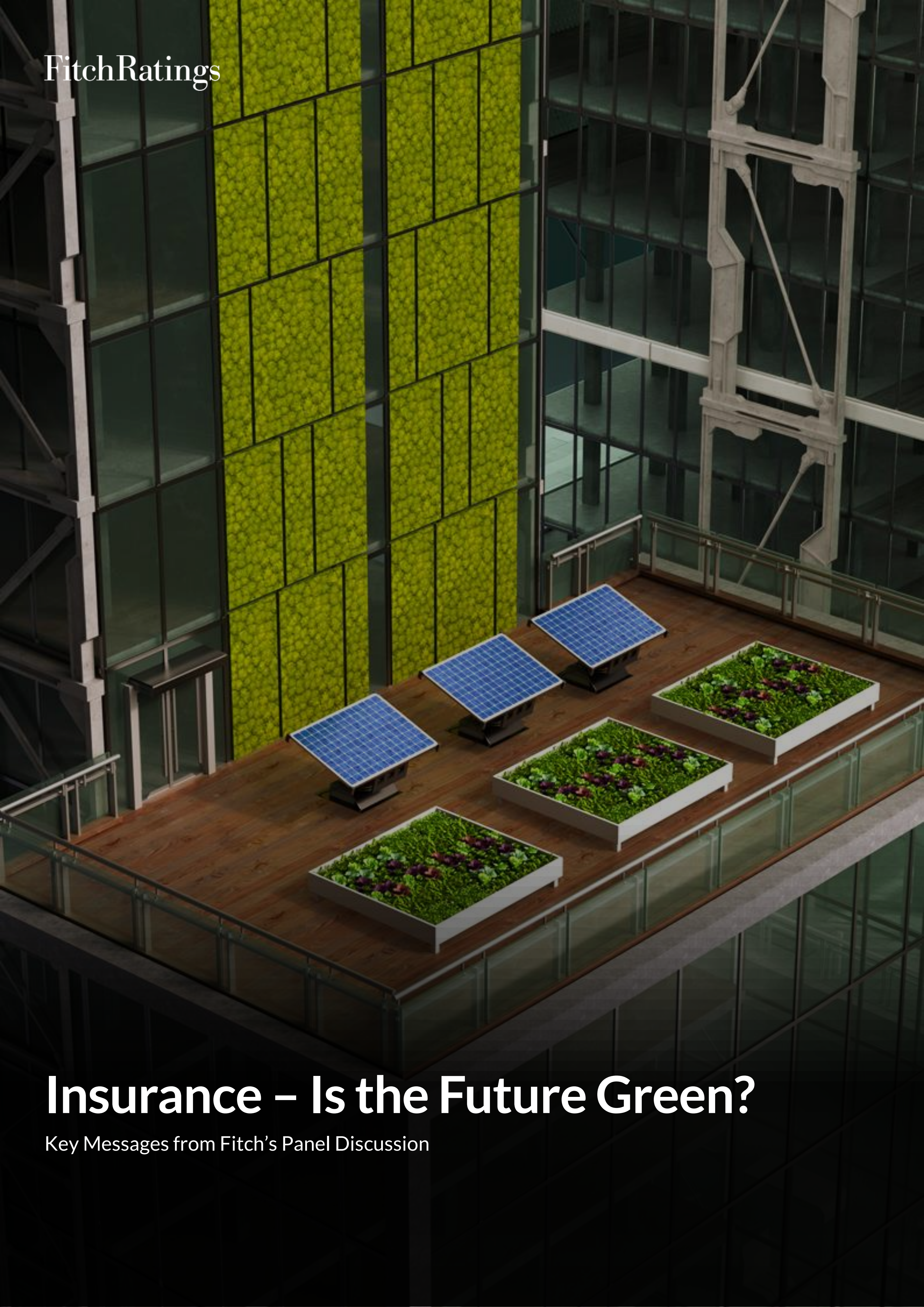

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Insurance – Is the Future Green?

Key Messages from Fitch's Panel Discussion

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> "The insurance sector is well placed to act as an enabler of environmental policies in the move towards a low-carbon economy. The sector is used to assessing long-term risks and it can help redirect finance towards innovative infrastructure sectors in need of long-term funding."
>
> Janine Dow, Sustainable Finance, Fitch Ratings

This report summarises Fitch Ratings' February 2021 webinar exploring 'green' areas of interest for the insurance sector. The key areas discussed were insurance companies' role in supporting the transition to a more sustainable economy, prospects for green bond issuance, and climate change stress testing.

Insurers Are Green-Economy Enablers

The insurance sector could be key in developing a more sustainable global economy. As investors, insurers are demanding more ESG transparency from investee companies and are encouraging them to adopt strategies that support the net-zero carbon targets defined in the Paris Agreement.

A long-term investment focus means insurers are particularly well placed to channel investment into infrastructure projects, notably in the area of renewable energy.

Insurers can design products to reduce some of the risks inherent in infrastructure projects and therefore increase their attraction to investors. The ability to help channel investment into sustainable projects is viewed as a sizeable growth opportunity for the insurance sector by our panellists.

Green Bond Issuance Set to Grow

Insurers are marginal issuers in the green bond market. However, their green issuance is set to grow, especially as attracting ESG investors boosts order books and achieves better pricing for green bonds. In addition, inaugural green bonds are a strong opportunity for insurers to signal their ESG credentials and highlight their sustainable investment strategies.

Stress Tests Inform on Climate Change Risks

Climate change stress tests to be performed in France and the UK – with results expected in April and June 2021, respectively – will make clearer the extent to which the insurance sector is exposed to climate change risks.

Neither test will result in automatic changes to prudential solvency requirements but Fitch believes additional capital charges could be introduced over the medium term given the increased impact of natural catastrophes on insurers' claims ratios and financial profiles.

The tests are a learning exercise and will help inform market participants about data gaps, business model vulnerabilities, weaknesses in risk management and management knowledge gaps. In our view, uncovering these areas is as important as being able to quantify the risks.

Related Research

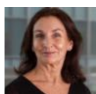
Sustainable Finance: Is the Future Green? (February 2021)

Insurers Well-Equipped to Cope With Climate Change Challenge (February 2021)

Latin American ESG Relevance Scores in Insurers' Ratings (January 2021)

The Next Phase: Megatrends and Financial Institutions' Ratings (November 2020)

Analysts



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Insurance Sector Is Part of Green Solution

The insurance sector is well placed to enable environmental policies in the move towards a low-carbon economy, according to our panellists. Life insurers, who manage large pools of capital and are used to making long-term investments to match the long-term duration of their liabilities, can help redirect finance towards innovative infrastructure sectors in need of long-term funding.

In addition to the industry acting as an investor, it can also assess the new risks associated with innovative infrastructure projects – such as offshore floating solar farms and broader renewable energy solutions – and, by structuring new insurance offerings, can boost the attraction of infrastructure as an asset class for investors. Insurers are experienced at raising debt in the capital markets and investors understand their stable, well-diversified business models.

As such, they are well placed to issue green and sustainable bonds and tap into new investor pools. These instruments also provide a good opportunity for insurers to communicate their green and sustainable investment strategies and explain their role in contributing to transitioning to a greener economy.

Marginal Green Bond Issuance Set to Grow

Insurers are still marginal issuers in the green bond markets. Only five Europe-based insurance companies have issued such bonds: Assicurazioni Generali S.p.A. (Long-Term Issuer Default Rating: BBB+/Stable), Munich Reinsurance Company (AA-/Stable), Just Group plc (A/Negative), Unipol Gruppo S.p.A. (BBB-/Stable) and Swiss Life (not rated). However, we expect growth in this area as insurers become attracted to the potential of tapping into a broader investor base, boosting order book volumes and potentially achieving better pricing on green bonds. The panellists suggested that, to date, insurance companies in Europe have had savings of around 10–15bp on Tier 2 green instruments and around 5–10bp on similar senior instruments.

Pricing benefits generally compensate for additional costs associated with inaugural green bond issuance, including independent certification of the framework, the launch of a green marketing campaign and additional dialogue and communication efforts required to ensure all internal stakeholders are on board. Before embarking on the idea of raising a green bond, one panellist highlighted the importance of raising awareness among internal stakeholders to make sure they fully understand the investment limitations associated with the launch of a green instrument. Funds raised need to be invested in line with criteria, which must be transparently laid out in a green bond framework, and insurers' asset-management teams need to feel comfortable about these restrictions at the outset.

ESG Indispensable, but Returns Are Still Key

The investor panellists made clear that financial returns are still essential as they assess investment opportunities in sustainable and green instruments. Fiduciary duties are central to investment selection criteria and if yields on sustainable investments are lower than those offered on comparable traditional instruments, there must be very clear drivers justifying the differentials. An ESG label alone is not sufficient to hang an investment decision on, but an investee company's failure to address long-term sustainability trends and to demonstrate that it is preparing itself to compete in and contribute to a net zero economy will probably weigh negatively on an investor's decision.

This is because investors are increasingly adopting a holistic approach to investment assessment and recognise that the absence of disclosure around non-financial risks, such as potential fallout from environmental issues, may well indicate potential strategic pitfalls going forward.

Transparent Integration of ESG Strategy

Companies that already integrate ESG principles into their strategy are better placed to attract investment. Insurers increasingly integrate ESG factors into their underwriting and investment criteria and implement a number of screening and exclusion policies and due diligence processes focused on sustainability objectives. Most recognise the limitations of relying on external ESG ratings and products and have built up strong in-house ESG analytical teams to assess investment opportunities.

Investee companies often struggle to provide ESG data, but panellists were clear that a failure to provide information is a negative. In fact, disclosure requirements are becoming tougher and minimum investment criteria thresholds often require investee companies to provide measurable data relating to carbon footprints, pathways for reducing these, and strategies for promoting sustainability.

Insurers also highlighted the impact they can make on sustainability trends by maintaining dialogue and engagement with investee companies to encourage them to adopt more sustainable business models.

Insurers as Activists

The drivers of ESG investment strategies are finely balanced between internal convictions and external pressures, according to our panellists.

Internal ethical and moral judgements that formed the starting points used to inform ESG investment policies for some insurers have largely been superseded by technical, evidence-based research to support performance targets. As data improves and records lengthen, particularly in areas of innovation such as renewable energy companies, buy-side interest in ESG metrics is increasing.

External pressures are equally important. An ESG investment framework is essential for bringing in new investment flow and preventing outflows. Competitive pressures are mounting, especially as retail investors are increasingly being asked about their ethical investment preferences and as awareness of allocation options increases. Investors that become involved in ESG earlier will be in a better position as they will have a longer proven history of involvement. This is particularly important as the move towards mainstream sustainable investment strategies is global and accelerating.

Stress Tests Can Be Used to Collect Data

Secondary peril events, such as convective storms and wildfires, are increasing in frequency and increased claims are affecting insurers' financial profiles. Regulators, such as EIOPA, are addressing this and consulting on capital charge proposals whereby insurers would consider climate change risks in their application of standard models for calculating solvency ratios. Climate change stress tests applied to insurers, such as those conducted by the French and UK regulators, will assess the effects of climate-related risks and inform insurers how best to introduce prudential measures to mitigate these. The tests will not give rise to immediate additional capital charges but Fitch's view is that these will be introduced over the medium term.

The tests will help insurers to collect data and move towards a more transparent disclosure of climate-related risks. This will help regulators to forge opinions about how these trends and events affect the industry's underwriting standards and solvency. Ensuring insurers remain financially solid while providing insurance at affordable prices for natural catastrophe protection products is crucial. Fitch's view is that the industry may have to work with government to forge public-private partnerships capable of sharing the additional burden of catastrophe risk costs, especially for insurers operating in countries that face a much higher frequency of climate-related events.

Social Aspects Need to Be Managed

Insurers highlighted the need to manage social risks as they implement investment and exclusion screening policies. Many have already excluded investment in new coal mines and oil sands extraction and have committed to reducing investments in the fossil fuel sector. Halting, reducing, or significantly adjusting pricing on insurance cover for companies operating in countries whose economies are heavily commodities-dependent can bring significant social risks. In these cases, timetables for introducing adjustments can stretch out to 20 or 30 years so as to allow economies to transition towards more sustainable models.

Our Panellists:

Insurers:

- Unipol Gruppo S.p.A. – Maria Luisa Parmigiani
  (Group Head of Sustainability)
- Munich Reinsurance Company – Andreas Sauerbrey
  (Head of M&A Transactions)

Bankers:

- HSBC Holdings Plc – Gabriel Moulinier
  (Director, Insurance Capital Solutions)
- JPMorgan Chase & Co. – Paul O'Connor
  (Head of EMEA ESG DCM)

Investor:

- Amundi – Alban de Fay
  (Head of Fixed Income SRI Processes)

Credit Rating Agencies:

- Fitch Ratings – Robert Mazzuoli
  (Director, EMEA Insurance)
- Fitch Ratings – Janine Dow
  (Senior Director, Sustainable Finance)

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