

# The Interrelationship between Climate Change & Insurance

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## What are Environmental, Social & Governance (ESG) factors?

The consideration of environmental, social and governance factors alongside financial factors in the investment and underwriting decision-making processes.



Environmental factors: concern issues related to resource use, pollution, climate risk, energy use, waste management and other physical environmental challenges and opportunities.



**Social factors:** concern issues related to how a company interacts with the communities it operates in, its suppliers, employees and customers. These include, for example, labour standards, health and safety, supply chain management and nutrition and obesity.



**Governance factors:** concern procedures and processes according to which an organization is directed and controlled.



#### **ESG Factors and Credit Factors**

ESG Credit Factors are the intersection between standard credit factors and ESG factors that are applicable to the insurance industry – these are not new factors but a subset of credit factors

Credit Factors ESG Credit Factors Factors

AM Best analyzes ESG Credit Factors and how these risks / opportunities can affect the Financial Strength of insurers.

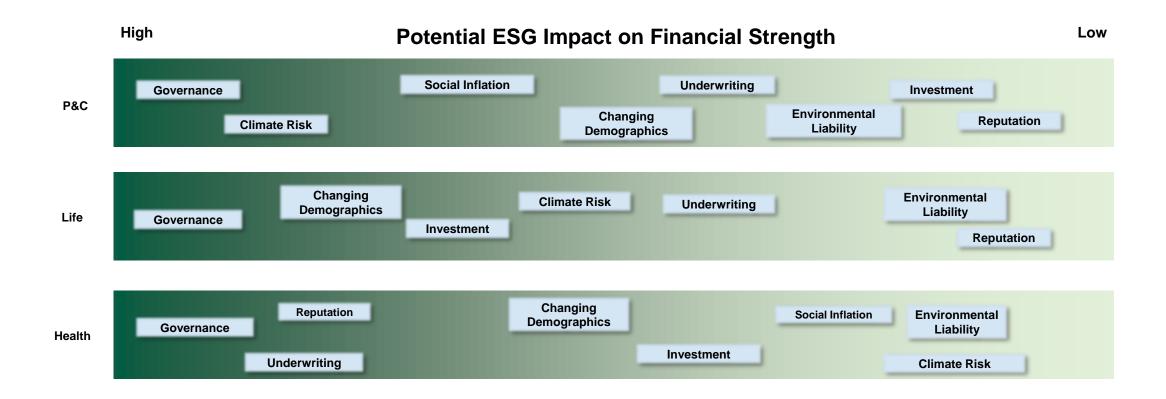
Are ESG risks and opportunities
relevant to creditworthiness?

How is the company managing them?

Some ESG issues may seem less important today, but may have greater importance over the medium-to-long term, and thereby have the possibility to impact financial strength, particularly if no action is taken.



## **ESG Impact on Credit Quality is not Uniform – Examples**





#### **Assessing Physical Climate Risk through the Rating Process**



Climate Risk



- Capital position withstands shocks
- Protection against peak exposures and aggregation of losses
- Low volatility / sensitivity to climate risk
- Diversification in investment portfolio

- Stability of earnings
- Limited impact of stranded assets
- Adequate modelling and pricing
- New climate products earnings accretive

- Underwriting profile diversified and insulated against climate risks
- Development of new products
- Clearly defined policy wording and contracts

- Climate risks factored into ERM approach
- Ability to absorb climate stress tests
- Ability to model weather-related risks
- High visibility of climate reporting, (financial disclosures, regulatory reporting)
- Board oversight

#### Balance Sheet Strength

- Rapid decline in capital position – over-exposure, unexpected losses
- Inadequate protection against peak exposures
- High volatility / sensitivity to climate risks
- Material write-downs of stranded assets

### Operating Performance

- Volatile earnings
- Financial losses due to stranded assets
- Climate risks not considered in underwriting model
- Unexpected losses
- Adverse mortality and morbidity rates from resistant disease

#### **Business Profile**

 Underwriting or investment profile concentrated and exposed to climate

risk

 Uncertain or indirect exposures to climate risks

#### Enterprise Risk Management

- Breaches of appetite and tolerance
- Stress test failures
- Inadequate risk modelling – poor data quality
- Non-disclosure in financial reporting
- Inadequate protection against peak exposure, or aggregation of risks

#### Issuer Credit Rating



## Q&A



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