JOINT MEETING OF THE INSURANCE, PENSIONS AND RISK MANAGEMENT COMMITTEES

SUSTAINABILITY IN INSURANCE BUSINESS

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About us

Annina Pietinalho

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- AAE Insurance committee vice-chair
- Past president of the Actuarial society of Finland (ASF)
- ASF regulation working group chair
- LocalTapiola Life: ALM & Solvency director, former chief actuary
- AMICE prudential regulation wg member
- EIOPA IRSG member

Sustainability – what has happened recently

Climate change has been for decades something that actuaries have been analysing and actively participating on the global discussions. In the recent years, other Environmental but also Social and Governance type of issues have came more and more into awareness of insurers. How to deal with these ESG-factors and the way they might change the insurance business seems to be a topics that also actuaries might need to be aware and have ways to look it from the financial perspective. Some of the recent publications:

- Paris agreement 4/2016 - which will start in 2020.
- UN sustainable insurance report 8/2017 (updated from 2012) and the UN sustainable development goals
- The EU 2030 Agenda for Sustainable Development
- European Commission 1/2018 - Final Report 2018 by the High-Level Expert Group on Sustainable Finance (Esko Kivisaari as one of the members)
- IAIS and SIF Issued Paper on Climate Change Risks to the Insurance Sector 7/2018 – 80 pages of supervisory approaches and industry practices globally
- Financial Stability Board's Task Force on Climate-related Financial Disclosures (TFCD) has set out recommendations for consistent, comparable, reliable, clear and efficient climate-related disclosures by companies
- Formal request from the European Commission to EIOPA and ESMA concerning sustainability risks and sustainability factors - 7/2018

Sustainability in insurance business – why this seems to be important topic for insurers?

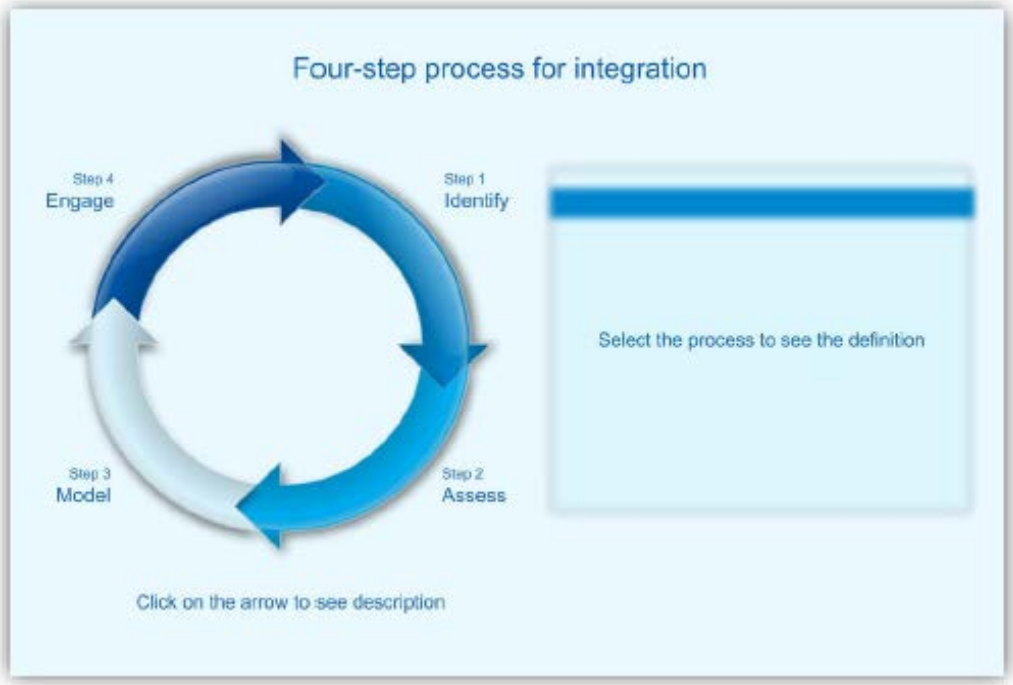
- **The risk based idea**: If an insurer does not believe in a positive development in some particular risk (e.g. coal) the company might want to make sure to minimize its exposure to that risk. This will cause actions in underwriting, investing and in its internal operations.
- An additional risk area will be **liability risks**. There already are possibilities, mainly in the US, that, e.g., coal plants are made to pay for the damage caused by climate change. Insurers could end up paying for these.
- It seems to be important to **understand how insurance business might develop if/when ESG-factors will be more present** in everyday business?
  - E.g case study on what happened to insurance business over decades when the tobacco exposures were cut down, could give good insight of the future change.
  - If there becomes a growing understanding of some particular risk it might affect the insurance pricing in two ways; there will be higher price because of the better understanding of what might happen in the worst case AND there might be less insurers underwriting that risk (less offering, less competition).
  - Might encourage the companies to change their business to more sustainable direction.

Sustainability in insurance business – why this seems to be important topic for insurers?

- **The data and reporting**: For any insurer to be able to understand risks and set its risk appetite **more data needs to flow to insurers**. This basically seems to mean better reporting from the actual companies operating in a country or globally. this same data also needs to flow to all third parties in the middle (between the operating company and the investing/underwriting insurer) like funds, asset managers, companies collecting and selling investment data etc.
- With respect to data it is not only a one way street with insurers wanting more data – in their normal process of claims handling insurers get a good hands on experience of emerging risks and therefore **insurers can help societies in understanding where action is needed**.
- **In EU** the actions from EC will (most probably) flow into business reporting, stress scenarios and guidance towards customers
- **Directing or reallocating investments seems to be bit more easy than to refuse from underwriting some specific industries** – insurers, and their decisions making bodies might be really close to societies an dsometimes quite locally also.
- A distiction needs to be done between **what's sustainable and what's ethical**

Sustainability in investments

- UN Principles of Responsible Investment has one way of looking how ESG factors could be integrated into investment decisions
- Sustainable investing is already being measured in some extent. So called ESG indexes do already exist, for instance S&P has equity/smart beta index families.
- Especially pension funds have been implementing ways to have ESG factors included into their investment decision



- Step 1 – Identify

What are the relevant ESG issues for the target investment?

- Step 2 – Assess

How is the target investment affected by these issues and to what degree?

- Step 3 – Model

How are ESG issues accounted for in financial projections and risk assessment models?

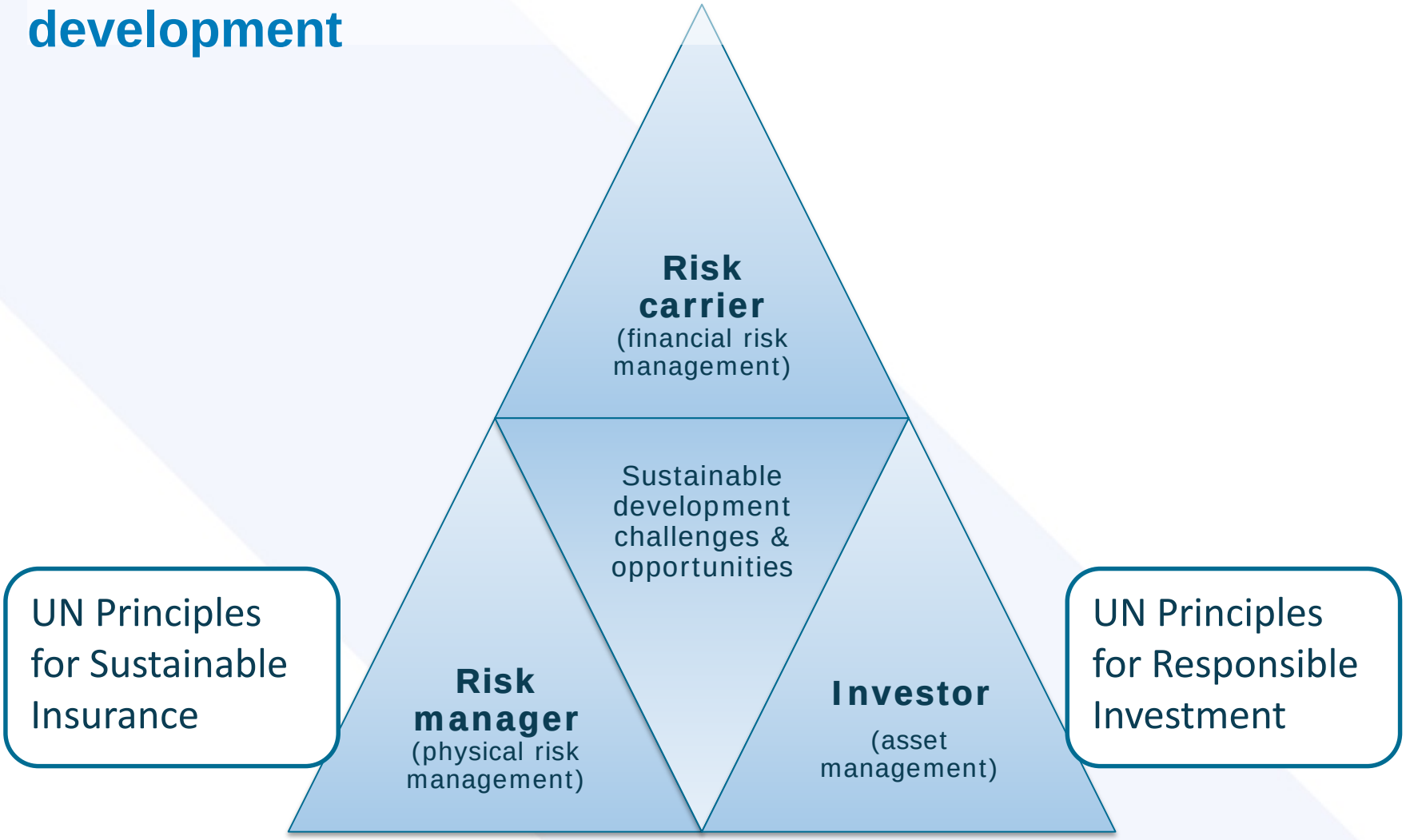
- Step 4 – Engage

Is there an opportunity to mitigate residual ESG risk through shareholder engagement and voting?

Motivation: Sustainable business

- In a market environment, profitable business activities create economic value. Even when absolutely legal and economically beneficial, any business activity may also have unintended social and environmental downsides. If such impacts are ignored, they may pose a threat to societies' long-term sustainable development.
- In consequence, companies need to have (and many companies have developed) a well-defined approach (e.g. Sustainability Risk Framework) which is designed to identify and mitigate such risks through embedding the principles of respect for human rights, environmental protection and due diligence into business processes.
- While embedding ESG issues into our insurance business enables companies to manage the risks, it also opens up new opportunities for solutions that support sustainable development and a low-carbon future.

The insurance industry has many roles in sustainable development



Source: Butch Bacani. Sustainable insurance: Turning environmental, social and governance challenges into sustainable opportunities , UN Environment's Principles for Sustainable Insurance Initiative, 2017

The Principles for Sustainable Insurance: A global roadmap to drive systemic change

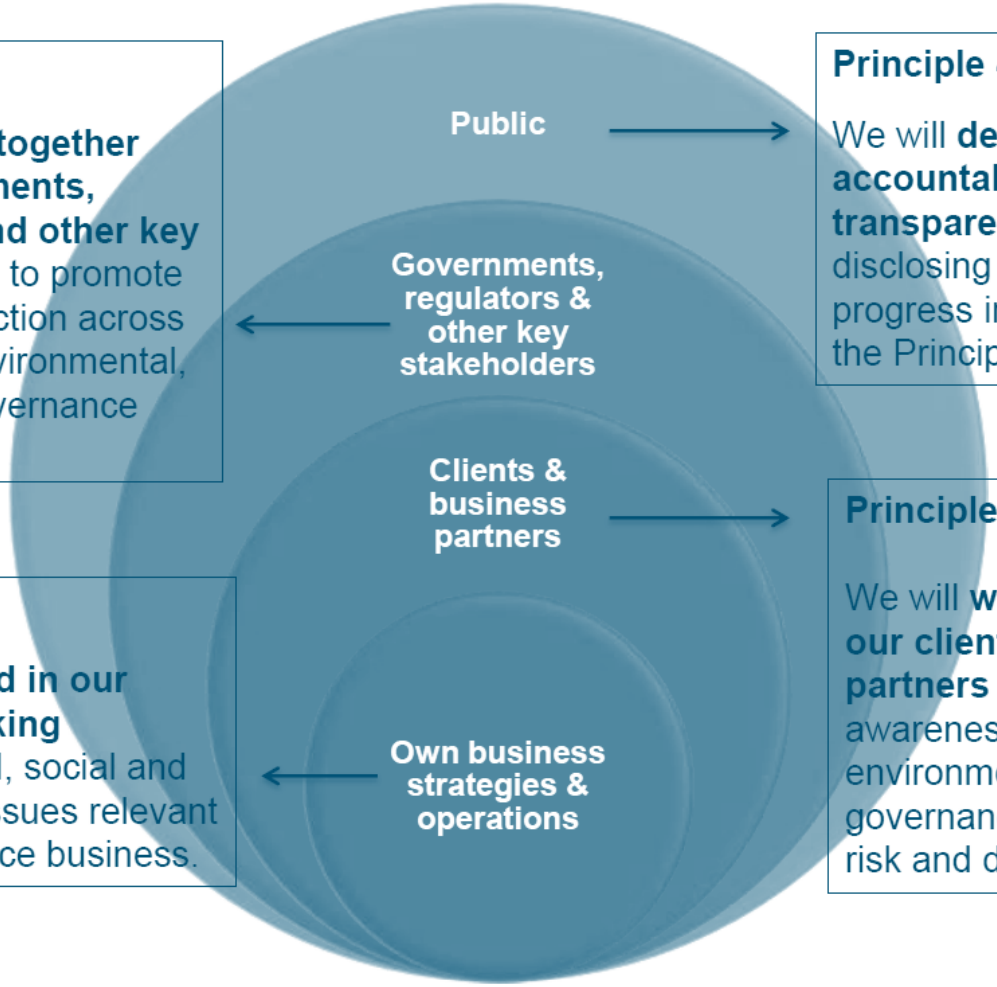
PSI
Principles for Sustainable Insurance

Principle 3:

We will **work together with governments, regulators and other key stakeholders** to promote widespread action across society on environmental, social and governance issues.

Principle 4:

We will **demonstrate accountability and transparency** in regularly disclosing publicly our progress in implementing the Principles.



Principle 1:

We will **embed in our decision-making** environmental, social and governance issues relevant to our insurance business.

Principle 2:

We will **work together with our clients and business partners** to raise awareness of environmental, social and governance issues, manage risk and develop solutions.

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Source: Butch Bacani. Sustainable insurance: Turning environmental, social and governance challenges into sustainable opportunities , UN Environment's Principles for Sustainable Insurance Initiative, 2017

ESG

- Environmental, social and governance (ESG) refers to the three central factors in measuring the sustainability and ethical impact of an investment in a company or business.
- These criteria help to better determine the future financial performance of companies (return and risk).

Environmental

- Climate change and natural disasters
- Biodiversity loss & ecosystem degradation
- Pollution
- Water scarcity and food insecurity

Social

- Human rights and labour standards
- Political environment and public perception
- Diversity
- Health and safety risks
- Social inequlity
- Animal welfare
- Ageing populations and demographic change

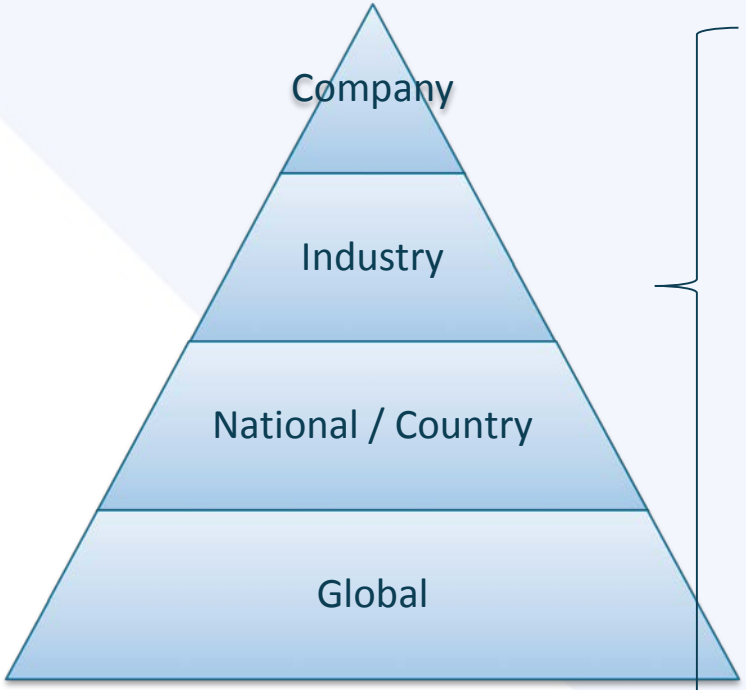
Governance

- Accountability and transparency, disclosure
- Unethical business conduct
- Corruption
- Compliance
- Consultation and
- Responsible and careful planning and assessment

In more detail please see Appendix 3.

Components of ESG analysis

ESG issues can affect at a global, national, industry and company level and can have material impact on business performance.



Principles to certain sensitive sectors, e.g.

- Defence industry
- Oil and gas, artic drilling
- Mining
- Dams
- Animal testing
- Forestry, pulp & paper and oil palm
- Nuclear weapons proliferation

Example: Industry Large Dams
(hydro power / water management)

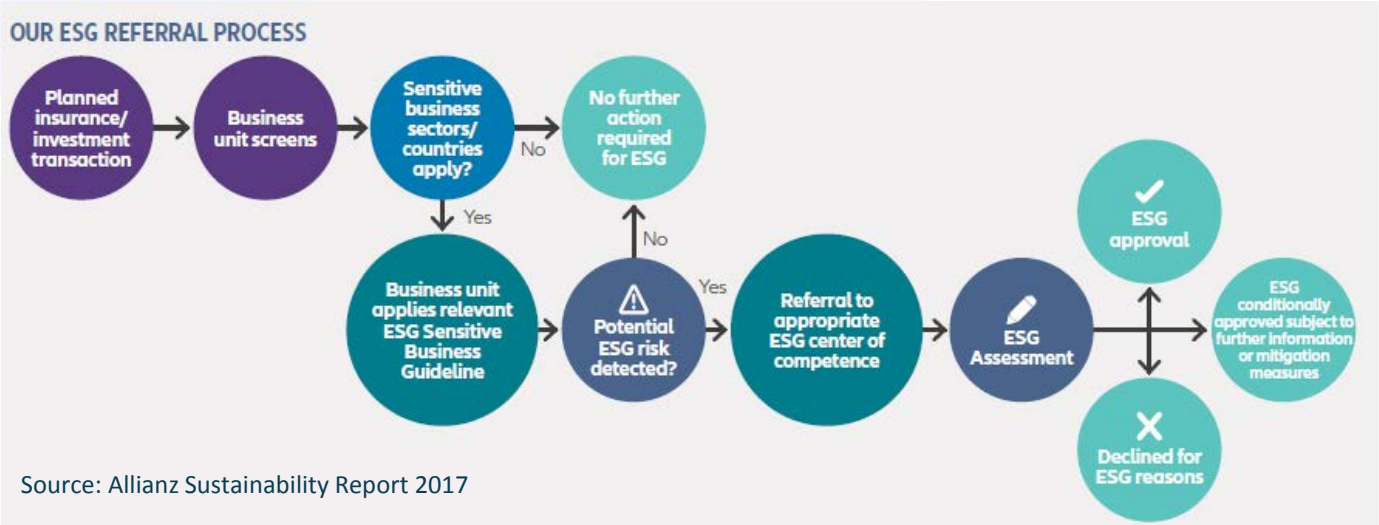
Environmental Issues	Socio-Economic
- Deforestation - Habitat fragmentation (i.e. blockage - of critical fish migration routes) - Biodiversity loss - Impacts on water quality - Pollutant emissions due to - non-deforested inundation areas	- Labour laws - Displacement of communities - Insufficient local consultation - Loss of livelihoods (e.g. fishing and farming) - Depletion of fish stocks - Impact on regional food security - Inadequate health and safety standards - Adverse impact on downstream neighbouring states and interests - Negative impact on indigenous people - Cultural heritage

Assessment of Mitigation Measures
- Environmental social impact analysis - Labour assessment - Health, safety and environment plans - Standard of financing entity - Local opposition / controversy (media search) - Adoption of CSR standards and principles by contractors - Application of the recommendations of the World Commission on Dams

Source:Working Group Paper Nr.89 : Sustainability aspects in engineering underwriting and corporate responsibility for insurance and reinsurance companies, IMIA Conference in Cannes Mandelieu, 2014

ESG process

- ESG factors have emerged as central factors in measuring the sustainability and ethical impact of insurance business. However, when it comes to underwriting risks, ESG concerns may appear less relevant for underwriters than many other risk aspects (e.g. technology risks, exposure to Man-made and Natural Cat, Risk Mitigation, Legal requirements).
- If ESG factors are not addressed appropriately they can escalate into substantial risks.
- Alternatively, ESG factors can also present opportunities to induce positive change, such as increased requirements for renewable energy investments or offering solutions for emerging markets.



Source: Allianz Sustainability Report 2017

In Appendix 4 more about ESG integration

ESG risks and risk management

- ESG risks can develop into legal risks, reputational risks, supply chain and business disruption risks, quality risks, operational risks, human rights risks, financial risks, and/or investment risks for insurance company, its customers and/or its invested companies.
- Traditional tools used to assess risk and return are based on information that can be easily quantified. ESG data is non-financial and by definition qualitative. It is not only highly subjective but also particularly difficult to quantify and more importantly verify.

- Approaches:
  - Beyond climate change, insurance companies have implemented frameworks to integrate ESG risks and opportunities across line of business.
  - The Oasis Loss Modelling Framework has proposed a new platform for catastrophe and climate risk assessment to further broaden the applicability of catastrophe risk models, ultimately seeking to expand insurance coverage.

More on reporting requirements please see Appendix 5 (The Guidelines on non-financial reporting)

Possible actions from AAE regarding the sustainability

- The actuarial profession seems to have capabilities to deal with this issue and therefore might even need to be active in this area
- Bringing awareness to insurers on what kind of ESG risks there might be and how link the risks to the business plans might be one possible action
  - before able to do this there needs to be quite good basic understanding on how different ESG-factors might affect the industry and this needs a lot of studying and ground work.
  - There's a clear link to the ORSA/ORA work where already standards exist
- Also modelling of the risks will be needed but modelling rare events, or something that has never happened is a hard task
- AAE might want to decide whether this is a topic where more publicity is needed from AAE side.

actuarial association of europe

THANK YOU!

Material and references

- Allianz ESG Integration Framework (version 2, 2017)
- Allianz Sustainability Report 2017 (2018)
- Butch Bacani. Sustainable insurance: Turning environmental, social and governance challenges into sustainable opportunities, UN Environment's Principles for Sustainable Insurance Initiative (2017)
- CRO Forum: Environmental, Social and Governance factors in Country Risk Management – a new horizon (2013)
- CRO Forum: Recommendations for Managing Environmental, Social and Ethical Challenges in Business Transactions (2010)
- European Commission: Guidelines on non-financial reporting (2017)
- IAIS: Issues Paper on Climate Change Risks to the Insurance Sector (2018)
- Munich Re website: Corporate Responsibility (https://www.munichre.com/corporate-responsibility/)
- Swiss Re: Sustainability Risk Framework (2016)
- Swiss Re website: (http://reports.swissre.com/corporate-responsibility-report/2017/)
- UNEP: PSI Principles for Sustainable Insurance (2012)
- UNEP: Sustainable Insurance The emerging agenda for supervisors and regulators (2017)
- UNEP: The global state of sustainable insurance (2009)
- Zurich Insurance: Mitigating environmental, social and governance (ESG) risks in underwriting and investment management (version 1.0)
- Zurich Insurance: Responsible Investment at Zurich (2017)
- Zurich Insurance website: (https://www.zurich.com/en/sustainability)
- Working Group Paper Nr.89 : Sustainability aspects in engineering underwriting and corporate responsibility for insurance and reinsurance companies, IMIA Conference in Cannes Mandelieu (2014)

Appendices

Apendix 1:
Sustainability – European Commission active

Sustainable finance: Commission's Action Plan for a greener and cleaner economy 8/2018

- **EC's statement**: 'As our planet increasingly faces the unpredictable consequences of climate change and resource depletion, urgent action is needed to adapt to a more sustainable model. Around €180 billion of additional investments a year are needed to achieve the EU's 2030 targets agreed in Paris, including a 40% cut in greenhouse gas emissions.
- **Actions include** the HLEG work and a roadmap to boost the role of finance in achieving a well-performing economy that delivers on environmental and social goals as well (part of the Capital Markets Union's (CMU) back by e.g. Frans Timmermans, Valdis Dombrovskis, Jyrki Katainen and Miguel Arias Cañete.

- **Key features of the Action Plan and the HLEG work:**
  - Establishing a common language for sustainable finance, i.e. a unified EU classification system – or taxonomy – to define what is sustainable and identify areas where sustainable investment can make the biggest impact.
  - Creating EU labels for green financial products on the basis of this EU classification system: this will allow investors to easily identify investments that comply with green or low-carbon criteria.
  - Clarifying the duty of asset managers and institutional investors to take sustainability into account in the investment process and enhance disclosure requirements
  - Requiring insurance and investment firms to advise clients on the basis of their preferences on sustainability.
  - Incorporating sustainability in prudential requirements: banks and insurance companies.
  - Enhancing transparency in corporate reporting.

Appendix 2:
Market development and expectations for the insurance industry

- Supervisors and regulation:
  - EU High-Level Expert Group on Sustainable Finance: EC will on recommendations to determine how to integrate sustainability considerations into EU's rules for the financial sector.
  - a growing number of authorities taking action based on their core prudential mandates and extending these to new environmental threats.
- Need for ESG integration at industry level is emphasized by the advanced companies. Industry-wide ESG standards will be key for a common approach in the sector.

UN Secretary-General's 5 new challenges to the insurance industry:

- Measure **carbon footprint** of investment portfolios by 2020, and **decarbonize investments**
- Double **investments in sustainable energy** by 2020
- Work with UN to ensure that **early warning and early action systems** are made available to most vulnerable countries by 2020
- Provide the most vulnerable with greater access to **risk transfer mechanisms**
- Develop **auditable standards** in insurance industry that incorporate the **Sustainable Development Goals**

UNEP: Sustainable Insurance The emerging agenda for supervisors and regulators (2017)
Butch Bacani. Sustainable insurance: Turning environmental, social and governance challenges into sustainable opportunities,

Appendix 3:
Illustrative list of ESG factors and criteria

Criteria			
Factor	**Aspect**	**Vulnerability**	**Mitigation measures**
Environmental	Natural resources	– Natural resources – Biodiversity and endangered species – Water resources – Land use	– Areas under sustainable management – Environmental policy frameworks & international standards – Information about the level of protection of natural resources
	Emissions	– Greenhouse gas emission levels due to economic activity and land use change.	– Emission reduction policies by using non fossil fuels and improving energy efficiency.
	Environmental exposure	– Exposure to extreme events like windstorm, tropical cyclones, flood, drought, wildfires and earthquakes – Strong economic dependence on natural resource revenues from forests, minerals, coal, oil, gas etc.	– The country's efforts in terms of environmental sustainability, considering both policy measures and investments – The country's resilience to adverse natural events using social, governance, institutional, physical, and economic yardsticks – Effectiveness and speed in the implementation of adaptation projects as well as the readiness of the society and the economy to absorb and adhere to adaptation efforts
Social	Empowerment	– Gender – Social inclusion and equality – Health status – Education & technology readiness	– Equal access policies – Social inclusion policies – Health expenditures – Expenditures in education
	Economic framework	– Poverty – Employment – Vulnerability to food crises	– Social expenditures – Sustainable business – Investments in agriculture
Governance	Political institutions	– Government effectiveness – Corruption – Accountability/ – responsiveness – Rule of law – Civil liberties/political rights	– Democratic governance – Control of corruption – Judicial independence – Enforcement power – Protection of human rights
	Security	– External conflict – Internal violence – Organized crime	– International cooperation – Amount of social capital – Effectiveness of security enforcement

Source: CRO Forum: Environmental, Social and Governance factors in Country Risk Management – a new horizon (2013)

Appendix 4:
ESG integration

1. **Board commitment on ESG & Definition of tolerance level**
2. **Standardized and streamlined structures**
   - Governance processes, responsibility and ownership in Enterprise Risk Management.
   - Coherence: Strive to apply the same sustainability approach to various business activities (investment and insurance)
   - Ensure that the possible conflict between growth targets and sustainability goals is handled.
3. **Integration into core UW process and tools**
   - Have methods and processes in place to identify and assess sustainability issues.
   - Give employees the appropriate tools to make transaction-by-transaction evaluations.
   - Have authority for sign-off / declines / conditions and expertise for UW
4. **Provision of clear guidance and empowerment of employees**
   - Awareness of sustainability challenges in business transactions: At all levels of insurance and investment activities.
   - Risk dialogue with clients on critical issues support informed decision making, transparency and risk mitigation

Appendix 5:
The Guidelines on non-financial reporting

- Appropriate non-financial disclosure is an essential element to enable sustainable finance. Greater transparency is expected to make companies more resilient and perform better, both in financial and non-financial (environmental, social and governance-related) terms.
- The aim of NFI guidelines is to help companies disclose high quality, relevant, useful, consistent and more comparable non-financial information in a way that fosters resilient and sustainable growth and employment, and provides transparency to stakeholders.
- Companies falling within the scope of Directive 2014/95/EU have to disclose relevant information on policies, risks, and results as regards environmental matters, social and employee-related aspects, as well as respect for human rights, anti-corruption, and bribery issues, and diversity on the boards of directors.
  - The greater transparency is especially important for the financial services sector which has a huge responsibility – and opportunity – to support the delivery of societal priorities such as the United Nations (UN) Sustainable Development Goals.
  - Those requirements contribute as well to implementing the Paris Climate Agreement, notably greater transparency is expected to lead to financial flows more consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.

Appendix 6:
Possible data for ESG analysis

DATA AND ASSURANCE

To enhance the quality of our sustainability reporting and data, our full sustainability report has been assured to a limited assurance-level by PwC since reporting year 2016. This helps to formalize the way sustainability is embedded across core functions and business units. A sample of operating entities of Allianz SE are reviewed by PwC on a regular basis depending on their impact on the Group's sustainability activities.

You can find the current assurance report here.

RATINGS AND BENCHMARKS

As we strive to be a sustainability leader in our sector, sustainability ratings and industry benchmarks provide an important opportunity to improve our performance and transparency. We also rely on these ratings to support long-term ESG integration across our proprietary investments and the responsible investment products offered to our asset management customers.

We take part in a wide range of external assessment and benchmarking initiatives, including:

Dow Jones Sustainability Index (DJSI)

Allianz has been included in the DJSI since 2000. In 2017, Allianz Group took the leading position within the insurance sector, scoring 87 out of 100 points. We have been included in the DJSI with top ranking positions every year since 2000.

Carbon Disclosure Project (CDP)

Allianz Group supports the CDP as a responding company and as an asset owner and asset manager. We were also a founding signatory of the CDP. Allianz has been listed in the Carbon Disclosure Leadership Index from 2011 to 2015. In 2017 we achieved a B rating.

FTSE4Good Index

Included since 2001, Allianz is one of the longstanding members of the FTSE4Good Index series. In the 2017 assessment, we were ranked in the top 3% of our sector.

MSCI Rating

In 2017, Allianz once again received AAA rating from MSCI ESG Research. We are one of the top performers in our sector.

Oekom Corporate Rating

Allianz has once again received Prime status in 2017, which ranks us among the world's best companies in our industry.

Source: Allianz Sustainability Report 2017 (2018)

8.5 External sources of information

SOURCE	E	S	G
AQUASTAT (FAO) & FAOSTAT	X	X	
Coface		X	
Environmental Performance Index Yale indicators	X		
Fraser Institute			X
Freedom House & Transparency International			X
Institute for Democracy and Electoral Assistance (IDEA)			X
International development Association	X		
International Labour Organisation		X	
International Monetary Fund		X	X
ONDD		X	
Revenue Watch Institute			X
The footprint network	X		
The World dataBank	X	X	X
UN Development Program	X	X	
UNCTAD		X	
UNDESA - Population Division and UNESCO		X	
UNFCCC	X		
United Nations Population Division		X	
World Bank Sustainability Safeguards	X	X	X
World Economic Forum		X	X
World Health Organization / UNICEF Joint Monitoring Programme		X	
World Wildlife Fund	X		

Sources: LIC (1991), Lorenz et al. (2001), Delal-Clayton and Bass (2002)

Source: CRO Forum: Environmental, Social and Governance factors in Country Risk Management – a new horizon (2013)