Climate Risk Management for Insurers – Benchmarking: Update to November 2021 paper

Solvency II Wire

ROYAL LONDON ASSET MANAGEMENT

Climate risk management and the resultant disclosures remain a key focus for insurers, driven by developing regulations and wider stakeholder demand.

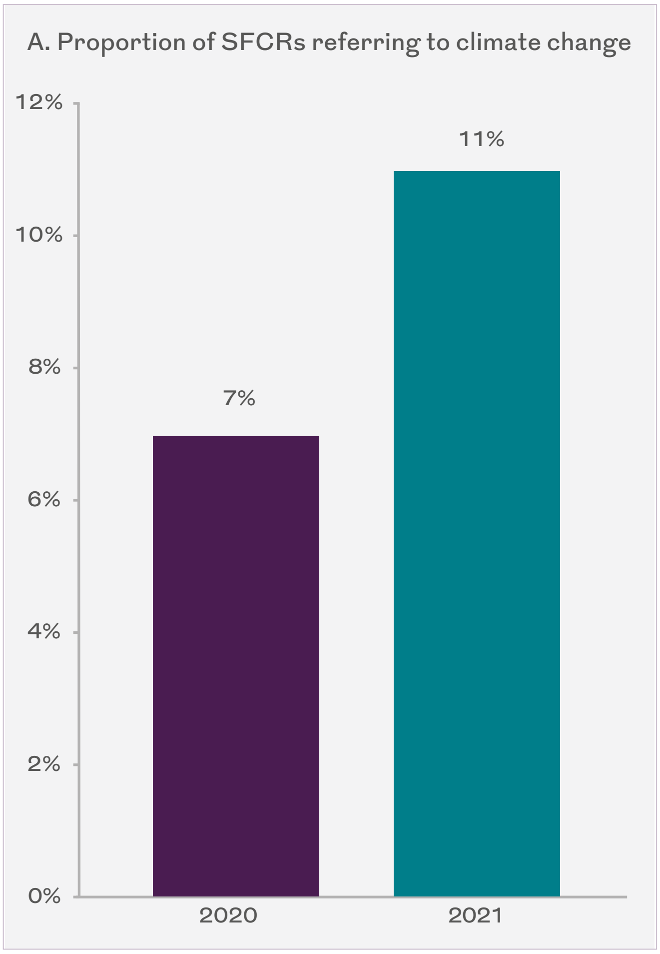
To assess how the industry has been approaching this critical topic, we analysed the climate-related public disclosures of European and UK insurers in 2021. The analysis was published in our November 2021 paper which was produced in collaboration with Solvency II Wire 'Climate Risk Management for Insurers – Benchmarking of Emerging Best Practice'[1].

Recognising that this is an area of rapidly evolving practices, we provide an update, again in collaboration with Solvency II Wire of the analysis based on the 2021 year-end disclosures.

The analysis draws on two main data sources:

1. A systematic search for key terms relating to climate risk in the Solvency and Financial Condition Reports (SFCRs) of c. 2,500 European insurers subject to Solvency II.
2. A detailed review of the approaches taken by a sample of 20[2] of the largest European and UK insurers to provide more granular insights into the disclosures and identify current practices and future 'best practice'.

A summary of our findings is presented in the table and annexes below.

Area	Main conclusions
	SFCR Analysis
A. SFCR analysis  Source: RLAM as at May 2022	• Text search analysis of c. 2,500 SFCR reports to identify references to key ESG (Environmental, Social and Governance) and climate risk terminology. • The analysis covers about 70% of the firms as not all insurers have published their 2021 SFCRs to date. • Even allowing for the smaller 2021 dataset, the overall upward trend of disclosing climate information in the SFCRs continues. This is consistent with a growing awareness that the risks attached to ESG are often material (particularly around climate change) and hence should be covered to some extent in SFCRs. • However, just over 1 in 10 of the reports referenced climate change. • All of the four representative terms selected (ESG, climate change, carbon and climate risk) were more prevalent in the 2021 reports. • Figures for the terms carbon and climate change have almost doubled since 2020, while ESG rose from 21% to 34%, but climate risk remains almost unchanged. • The disclosure of net zero targets increased from 26 in 2020 to 72 but carbon footprint remained unchanged with 31 in 2020 and 2021. • Mention of climate-risk scenarios and their inclusion in the ORSA (Own Risk and Solvency Assessment) process also seem to be more prevalent. However, terms such as *Scope 1* barely registered in the search.

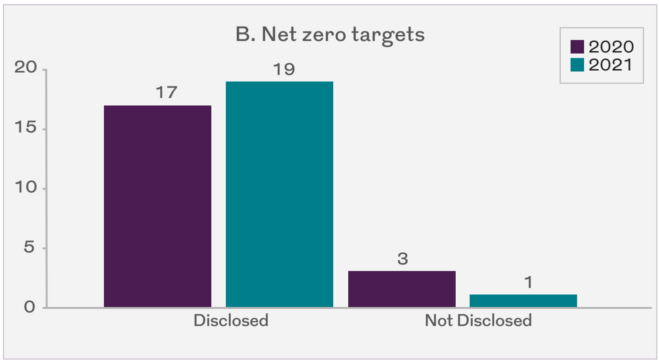
[1] Climate Risk Management for Insurers – Benchmarking of Emerging Best Practice' is available at: https://www.rlam.co.uk/institutional-investors/our-views/2021/climate-risk-management-for-insurers--benchmarking-of-emerging-best-practice/

[2] List of insurers can be found in Appendix A.

- Within the sample of the larger insurers, most provided some climate-related information in their 2020 SFCRs.
- Information published in the 2021 SFCRs was mostly along similar lines, with a few companies expanding on their activities and figures provided. For example, both Pension Insurance Corporation and Canada Life now have dedicated climate change sections in their SFCRs.
- In all cases the volume and level of detail was significantly lower than in other publications, with fewer than half publishing actual figures, instead describing this qualitatively.
- Both Sampo and Tryg did not publish any climate-related information in their SFCRs in both years, this despite extensive information disclosed publicly elsewhere.

Benchmarking of larger insurers

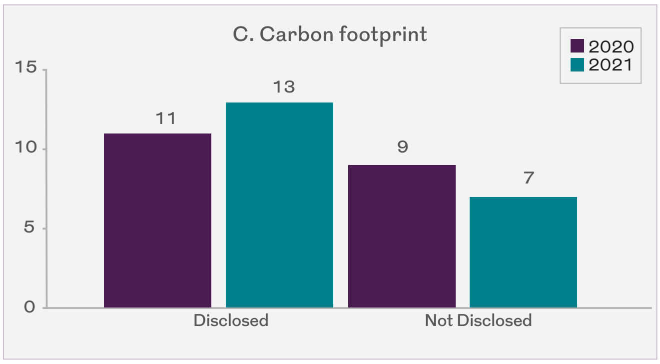
B. Net zero targets



Source: RLAM as at May 2022

- All but one of the 20 insurers in the benchmarking group (Tryg being the exception) have now disclosed a net zero target for their businesses.
- Two of the insurers that did not disclose a target in 2020 have done so for 2021 (Sampo and Mapfre). The targets are aligned with the Paris agreement of achieving net zero by 2050.
- Aviva is the only insurer targeting net zero in advance of 2050 – by 2040.
- The most common intermediary target is to achieve net zero for operations by 2030. More insurers have committed to the target in their 2021 disclosures.

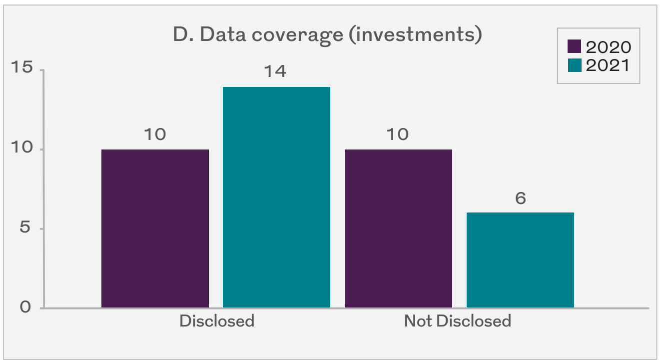
C. Carbon footprint



Source: RLAM as at May 2022

- Of the seven European insurers that disclosed their carbon footprint last year, five have reported a reduction since 2020.
- Of the UK insurers, both Aviva and Lloyd's disclosed updated and substantially reduced carbon footprint figures.
- Pension Insurance Corporation started disclosing this metric in 2021.

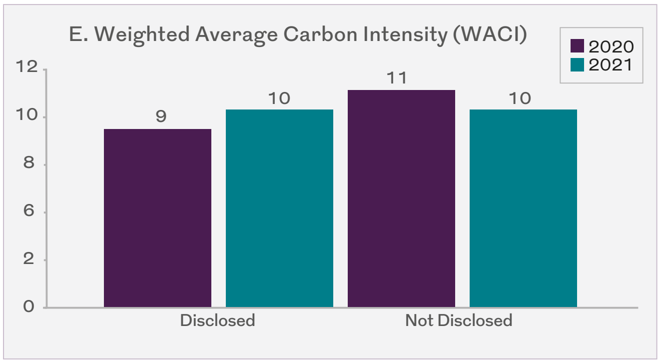
D. Data coverage (investments)



Source: RLAM as at May 2022

- Data coverage for investments was the least reported on in the 2020 data set.
- Of the seven European insurers that disclosed the metric previously, four updated their figures, with most reporting increased coverage from 2020.
- The biggest increase in data coverage was reported by Sampo Group (62% in 2020 compared to 92% in 2021).
- In the UK, one out of the three insurers that disclosed this metric previously provided updated figures. Most notably, Phoenix Life's data coverage increased from 75% to 87%.
- The average data coverage for both European and UK insurers increased over the year (by 6% and 4% respectively) reflecting the extensive efforts from both insurers and their underlying investment managers to increase coverage.

E. Weighted Average Carbon Intensity (WACI)



Source: RLAM as at May 2022

- There is a high divergence of disclosures for the level of Weighted Average Carbon Intensity (WACI) between the insurers in the comparator group.
- L&G remains the insurer that disclosed the highest level of WACI, which has remained unchanged from 2020.
- The WACI of all the UK insurers remained unchanged from last year, apart from Aviva, whose WACI score has decreased.
- Of the European insurers, 3 updated their figures. Generali Group's WACI has increased from 2020, whilst for Allianz and Sampo this has decreased.

F. Use of 'Green' investments

- The trend for the larger European insurers to make specific investment allocations to green assets has continued.
- However, we note that these remain a relatively small part of these insurers' overall asset allocations.
- Examples of recent green investments include: Swiss Re committing at least USD 4bn in green, social and sustainability bonds by the end of 2024 and Tryg allocating DKK 60m to developing renewable energy sources in East Africa.

Conclusion

In all the areas we surveyed, there is an overall improvement in the volume of disclosures and their quality, pointing to the fact that the insurance industry has been upgrading its capabilities to identify, quantify, report, and manage climate-related financial risks.

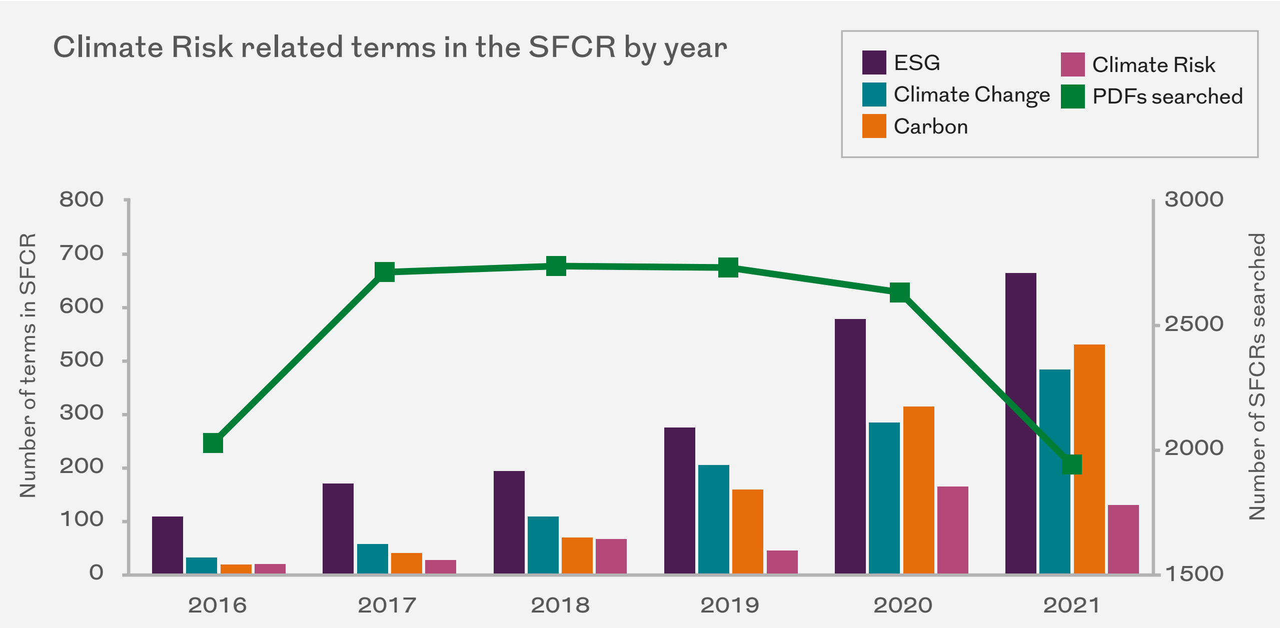
The analysis shows that the largest European insurers have been making further progress relative to last year — both in terms of the metrics being disclosed and the impact of climate risk on their businesses — for example, increased data coverage and reducing carbon intensity.

In addition, wider analysis of the SFCR reports shows that the market as a whole is now disclosing information around ESG and climate-related risks when they did not previously. However, the scope and detail of the disclosures in the SFCRs falls short of what is expected if the reports are to become a meaningful go-to document for assessing all risks faced by an insurer.

Delivering the required capabilities to meet the demands of climate risk disclosure has been a major effort for many insurers — especially given the other challenges they are facing around regulations, the investment environment, and the ongoing operational disruption from the pandemic. At the same time, the development of climate risk and disclosure frameworks and increased expectations from stakeholders for more robustness in the approaches, means that climate-related risk is likely to remain a key area of focus for most insurers for years to come.

Appendix A – results of benchmarking analysis

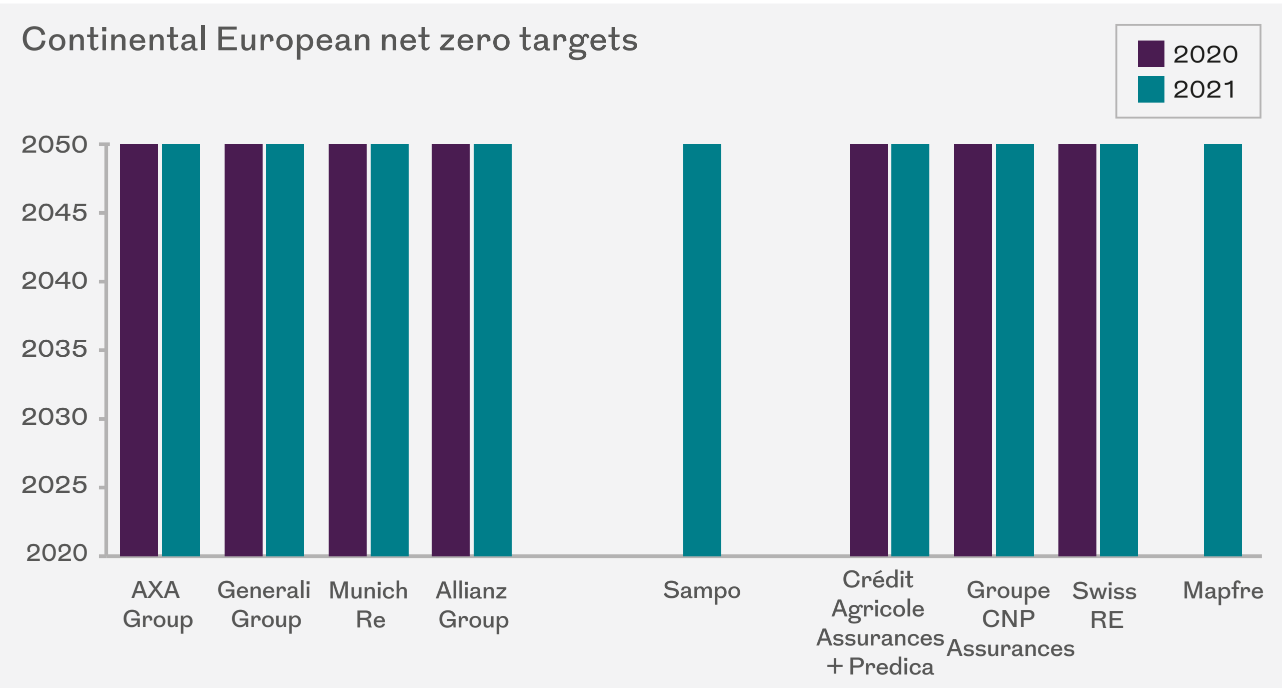
A. SFCR analysis[3]



Source: RLAM as at May 2022

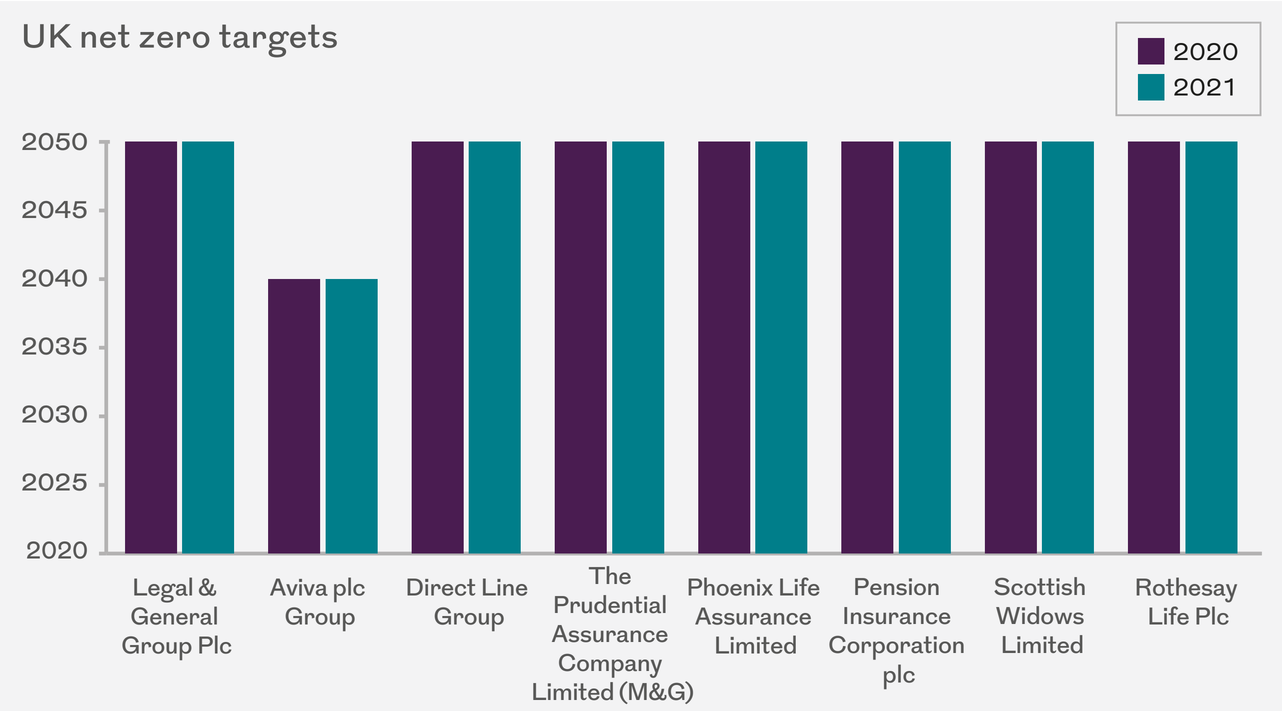
Analysis of large insurer benchmarking group[4]

B. Net zero targets



[3] The SFCR analysis was conducted using the Solvency II Wire Data insurance database. Search terms were translated into the languages of the major markets. Some duplication may arise due to those entities that publish a single group SFCR for all solos. The number of SFCRs analysed varies each year depending on the number of reporting entities and quality and availability of the reports.

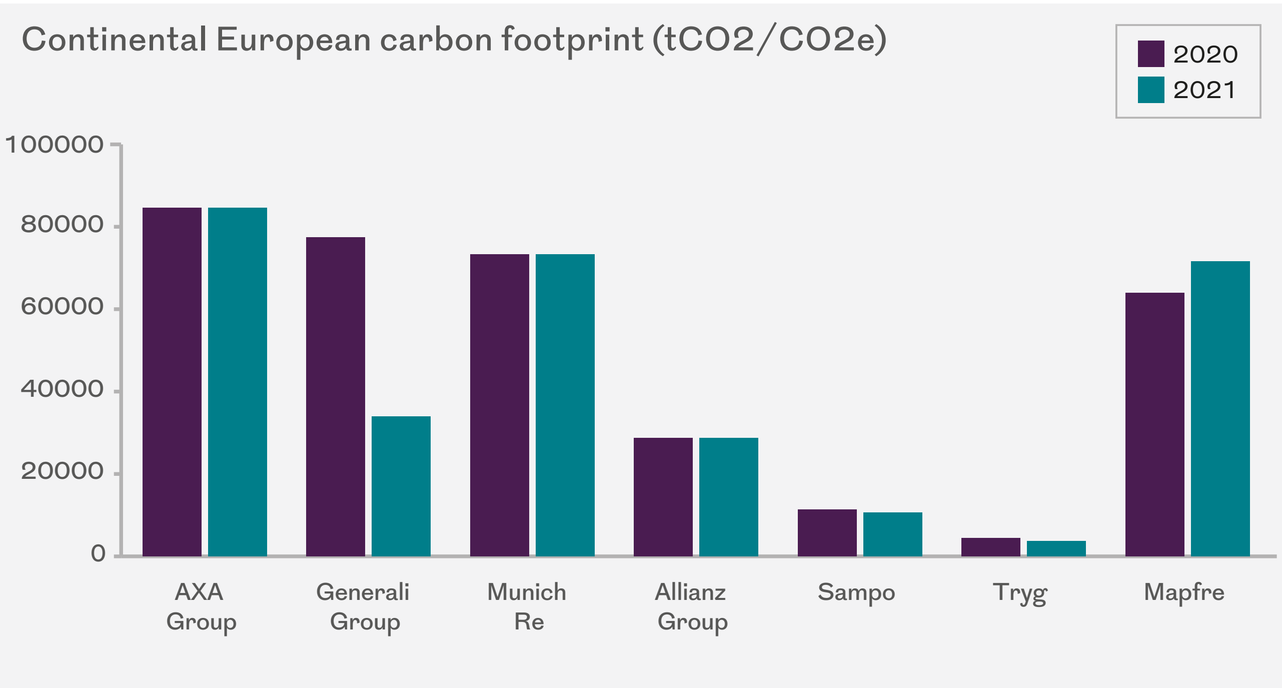
[4] The analysis includes 10 UK insurers (Aviva, Canada Life, Direct Line Group, Legal and General, Lloyd's of London, M&G, Pension Insurance Corporation, Phoenix Life, Rothesay Life, Scottish Widows) and 10 Continental insurers (Allianz, Axa, CNP, Credit Agricole, Generali, Mapfre, Munich Re, Sampo, Swiss Re, Tryg).

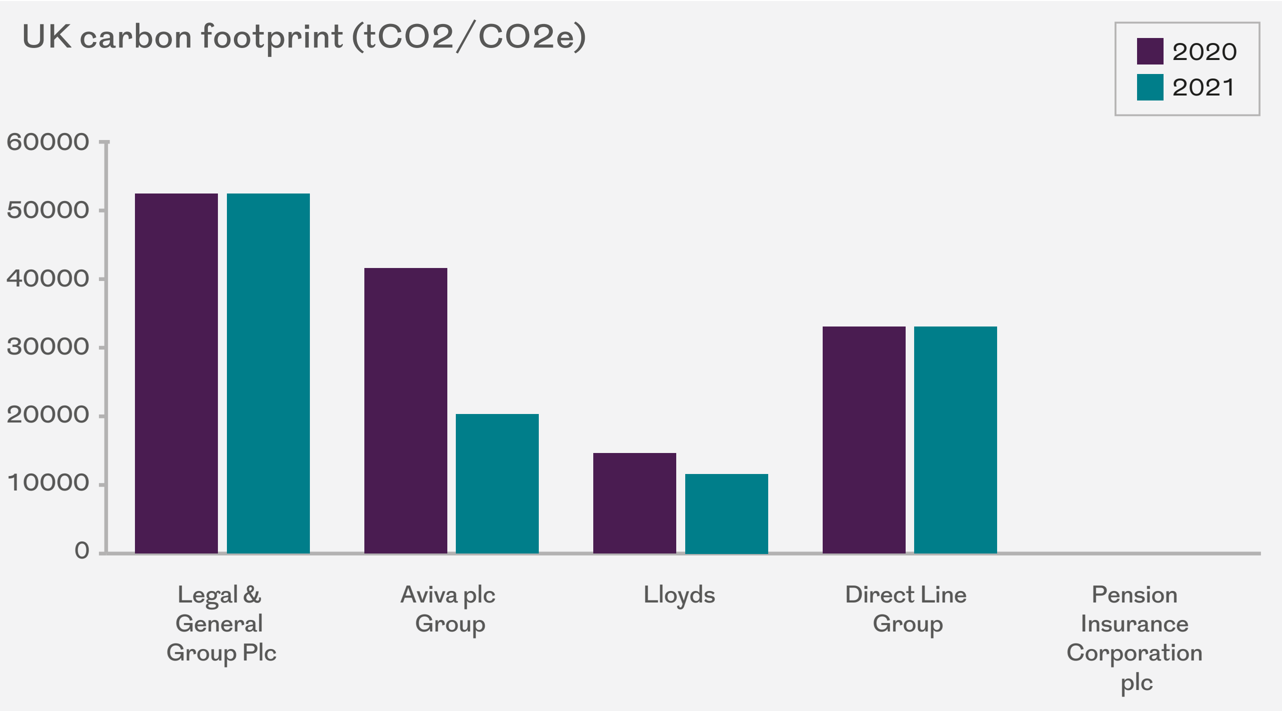


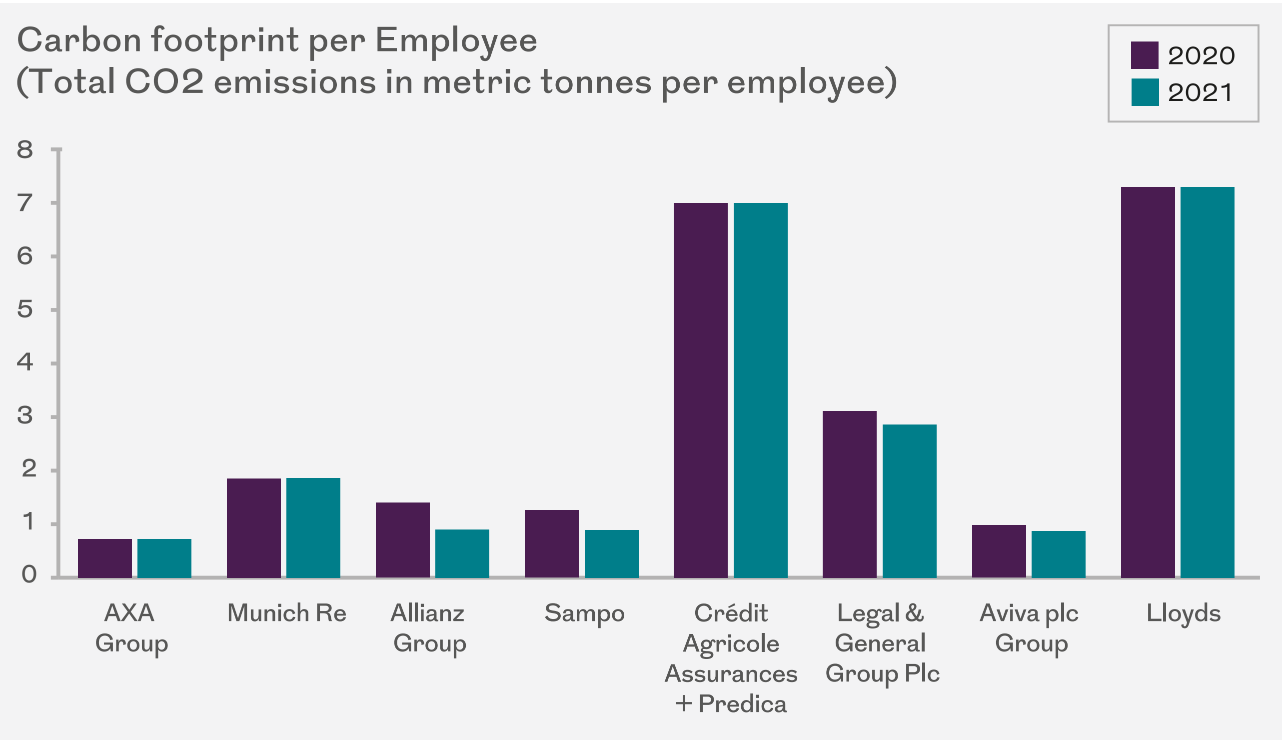
Not disclosed: Tryg

Source: RLAM as at May 2022

C. Carbon footprint



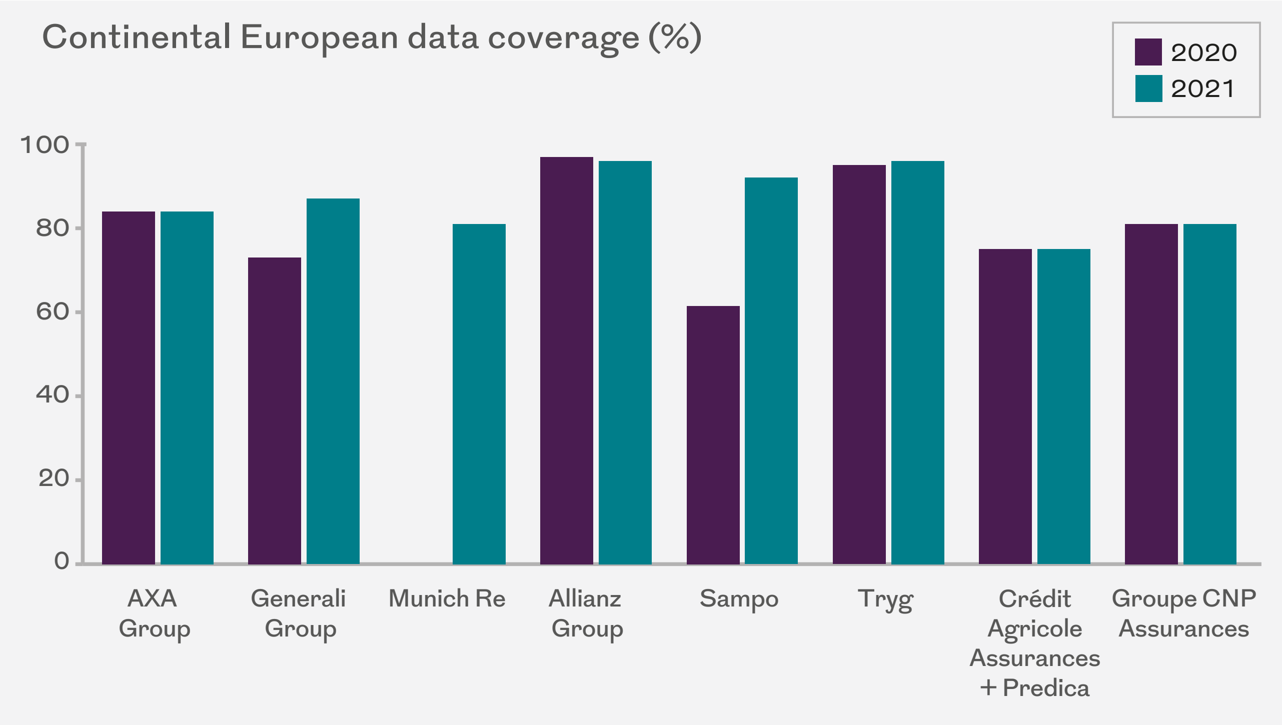


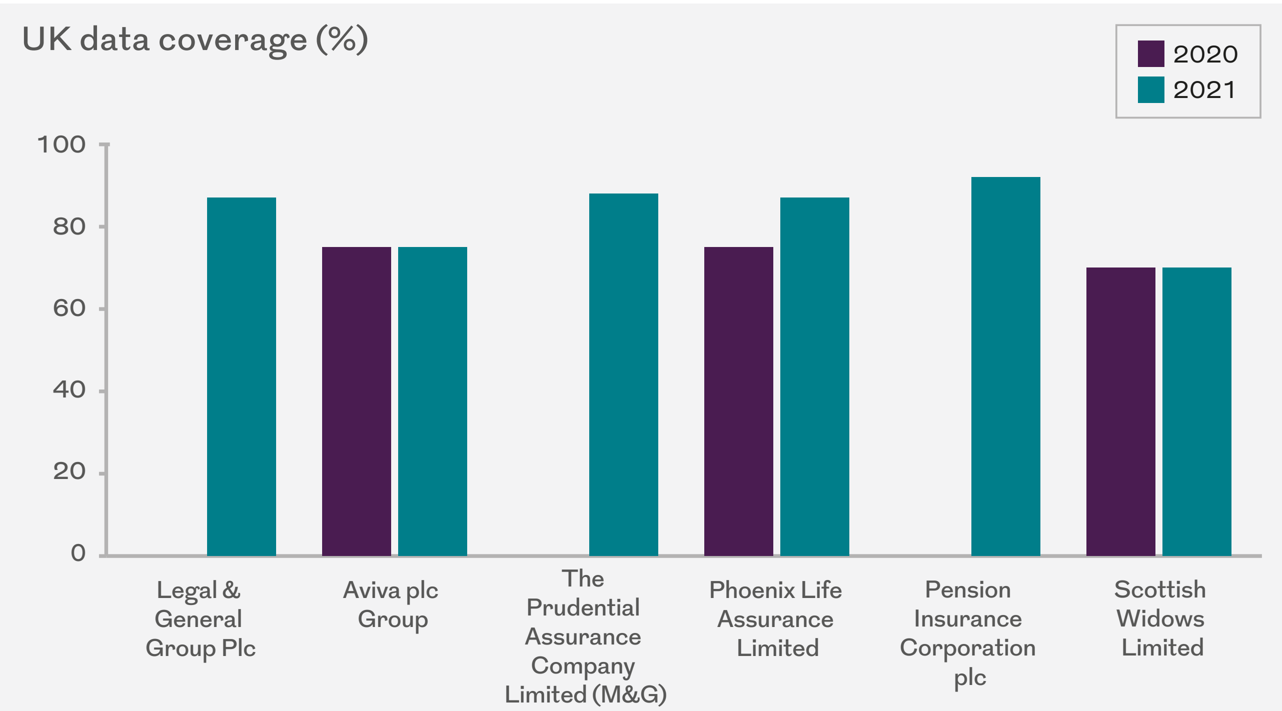


Not disclosed: Group CNP, Swiss Re, M&G, Phoenix Life, Scottish Widows, Canada Life, Rothesay

Source: RLAM as at May 2022

D. Data coverage

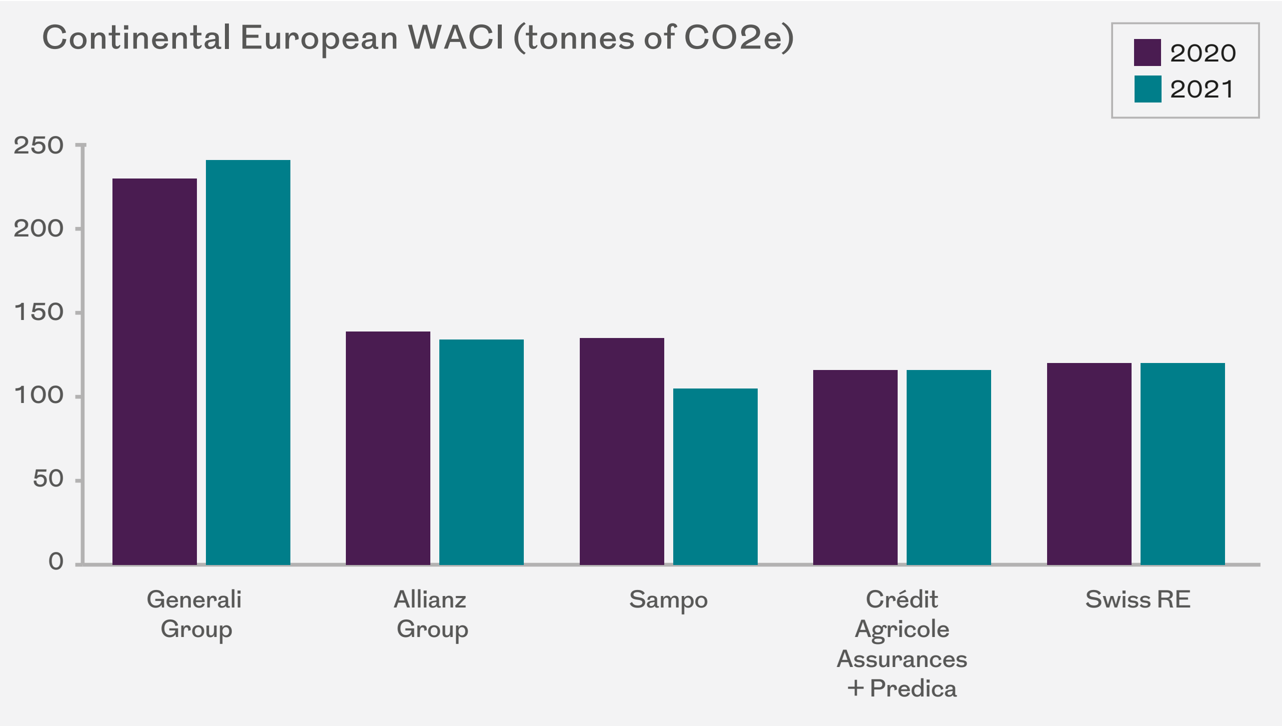


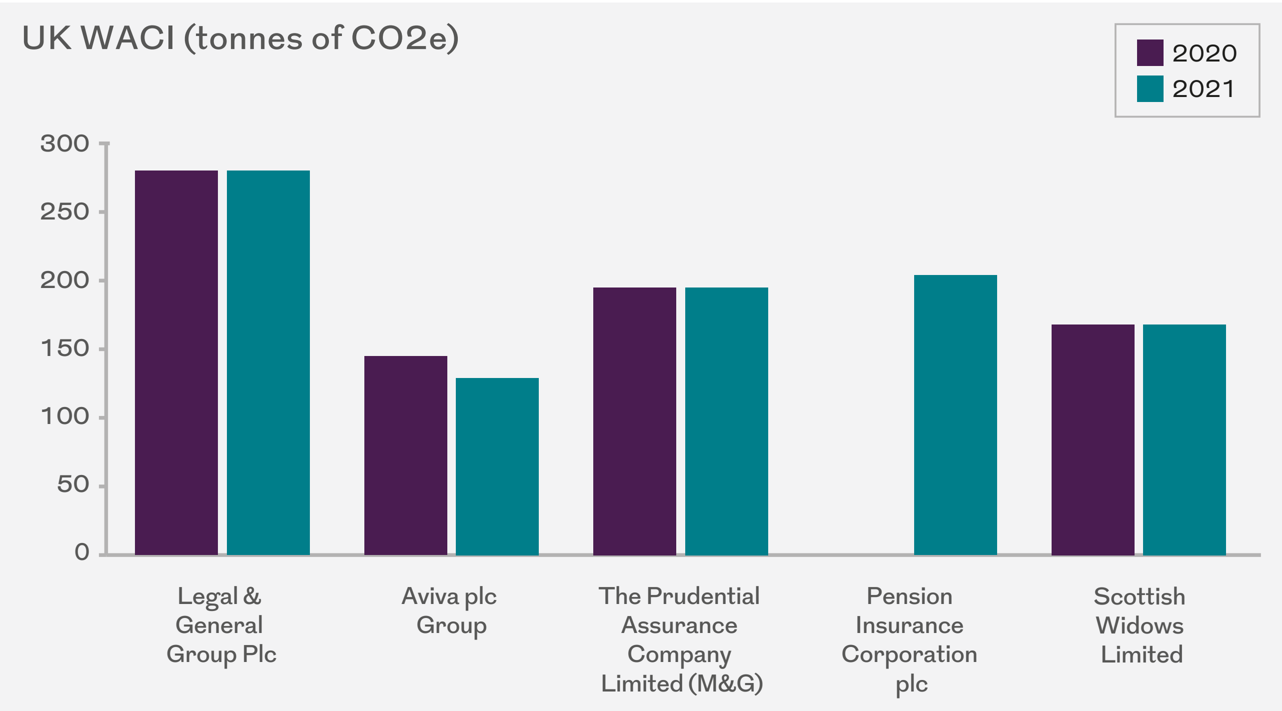


Not disclosed: Swiss re, Mapfre, Lloyd's, Direct Line Group, Canada Life, Rothesay Life

Source: RLAM as at May 2022

E. Weighted Average Carbon Intensity (WACI)





Source: RLAM as at May 2022

F. Use of 'Green' investments

Examples of additional 'Green' investments announced since our last paper include:

- Swiss Re has committed to holding at least USD 4 billion in green, social and sustainability bonds by the end of 2024.
- Allianz Real Estate and other Allianz operating entities invested proprietary assets totalling € 6.4 billion (2020: € 5.6 bn) in green buildings, including equity and debt investments. This equals a share of 11% of their total real estate portfolio of € 59.5 billion.
- Tryg are further contributing to the green transition, they have committed DKK 60m to continue their investment in developing renewable energy sources in East Africa.

Appendix B - update on regulatory developments and wider expectations

Insurance focused	
BANK OF ENGLAND PRUDENTIAL REGULATION AUTHORITY	• Dear CEO' letter (12 January 2022) - Insurance supervision of climate related financial risks into core supervisory approach • PRA speech (2 March 2022) - supervisory priorities. Climate change and ESG considerations one of four top priorities
HM Treasury	• Consultation around Solvency II changes post-Brexit (28 April 2022) including objective to promote more sustainable longer term investments
eiopa EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY	• Sustainable Finance Activities (7 December 2021) outlined its priorities to address sustainability risks over the period 2022-2024 • Climate change risk scenarios in the ORSA (10 December 2021) • Financial stability report (13 December 2021) ESG risks remained the top risk in terms of the highest expected increase in materiality for insurers, because of the increasing intensity and frequency of climate events • Discussion paper on physical climate change risks (20 May 2022)

Wider initiatives	
BANK OF ENGLAND	• Second round of its Biennial Exploratory Scenario (CBES) (9 February 2022), with 21 insurers participating in addition to banks, to assess the financial risks posed by climate change • Results from CBES published on 24 May 2022 together with Sam Woods speech. • Climate change costs viewed as manageable if they acted now - but any delay could mean higher costs for them and their customers
FCA FINANCIAL CONDUCT AUTHORITY	• Consultation around Sustainability Disclosure Requirements and investment labels (3 November 2021)
FSB FINANCIAL STABILITY BOARD	• Supervisory and Regulatory Approaches to Climate-related Risks - Interim Report 29 April 2022

Contact us

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Royal London Asset Management
55 Gracechurch Street
London EC3V 0RL

rlam.com

Andrew Epsom
Insurance Client Solution Director
0203 272 5594
andrew.epsom@rlam.co.uk

Isabelle Buckland
Business Development Executive
0203 272 5428
isabelle.buckland@rlam.co.uk

For Solvency II Wire
Gideon Benari
Editor
gideon.benari@solvencyiiwire.com

Ref: AL RLAM PD 0141

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