Climate change and its consequences present unprecedented risks for the financial industries – as well as for humanity. Inaction is not an option.

SUSTAINABILITY MATTERS

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The climate crisis is already urgent: in 2020 global heating saw temperatures pushed to 1.2°C higher than pre-industrial levels, with clear impacts on weather events and natural phenomena. It is widely accepted that a rise beyond 1.5°C will be disastrous, and that crossing the 2°C threshold will lead to catastrophic and irreversible effects.

A global problem requires an international response, and with these grave consequences on the horizon the majority of countries signed up to the landmark 2015 Paris Climate Agreement. This specifically targets long-term emissions reduction by imposing specific commitments on individual signatories, in line with factors including the country's proportional contribution to emissions. Sounds great! Not entirely: even though the Paris Agreement is built on the need to keep heating levels well below 2°C, the actual reductions pledged by countries are not even close to achieving that goal – in fact, they put us on track to hit 3°C. This represents a huge climate action gap.

Sustainability – a critical response to the climate emergency, and an issue which is also more widely relevant to topics such as biodiversity, social responsibility and good governance – is an increasingly universal claim made on behalf of everything from toilet rolls to window frames to hospitality. The concept is often understood to >

be enacted in three dimensions: environmental, social and governance. Social sustainability is concerned with achieving healthy and fair communities in which everyone has access to a good quality of life, while sustainability-focused governance seeks to provide sound processes and compliance as well as transparency by means of adequate reporting. But it all comes back to climate.

The UN has described sustainability as 'meeting the needs of the present without compromising the ability of future generations to meet their own needs'. This creates a useful framework for understanding the different types of sustainability. It also encompasses the fact that, as the climate crisis poses huge risks for humanity, it ultimately endangers progress in all sustainability areas.

SUSTAINABILITY AND THE AAE

The AAE emphasises a broader understanding of sustainability but is clear that the environmental aspect is of immediate relevance and requires pressing attention. Climate change has direct and indirect impacts on parameters which are fundamental for actuaries as long-term risk managers – such as property claims, mortality, investment behaviour, business continuity. What's more, actuarial analysis must acknowledge bigger-picture issues: increased risk of weather events means increased capital requirements for insurance companies; rising sea levels or food shortages may drive population migration which transforms demographic profiles; increased incidence of individual risks leads to higher premiums and could even jeopardise the insurability of these risks.

In other words, actuaries are already engaged in managing risks related to climate, and looking at the stability of the insurance and pensions industries. The AAE has highlighted this in recent and ongoing discussions with key stakeholders the European Insurance & Occupational Pensions Authority (EIOPA), the European Commission (DG FISMA) and Insurance Europe. The AAE also ensures we are a relevant voice in the climate conversation through other actions, such as publication of our December discussion paper, 'Sustainability issues and reputational risk'.

FINANCIAL & SOCIAL SUSTAINABILITY

The ongoing Solvency II review, which is a central feature of stakeholder discussions, has proposed that incentives and disincentives are built into the amended capital requirements; in response the AAE has stressed its view that the basic principle of 'same risk, same capital' must continue and, if any penalising or supporting measures are introduced, they must be robust and science-based. It supports the already-proposed appropriate integration of climate risk into Solvency II, for example through the inclusion of climate scenarios into insurers' Own Risk and Solvency Assessments (ORSA). The AAE has already started examining which factors will be appropriate here.

Public awareness must be improved. With this in mind, pensions and insurance savings products should clearly inform policyholders about underlying investment strategies and their social considerations. One problem we recognise in this respect is the risk of 'greenwashed' financial products; as this is facilitated by a lack of established sustainability data in relation to financial products, it could be remedied through implementation of a transparent and rational classification system that implements ESG (environmental, social and governance) criteria.

CLIMATE SUSTAINABILITY & MINIMISING THE CLIMATE PROTECTION GAP

Pension funds and insurers can influence climate action in several ways: as long-term investors, their investment behaviour can significantly contribute to a more sustainable future by favouring 'greener' activities. It should be noted though, that immediate restructuring is likely to be impossible in many cases, due to the long-term nature of the investments in question. However, >

fundholders should be aware that delaying portfolio changes means assets could eventually be stranded.

The investment activities pursued by insurance and pensions funds can also actively promote the structural changes needed for long-term climate protection. AAE supports facilitation of investments which directly fund relevant transition projects, particularly in the form of structured green bonds or loans. Such products may need to be backed by governments and central banks; done correctly, these could be very attractive long-term investments.

Though non-life insurance is expected to be critical for mitigating losses caused by climate events, a greater focus on ESG criteria in underwriting is likely to make some risks increasingly unfeasible to insure over time, as the expected changes in climate have a progressively heavier impact. We believe that managing this will require insurance companies and public policy to come together and develop joint solutions. Here, consultant actuaries would be involved in ensuring the early identification of such protection gaps and maintaining coverage for those who need it. To be able to achieve this, as with ESG-oriented impact underwriting, reliable and appropriate data needs to be available; new data techniques may be required. Moreover, revised approaches will necessitate new products involving dynamic and static risk prevention, discounts as well as other incentives supporting climate-oriented behaviour change and actions to improve overall resilience against climate effects. Identifying the best levers for such new approaches will be another task for actuaries.

Ultimately the climate crisis requires consistent and targeted action – ideally on a worldwide basis – with no opportunities to ignore risk-based and scientifically sound rationales. Actuaries and the AAE are ready to take their place in supporting comprehensive, appropriate carbon and pollution accounting as well as valuation approaches, to uncover any such weak points that may exist. Sustainability cannot simply be an optional extra – all of us depend on it. <

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