ESG investing
Challenges for the Insurance Industry

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Agenda

ESG investing. Challenges for the Insurance Industry

ESG investing. Recent evidence from the OECD perspective

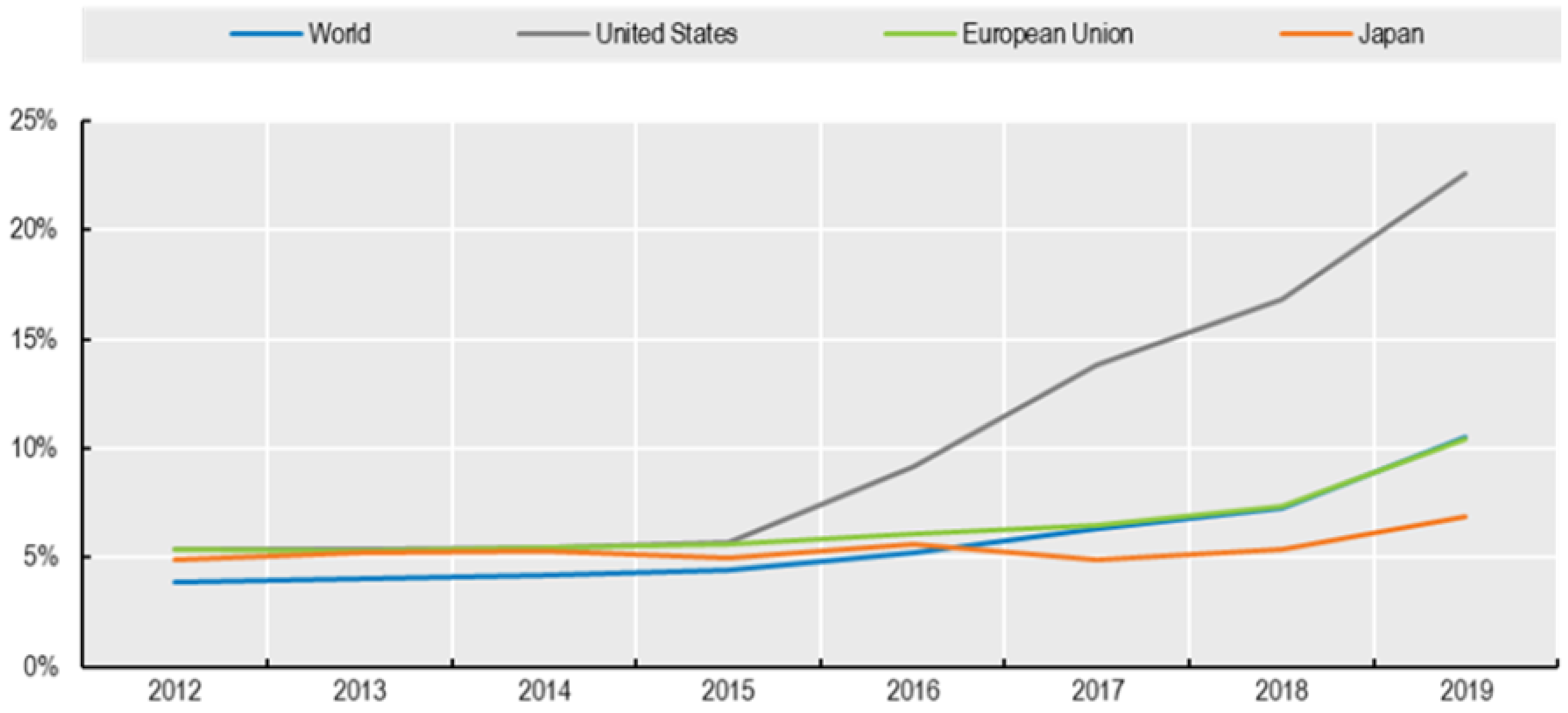
Challenges for the Insurance Industry in Europe

- EIOPA Opinion on Sustainability within Solvency II
- The Industry position

ESG investing. Recent evidence from the OECD perspective

ESG market coverage share

The percentage of market coverage is relatively low, particularly outside the US, even though it has greatly increased in recent years



Note: Calculated as the number of public companies with an ESG score over the total number of public companies, in each year.

OECD empirical research on ESG investing, 2020

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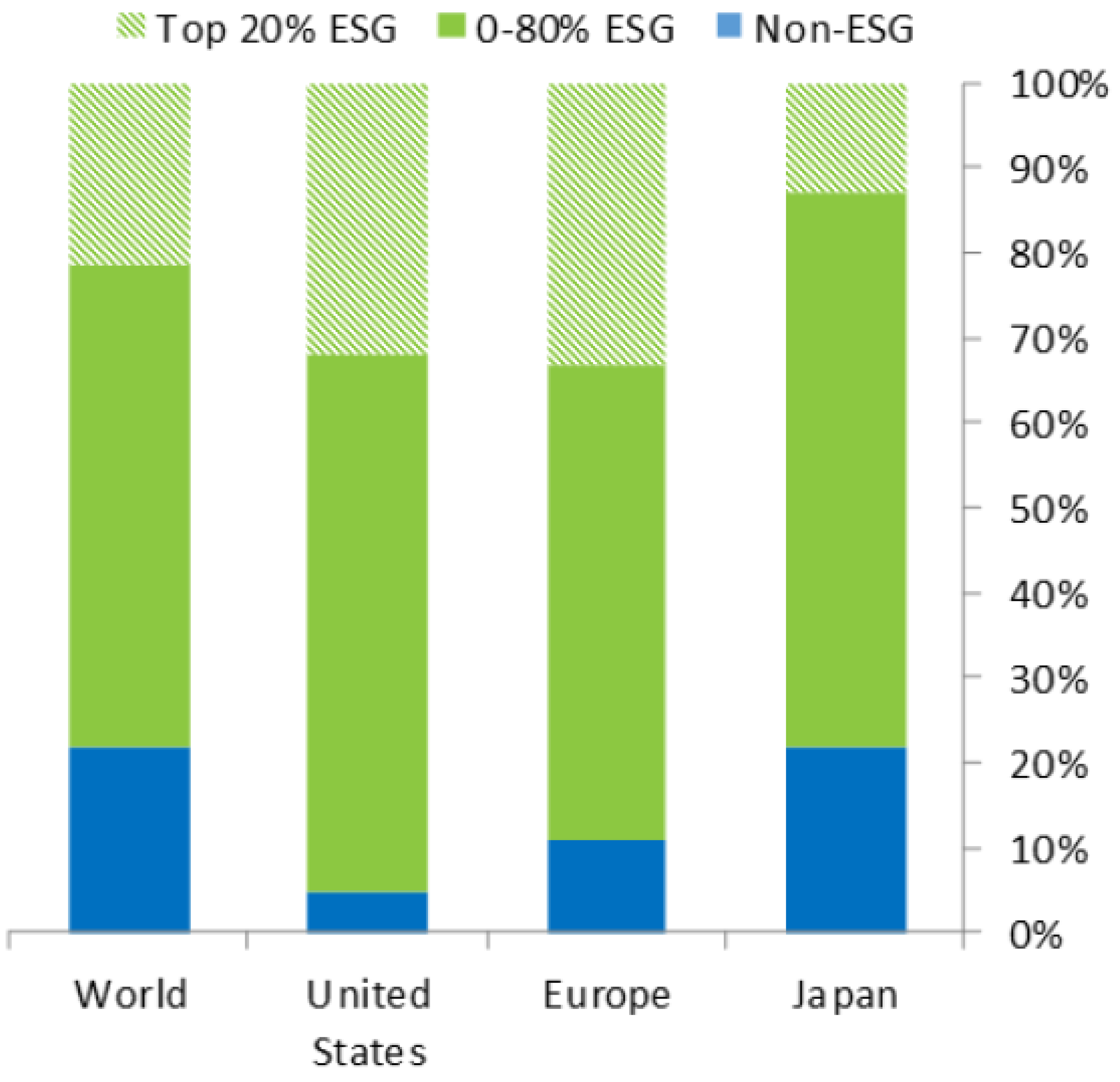
ESG market coverage share

When considering market capitalisation, we notice a different pattern: The market capitalisation of all ESG scoring companies represents 78% of the total market capitalisation in the world, 95% in the US, 89% in the EU, and 78% in Japan

Therefore, the ESG environment is dominated by large capitalised companies



Source: Refinitiv, OECD calculations

OECD empirical research on ESG investing, 2020

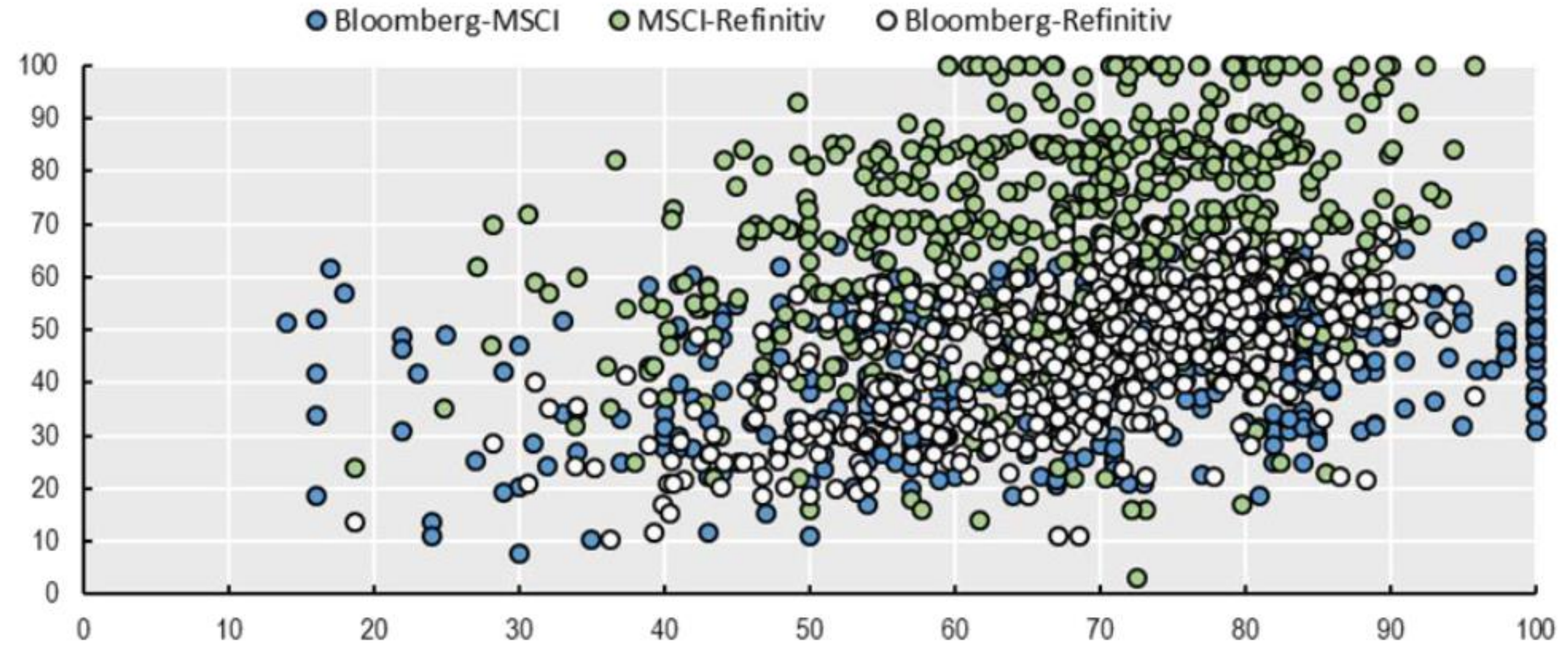
ESG scores from major ratings providers vary greatly

STOXX 600 ESG ratings correlation for different providers, 2019

The OECD assessed different rating providers (Bloomberg, MSCI and Refinitiv)

The figure refers to the component companies of each the STOXX 600 index and looks at the correlation of different ratings on each constituent

The average R^2 of 0.18 for the STOXX 600 is calculated as the average of three two-way correlations for each components

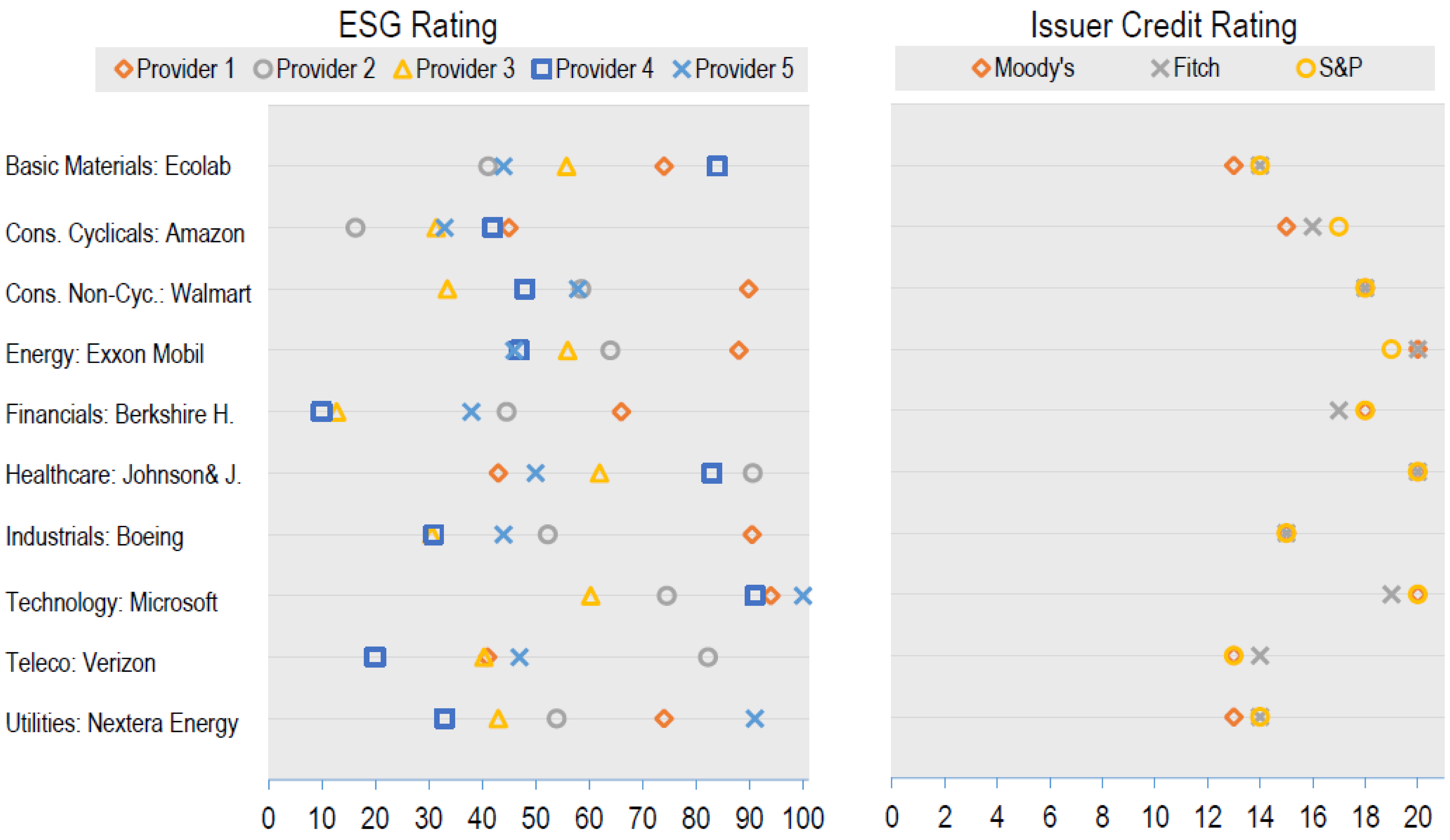


Note: Providers' names in the legend correspond to the Y axis when at the left and to the X axis when at the right (e.g.: Bloomberg-MSCI; Bloomberg = Y axis, MSCI = X axis).
Source: Bloomberg, MSCI, Refinitiv, OECD Staff calculations

OECD empirical research on ESG investing, 2020

ESG scores vary much more than Credit scores

Credit scores of individual issuers are much less divergent than those ESG



Note: Sample of public companies selected by largest market capitalisation as to represent different industries in the United States. The issuer credit ratings are transformed using a projection to the scale from 0 to 20, where 0 represents the lowest rating (C/D) and 20 the highest rating (Aaa/AAA).
Source: Refinitiv, Bloomberg, MSCI, Yahoo finance, Moody's, Fitch, S&P; OECD calculations

OECD empirical research on ESG investing, 2020

OECD

Key messages

- ESG scores of firms are largely dependent on the methodologies of providers (either ESG raters or portfolio managers themselves)
- Are current ESG scores able to provide value to end investors ?

OECD recommendation for Europe

i. ensuring relevance and consistency in reporting frameworks for ESG disclosure;

ii. opacity of the subjective elements of ESG scoring;

iii. improving alignment with materiality and performance;

iv. overcoming the market bias;

v. transparency of ESG products alignment with investors' sustainable finance objectives related to financial and social returns;

vi. public and regulatory engagement

Challenges for the Insurance Industry in Europe

EIOPA Definition of climate change risk

Physical risk
Transition risks
Liability risks

Physical risks

- arise from a number of factors, and relate to specific weather events (such as heatwaves, floods, wildfires and storms) and longer term shifts in the climate (such as changes in precipitation, extreme weather variability, sea level rise, and rising mean temperatures)

Transition risks

- can arise from factors influence this adjustment, including: climate change related developments in policy and regulation, the emergence of disruptive technology or business models, shifting sentiment and societal preferences, or evolving evidence, frameworks and legal interpretations

Liability risks

- come from people or businesses seeking compensation for losses they may have suffered from the physical or transition risks transferred by means of liability protection, such as Directors & Officers and Professional Indemnity insurance
- are likely to fall under three different categories: failure to mitigate; failure to adapt; failure to disclose

EIOPA Opinion on Sustainability within Solvency II, 2019

EIOPA Opinion
Key messages

EIOPA is committed to the international and European agenda on sustainability

Problem is the "tragedy of the horizon" coined by Mark Carney : market participants tend to believe that they have time to adapt their strategy

Valuation of assets

Valuation of liabilities

Investment practices

- it is prudentially relevant to require undertakings to take into account the impact of their investment activity on sustainability factors
- initiatives such as the EU taxonomy and the disclosure of sustainability risks will improve the industry's efforts
- EIOPA supports further transparency on sustainability ratings as well as on how ESG factors are currently considered in credit rating issuance

Underwriting practices

Capital requirements

- any change to capital requirements must be based on a proven risk differential compared to the status quo.

Internal models

Challenges in integrating sustainable finance in Pillar 1

- the medium to long-term impacts of climate change cannot fully be captured in the Solvency II capital requirements which are designed to reflect the risks that undertakings are exposed to over a one-year time horizon
- complementary tools such as scenario analysis and stress testing would be more appropriate to capture impacts of climate change

EIOPA Opinion on Sustainability within Solvency II, 2019

Industry
Key messages

(1/2)

The industry can play a key role in the sustainability transition by:

1) **investing in sustainable assets**
2) **providing insurance coverage to help the society to deal with sustainability risks**

The insurance industry commitment

- the insurance industry supports the ambitious objectives of the European Green Deal to make the EU economy sustainable, meaning an economy with net-zero greenhouse gas emissions by 2050initiatives such as the EU taxonomy and the disclosure of sustainability risks will improve the industry’s efforts
- these fundamental policy ambitions must be pursued despite the significant, new challenges created by the COVID-19 pandemic
- all economic sectors need to act jointly. For insurers to be able to contribute even further to the transition, an increased commitment is needed by companies and governments to financing sustainable projects and issuing green bonds which meet EU sustainability standards

Sustainable investments

- the demand for attractive sustainable assets is not matched by the availability of such assets
- right incentives are needed to stimulate sustainable transformation, by supporting projects and activities that will increase the volume of such investments
- policy actions should also focus on appropriate design and calibration of regulations to better reflect the long-term nature of the insurance and pension business. This does not mean introducing artificial incentives/disincentives inconsistent with risks
- The development of an EU Green Bond Standard is welcome: It is key that all its core components remain standardised at EU level to safeguard transparency, uniformity and comparability

Industry
Key messages

(2/2)

The EU sustainable finance tools (eg taxonomy, disclosures, etc.) can be used to promote the private investments needed to spur the green recovery

Company reporting and transparency

- increased transparency on sustainability is welcome, but it is not sufficient to create the sustainable investments needed to finance the transition and the recovery
- comparable and reliable ESG data is ultimately needed to enable investors to steer their portfolios towards the objectives of the European Green Deal and comply with their disclosure obligations
- the industry supports a centralised electronic EU register for ESG data, meeting the ESG requirements under the Non-Financial Reporting Directive (NFRD), Taxonomy and Disclosures regulations
- investee companies should be directly required to report standardised ESG data on a mandatory basis
- mandatory reporting by investors of indicators that require ESG data from investee companies should be phased-in with the availability of data

Management of climate risks

- the green recovery needs to focus on building an economy resilient to climate risks
- insurers are uniquely positioned to contribute to achieving a resilient economy and have a key role to play in advising public authorities on prevention, adaptation and risk management measures
- The EU has a role to ensure weather-related risks remain insurable despite climate change, notably by incentivising member states to adopt ambitious adaptation measures and by sharing good practices promoting climate-related risk management mechanisms for businesses and citizens across Europe

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Thanks for your attention