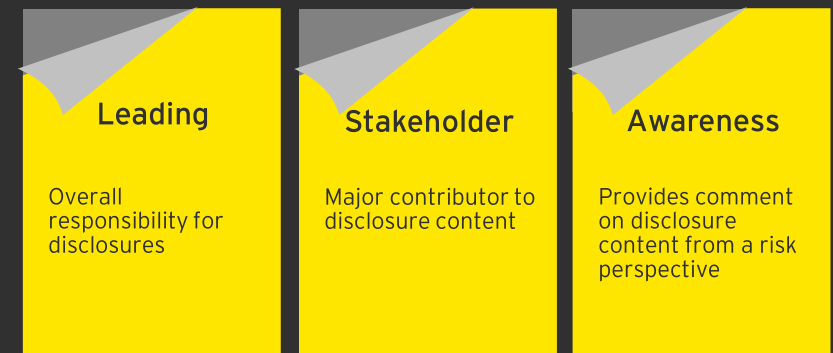
The role of the CRO in ESG-related disclosures



As the CRO, what role do you take on ESG-related disclosures for the following areas?



The role of each criteria:



- The "Stakeholder" and "Awareness" role is evenly distributed between "Environmental", "Social" and "Governance" with a relatively high percentage of "Awareness" in Social.
- Despite the important role of "Leading", it scores the lowest in all fields related to the role of the CRO in ESG-related disclosures.

Incorporation of climate risk assessments



How are the outputs from your climate risk assessments incorporated in Capital adequacy assessments (i.e. ORSA)?

- Climate change is explicitly factored into own view of risk and factored into SCR calculations. Long-term scenario testing in line with CBES forms part of the ORSA and used to support views on long-term viability of the business strategy including capital requirements.
- Incorporated through specific scenario analysis (stress tests)
- Qualitative assessment in ORSA
- Physical and transition risks were analyzed with various scenarios contemplated. Material insights were incorporated into the ORSA.
- We are working on this now



How are the outputs from your climate risk assessments incorporated in financial reporting and balance sheet valuations?

- Climate change is explicitly factored into own view of risk which in turn feed in to reserving processes. Limited impact elsewhere.
- As standard requirements - Group and local
- Investment policy
- Only incorporated into scenario testing
- They are a consideration, but no specific adjustments are made
- No specific integration into the financial reporting/balance sheet valuations

- Insurers **incorporate climate risk assessments in their ORSA in various ways** but many of them answered that it was through specific scenario analysis or qualitative assessments.
- Clear differences in the **financial reporting and balance sheet valuations** are observed, but **most insurers do not incorporate the outputs obtained.**

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Insurance survey on climate risk practices in the ORSA process

17 European Insurers

- ▶ The integration of sustainability risk (including climate risk) in the insurance industry is being driven from regulatory and market pressure in the asset management area (including unit-linked products)
- ▶ The sustainability insurance risk management on the liability side (especially in the underwriting and product development process) is generally in an early stage

1 Embedding climate risks into the ORSA process

- ▶ Climate risk assessments in the ORSA are predominantly performed on a qualitative basis so far
- ▶ A few leading insurance companies are including quantitative climate risk assessments in the ORSA process

2 Choice of climate scenarios

- ▶ The typical scenarios used are IPCC¹ and NGFS² (that is based on IPCC)
- ▶ The industry practice is to select at least 2 scenarios, whereas one assumes below 1.5°C and the other 2°C. Next to that a third scenario based on 1.5°C but with a different transition pathway is often added.

3 Data, Scope and Modelling Approach

- ▶ The focus of many insurance peers is on physical risk. Transition risk is often only marginally and qualitatively addressed
- ▶ Typically, only the major risk categories are modelled on a quantitative basis
- ▶ The majority of industry peers focus on models based on static balance sheets

4 Time horizon of climate risk analysis

- ▶ Market practice is to perform climate risk assessments at least on an annual basis
- ▶ very long-term scenarios (beyond 2050) are often ran on a qualitative basis. In case a quantitative model is used, cautious interpretation is required given the high uncertainty for the long-term scenarios

¹ IPCC: Intergovernmental Panel on Climate Change

² NGFS: Network for Greening the Financial System

Definition of maturity matrix for the industry survey

	Basic	Advanced	Leading	Pioneering
Maturity definition	Below current stakeholder and insurance industry expectations; an acceleration of responsible investment and sustainable insurance activities required. May struggle to meet regulatory expectations in some jurisdictions.	Meeting stakeholder and insurance industry expectations; responsible investment and sustainable insurance is not a differentiator. Compliance with regulatory expectations.	Exceeding stakeholder and insurance industry expectations on some dimensions; known collaborator on responsible investment and sustainable insurance.	Defining the future market; including aspirational examples of responsible investment and sustainable insurance innovation from broader financial services and the anticipated direction of travel.

Embedding climate risks into the ORSA process

	Basic	Advanced	Leading	Pioneering
Integration into ORSA	<ul style="list-style-type: none"> • Very limited climate risk assessment and integration in ORSA • Mainly traditional NatCat scenarios are covered 	<ul style="list-style-type: none"> • Climate risk is marginally covered in the ORSA report • Marginal integration of climate risk in the overall ORSA process 	<ul style="list-style-type: none"> • Climate risk is a major topic covered in the ORSA report • Climate risk is embedded in the overall ORSA process 	<ul style="list-style-type: none"> • Extensive coverage of climate risk assessment in ORSA • Well documented and followed processes for the integration of climate risk in ORSA
Quantitative vs. Qualitative	<ul style="list-style-type: none"> • Qualitative and quantitative assessment of NatCat • Qualitative assessment of climate risk in ORSA, if at all 	<ul style="list-style-type: none"> • Qualitative and quantitative assessment of NatCat • Qualitative assessment of climate risks in ORSA 	<ul style="list-style-type: none"> • Qualitative and quantitative assessment of NatCat • Qualitative and quantitative assessment (short-term only) of climate risk in ORSA 	<ul style="list-style-type: none"> • Qualitative and quantitative assessment of NatCat • Qualitative and quantitative assessment (short- and long-term) of climate risk in ORSA
Physical vs. Transition	<ul style="list-style-type: none"> • Physical only 	<ul style="list-style-type: none"> • Focus is on physical risk 	<ul style="list-style-type: none"> • Focus is on physical risk, transition risk is only marginally addressed 	<ul style="list-style-type: none"> • Physical and transition risk are both extensively covered
# answers	4	8	4	1

Choice of climate scenarios

	Basic	Advanced	Leading	Pioneering
Source of scenarios	<ul style="list-style-type: none"> Non-NGFS scenarios are used as the basis (local stress tests without scenario expansion) 	<ul style="list-style-type: none"> Non-NGFS scenarios are used as the basis (local stress tests with scenario expansion) 	<ul style="list-style-type: none"> Typical sources are NGFS or IPCC. Scenario expansion is applied where needed 	<ul style="list-style-type: none"> Typical sources are NGFS or IPCC. Scenario expansion is applied where needed
Number and type of scenarios considered	<ul style="list-style-type: none"> n/a 	<ul style="list-style-type: none"> 2 scenarios are used: <ul style="list-style-type: none"> Paris-aligned (below 2°C) Non-Paris aligned (above 2°C) 	<ul style="list-style-type: none"> 3 scenarios are used <ul style="list-style-type: none"> Paris-aligned (below 2°C) Non-Paris aligned (above 2°C) Non-Paris aligned (above 4°C) Scenarios don't cover different RPCC pathways 	<ul style="list-style-type: none"> At least 3 scenarios are considered: <ul style="list-style-type: none"> Paris orderly transition (below 2°C) Paris disorderly transition (below 2°C) Failed transition scenario (above 4°C) Scenarios consider different RPCC pathways
Interaction of physical and transition risk	<ul style="list-style-type: none"> Considers only physical risks 	<ul style="list-style-type: none"> Considers mainly physical risks Transition risk is considered independently from physical risk 	<ul style="list-style-type: none"> Considers physical and transition risks jointly 	<ul style="list-style-type: none"> Considers physical and transition risk jointly
# answers	8	2	7	0

Data Scope and Modelling Approach

	Basic	Advanced	Leading	Pioneering
Scope of assessment	<ul style="list-style-type: none"> Asset Management side only 	<ul style="list-style-type: none"> Primarily Asset Management The Liability side is covered only qualitatively, if at all 	<ul style="list-style-type: none"> Primarily Asset Management The Liability side is mainly covered qualitatively with some quantitative aspects 	<ul style="list-style-type: none"> All group-activities (Asset Management, Underwriting, ...) are assessed quantitatively
Data sources	<ul style="list-style-type: none"> Limited datasets are used for modelling Input data is sourced exclusively in-house 	<ul style="list-style-type: none"> Limited datasets are used for modelling Input data is primarily sourced in-house, but expanded with specialized climate databases 	<ul style="list-style-type: none"> Different datasets covering the insurance's activities are used for modelling Input data is primarily sourced in-house, but expanded with specialized climate databases 	<ul style="list-style-type: none"> A large range of datasets are used covering all of the insurance's activities Input data is a combination of Internal (Economic outlook, weather models...) and external data (specialized climate databases) Collaboration with specialized third-parties
B/S and I/S modelling	<ul style="list-style-type: none"> Static B/S and I/S are used 		<ul style="list-style-type: none"> Full modelling of B/S & I/S into the future by taking reasonable assumptions 	
Modelling approach	<ul style="list-style-type: none"> All risk types are modelled qualitatively 	<ul style="list-style-type: none"> Only market risk (investment valuation) is modelled quantitatively Liability is assessed qualitatively 	<ul style="list-style-type: none"> Few of the major risk types are modelled quantitatively 	<ul style="list-style-type: none"> All major risk types (Non-life, Spread, Market, NatCat) are modelled quantitatively and qualitatively
Physical and transition risk modelling	<ul style="list-style-type: none"> Market risk 	<ul style="list-style-type: none"> Market and spread risk 	<ul style="list-style-type: none"> Market and spread risk Liability and underwriting (especially P&C) 	<ul style="list-style-type: none"> Market and spread risk Liability and underwriting (P&C and Life/Health)
# answers	8	6	3	0

Time horizon of climate risk analysis

	Basic	Advanced	Leading	Pioneering
Calculation frequency	<ul style="list-style-type: none"> • Less frequently than annually 	<ul style="list-style-type: none"> • Annually or more frequently: Calculations are currently performed annually as the methods and market practice is continuously changing 		
Definition of long-term	<ul style="list-style-type: none"> • 10 years 		<ul style="list-style-type: none"> • 40 years 	<ul style="list-style-type: none"> • 80 years
Computation of long-term scenarios	<ul style="list-style-type: none"> • No integration of long-term climate risk scenarios in ORSA • No inclusion of new insurance products in long-term scenarios 	<ul style="list-style-type: none"> • Long-term scenarios are run only on a qualitative basis in ORSA due to the high degree of uncertainty • No inclusion of new insurance products in long-term scenarios 	<ul style="list-style-type: none"> • Long-term scenarios are run mainly on a qualitative basis in ORSA due to the high degree of uncertainty. Some quantitative assessments are made, but the results are used as an indication rather than a decision element • No inclusion of new insurance products in long-term scenarios 	<ul style="list-style-type: none"> • Long-term scenarios are assessed on a qualitative and quantitative basis • Results of long-term scenarios are also computed at intermediary intervals (i.e. not only at the end of the long-term scenario) • Quantitative results from long-term scenarios are interpreted with caution and only used for steering purposes • Assumptions on new insurance products in long-term scenarios are made
# answers	8	4	4	1

Thank You!

