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THE INDUSTRY'S RESOURCE HUB

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Hope Springs Eternal

FEATURED INTERVIEW

Meet Mitch He, CIO of Chesapeake Employers Insurance

Thought Leadership for the Insurance Investment Community

The unique climate change risks facing insurers

- **Global warming brings unique risk to both assets and liabilities**
- **Robeco can help to analyze and mitigate carbon risks in portfolios**
- **Solutions available to reduce the carbon footprints of investments**

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Climate change presents insurers with unique risks, from paying weather-related claims to finding lower-carbon investments. A new white paper by Robeco examines the whole issue and offers some solutions.

Global warming has become undeniable and no industry has greater exposure to its risks than the insurance sector. It's not only the rising costs from claims for damage to property caused by increasingly severe weather. Insurers invest the premiums they receive in financial markets to gain enough returns to fund their liabilities.

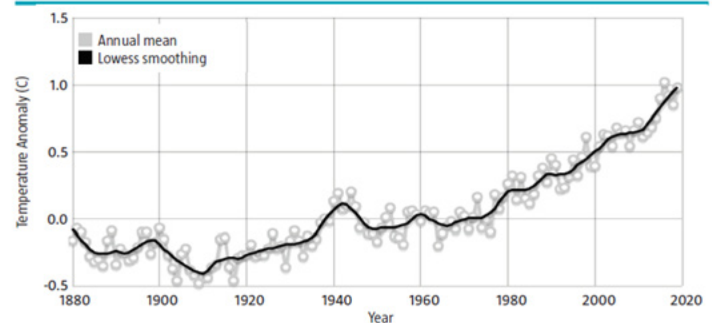
These investee companies are themselves exposed to climate risk, particularly through the need to decarbonize in the transition to a low-carbon economy. This creates a double whammy for insurers and it urgently needs addressing.

MULTIPLE ANGLES

A new white paper from the insurance team at Robeco entitled 'Climate change: a problem that insurance companies can't afford to ignore' examines the issue from multiple angles. First, there are the costs: the ever-increasing bill for claims from storm damage or flooding raises the question about what will be insurable in the future. Businesses near the coast or on flood plains may find themselves being rejected for cover.

The far bigger problem, though, comes from where insurance money is invested. Insurers tend to invest across a wide spectrum of stocks and bonds to spread their risks and raise as much return as possible within their risk budgets. This includes companies that are more exposed to climate change risks than others, plus those that face risks from the need to transition to a lower-carbon business model, such as fossil fuel providers and utilities.

Global land-ocean temperature index



Source: NASA's Goddard Institute for Space Studies (GISS) and Geo Risks Research

ASSET EXPOSURE TO CLIMATE RISK

EIOPA, the insurance regulator in Europe, says more than 10% of European insurers' investment assets are in sectors exposed to the effects of transitioning in response to climate change. But there could be many other losers across sectors as a result of the unknowable and unquantifiable effects of this fundamental shift. And that is where the real risk may lie.

Regulators are now beginning to stress test insurers for their ability to pay future claims. "Where undertakings have long-term assets to match long-term liabilities, they should consider whether climate change would impact either their ability to hold these assets over that timeframe or their expected cash flows," EIOPA says.

ASSESSING RISK IN PORTFOLIOS

At the portfolio level, Robeco has developed 'climate transition risk' sensitivity and stress scenario dashboards to provide an overview of the climate susceptibility of fixed income and equity portfolios. These dashboards show a portfolio's exposure to climate risk, through the distributions of its climate scores, both in absolute terms and relative to its benchmark, and the potential impacts on the portfolio's value and its performance relative to the benchmark.

It is also important to distinguish between equity and fixed income portfolios, since more defensive bond strategies carry less climate investment risk, less return potential and less influence on the company (through voting, which can only be done with equities) than a more aggressive portfolio. Insurers tend to prefer defensive portfolios that can be up to 90% focused on fixed income, so this can be an important consideration.

SOLUTIONS TO REDUCE CARBON FOOTPRINTS

Some portfolios target a lower carbon footprint than the benchmark from the outset, such as those that invest in companies making a net positive contribution to the UN's Sustainable Development Goals (SDGs). Several of the 17 goals are related to combatting global warming, while SDG 13 (climate action) targets it directly.

For insurance fixed income portfolios, Robeco has built customized tooling that enables insurance constraints to be managed, while building in carbon reductions that do not significantly impact expected yields and/or returns.

Even passive portfolios can have their carbon intensity reduced through enhanced indexing, which removes the more carbon-intensive stocks from the benchmark being followed, but without creating a significant tracking error.

Finally, active ownership through voting and engagement can be a powerful tool. Robeco has routinely engaged with oil and gas companies to speed up their transition away from fossil fuels into renewable forms of energy.

THE CHALLENGE OF OUR TIMES

In all, the challenges resulting from climate change for insurers are evident, but at the same time they are in a privileged position to be part of the solution. If insurance companies choose to reduce their exposure to companies that are contributing to climate change or actively encourage them to make profound changes to their business models, they could act as a powerful force for good.

Find out more on this topic in our "The unique climate change risks facing insurers" paper.

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