

NCOIL Special Environmental, Social and Governance (ESG) Series

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Understanding ESG Concepts

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



Environmental factors relate to resource use, pollution, climate risk, energy use, waste management, and other physical, environmental challenges and opportunities



Social factors relate to how a company interacts with the communities in which it operates, its suppliers, employees, and broader stakeholders



Governance factors relate to procedures and processes according to which a company is directed and controlled

What Are ESG Factors?

Examples of ESG factors

- Physical risks
- Transition risks
- Liability risks
- Stress test failures
- Environmental opportunities

Environmental



- Demographic changes
- Product liability
- Social inflation
- Data privacy
- Social opportunities

Social



- Corporate governance
- Corporate behavior
- Transparency
- Board composition
- Business ethics

Governance



ESG Impact on Credit Quality

**ESG is relevant when it has a visible impact on financial strength.
Positive ESG attributes might not have an impact on a rating.**

ESG is not a new concept.

**Environmental and governance factors have long been part of
AM Best's credit analysis and is captured in our rating opinions**

Translating into Criteria – Importance of ESG Factors Is on the Rise

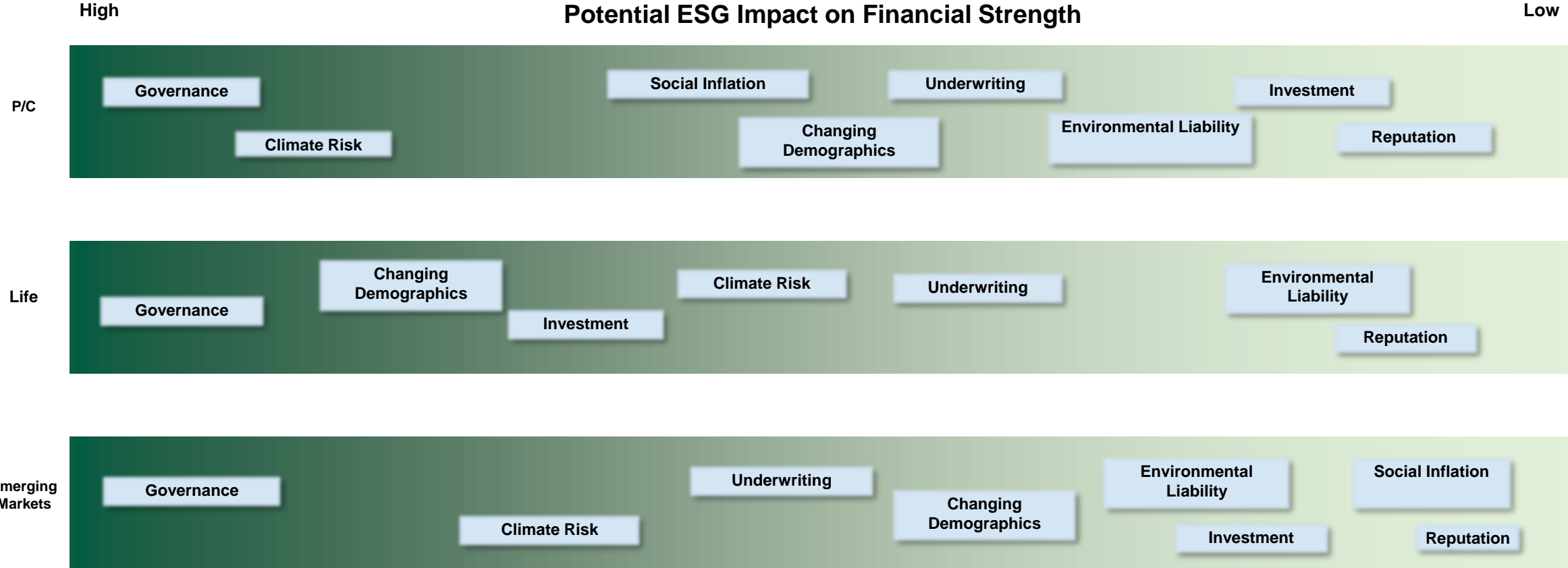
- ESG factors have always been considered in our rating process and have impacted ratings when they are material. AM Best also considers the long-term impact of ESG factors.

Balance Sheet Strength	Operating Performance	Business Profile	Enterprise Risk Management
<ul style="list-style-type: none">• Climate risk*• ESG integration in investing activities• Stranded assets	<ul style="list-style-type: none">• Social inflation• ESG-related litigation• Impact of ESG on profitability	<ul style="list-style-type: none">• Underwriting exclusions• Changing demographics• Data privacy• Reputational risk	<ul style="list-style-type: none">• Corporate governance*• Stress testing*• Management of insurance and non-financial risks

** ESG factors that are the most relevant over the near term.*

- ESG factors, when material and relevant, may affect one or more building blocks.
- ESG is viewed purely from an analytical perspective, with the focus on the impact on the credit rating.
- **No judgment is made regarding the ethical value of a company's ESG activities or ESG credentials.**

ESG Impact on Credit Quality Is Not Uniform – Examples



Billions-Dollar Events That Affected the US from 1980 to 2023

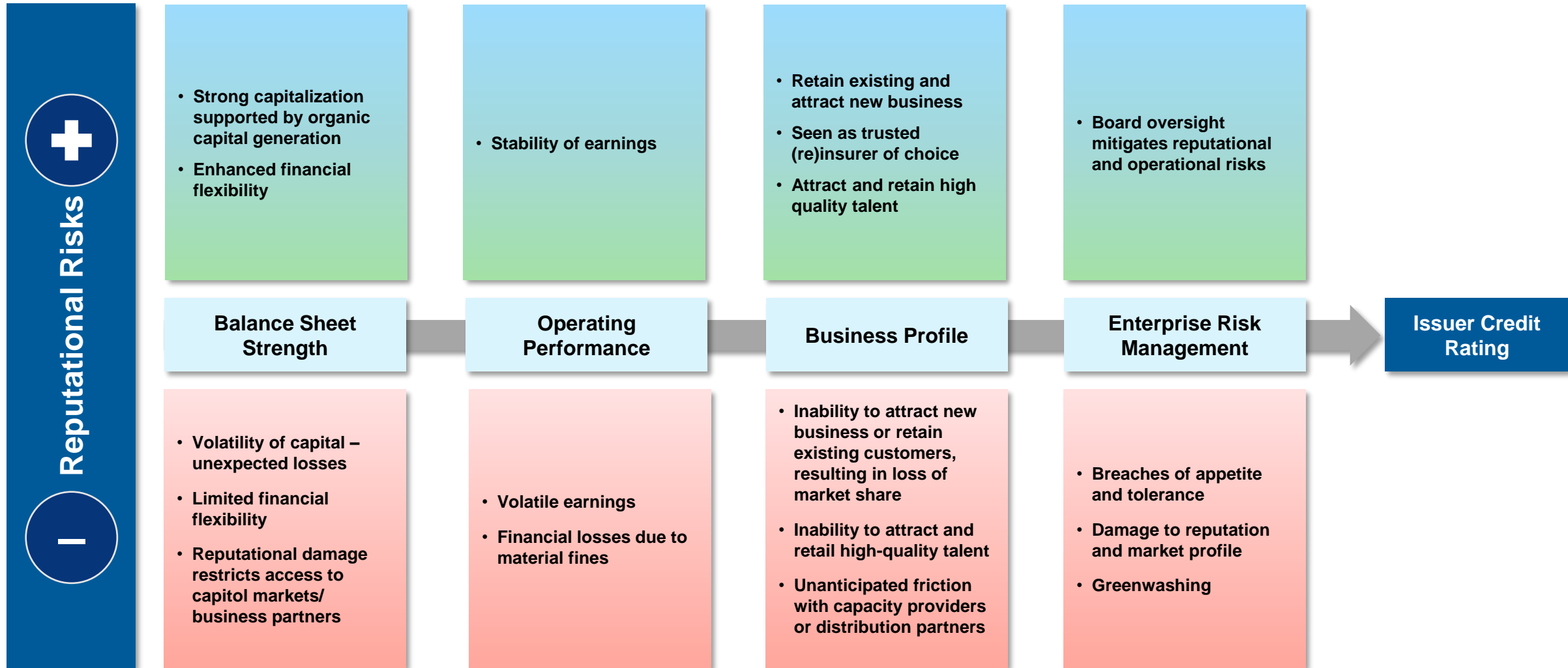
	Events	Events/Year	Percentage per Year	Total Cost	Percentage of Total Cost	Cost/Event	Cost/Year	Deaths	Deaths/Year
Drought	30	0.7	8.5%	\$332.3 billion	13.1%	\$11.1 billion	\$7.6 billion	4,275*	97*
Flooding	41	0.9	11.5%	\$187.6 billion	7.4%	\$4.6 billion	\$4.3 billion	723**	16**
Freezing	9	0.2	2.5%	\$35.7 billion	1.4%	\$4.0 billion	\$0.8 billion	162	4
Severe Storm	172	3.9	48.5%	\$407.1 billion	16.0%	\$2.4 billion	\$9.3 billion	2,068	47
Tropical Cyclone	60	1.4	16.9%	\$1,347.6 billion	53.0%	\$22.5 billion	\$30.6 billion	6,890	157
Wildfire	21	0.5	5.9%	\$134.5 billion	5.3%	\$6.4 billion	\$3.1 billion	435	10
Winter Storm	22	0.5	6.2%	\$96.3 billion	3.8%	\$4.4 billion	\$2.2 billion	1,402	32
All Disasters	355	8.1	100.0%	\$2,541.1 billion	100.0%	\$7.2 billion	\$57.8 billion	15,955	363

*Deaths associated with drought are the result of heat waves. (Not all droughts are accompanied by extreme heat waves.)

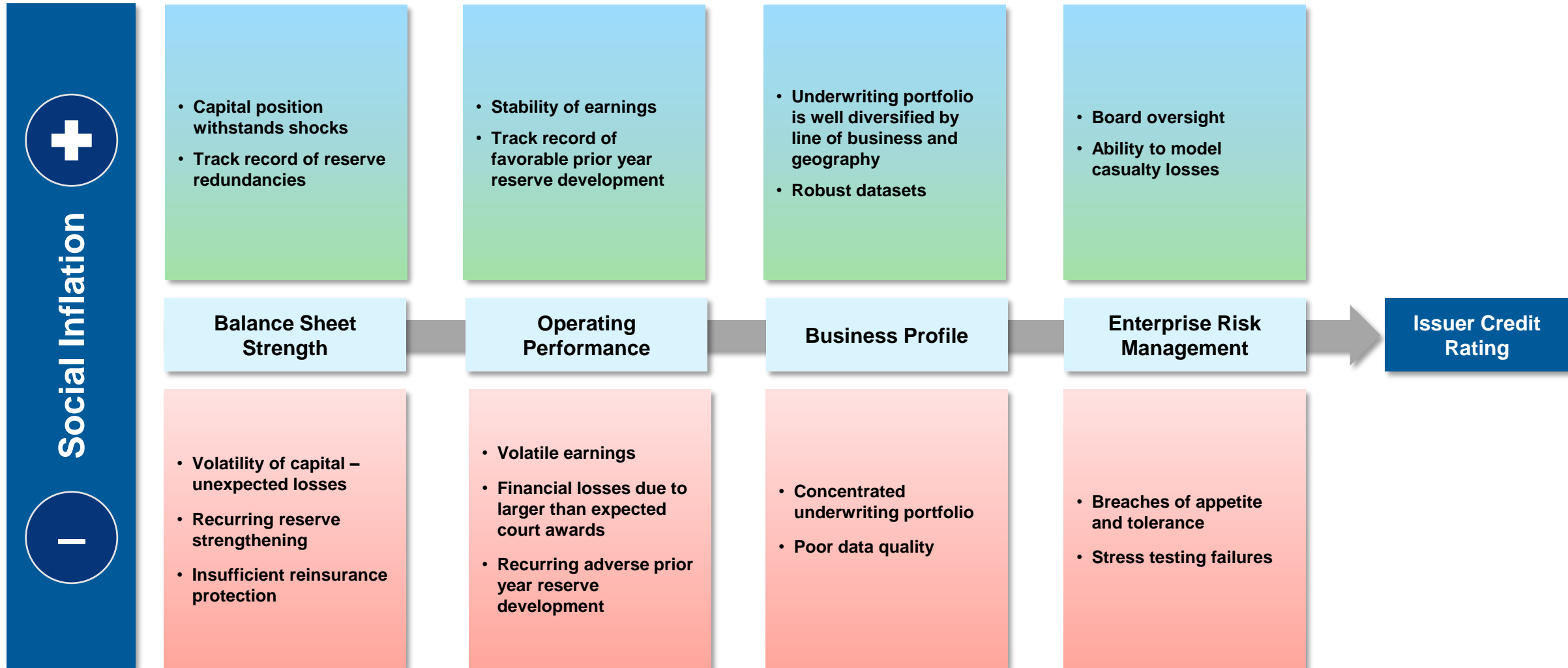
** Flooding events (river basin or urban flooding from excessive rainfall) are separate from inland flood damage caused by tropical cyclones.

Source: NCEI

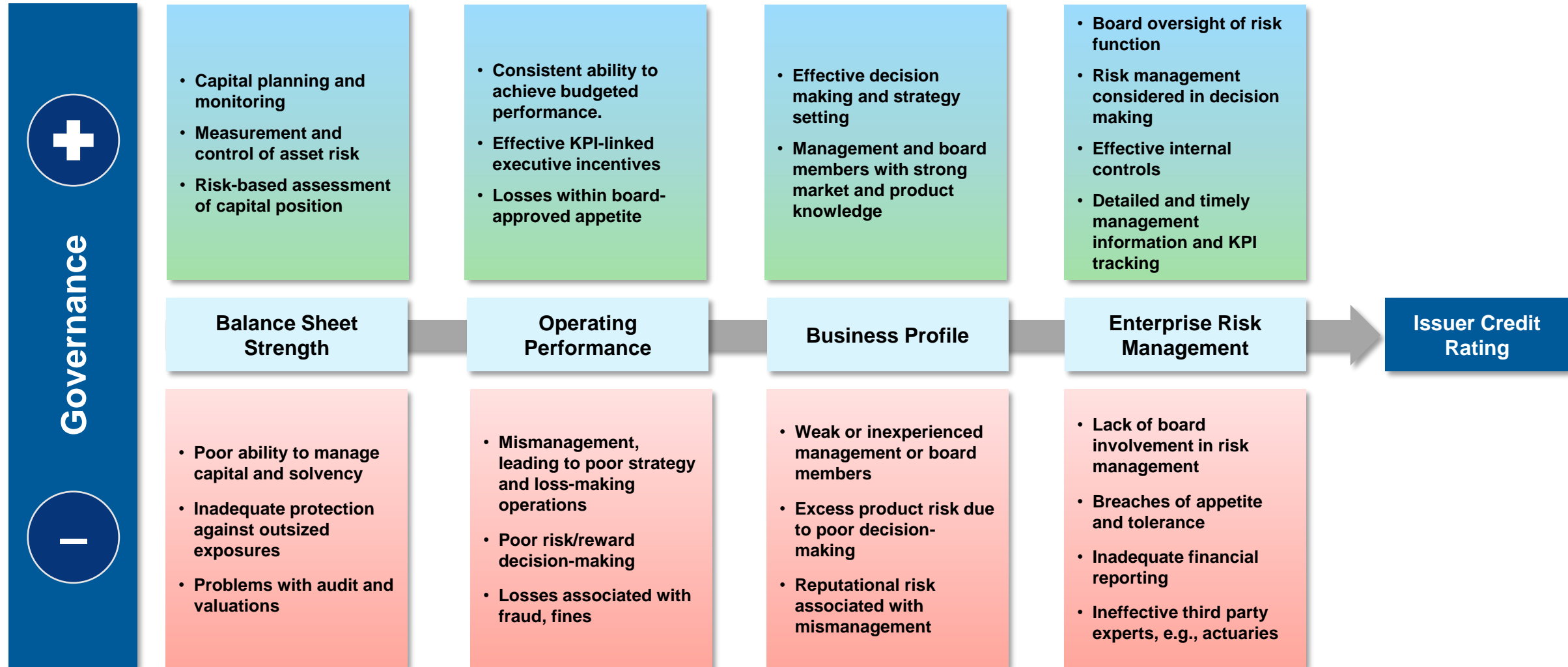
Assessing Reputational Risk in the Rating Process



Assessing Social Inflation in the Rating Process



Assessing Governance in the Rating Process



Social Factors AM Best Considers

- Data privacy
- Human capital
- Product liability
- Stakeholder opposition
- Health and safety
- Social inflation

Examples of ESG-Related Challenges Affecting Reinsurers

Financial Flexibility	Environmental Changes	Sustainability Policies	Transparency and Disclosure	Reputational Risks
<p>Pressure to remain an attractive investment proposition in a context in which institutional investments are becoming greener</p>	<p>Reinsurers on the first line to monitor and better understand changing environmental exposures due to position in the underwriting chain and the impact of severe natural catastrophe events</p>	<p>Growing attention on sustainability policies linked with investments, underwriting, or corporate behavior</p>	<p>Rising pressure on ESG transparency and disclosure from various stakeholders</p>	<p>Greater reputational risks owing to environmental, social or governance factors</p>



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