TRANSCENDENT GROUP INSIGHT

ESG takes effect in the ORSA process

Environmental, social and governance (ESG) has taken center stage in society, politics and business both nationally and globally. Particularly prominent has been a paradigm shift towards treating the topic of climate change as a systemic risk, that is likely to impact society and existing business models. Insurance companies have a central role both in terms of building climate-resilient communities and accelerating the transition to a net-zero emissions economy, as well as factoring in potential risks associated with climate change in existing business models.

Climate change will affect us all, if not already done so. The detrimental impact of global warming on natural and human systems is already visible today. The floods in Germany heatwaves in Europe and western part of US maybe among the most prominent incidents covered in media recently, rare events that have been made more likely by climate change. Without further international climate action, the global average temperature and associated physical risks will continue to increase, raising underwriting risk of (re)insurance companies, impacting asset values and challenging insurance companies' business strategies.

Keeping the global temperature increase below 2°C would require annual reductions in carbon emissions greater than occurred in any single year in the last 100 years, including during the deepest recessions, and 70-80% of proven fossil fuel reserves to be stranded, according to the CRO Forum. And it is worth keeping in mind that even if the Paris Agreement's goals of limiting global warming to well-below 2°C are reached, a "2°C-world" will still carry with it considerable physical risks.

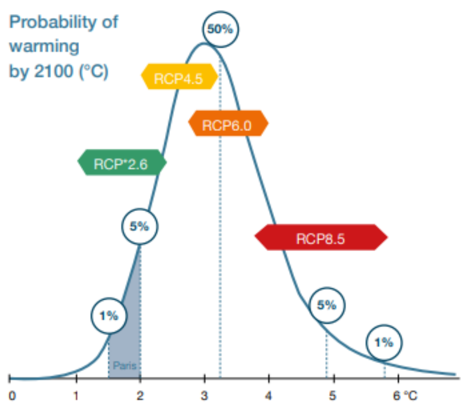

Figure 1 Probability of warming by 2100, by CRO Forum based on IPCC estimates.

EIPOA, The European Insurance and Occupational Pensions Authority, suggest that the increasing manifestation of climate change risks in the coming years and decades may provide (re)insurance companies with strategic opportunities, but also challenge current business models, jeopardizing the long-term risk profile and solvency. A higher incidence of extreme weather events and natural disasters may raise demand for insurance coverage. However, the increased cost of insurance coverage, or alternatively more restrictive terms and conditions, may constrain insurance business. Only 35% of the total losses caused by extreme weather events is currently insured across Europe.

EIOPA advise that national regulatory authorities should expect (re)insurance companies to take a broad view of climate change risk, including all risks stemming from trends or events caused by climate change.

Climate change risk can broadly be categorized into two drivers of risk: transition risks and physical risks. Transition risks are risks that arise from the transition to a low-carbon and climate-resilient economy, including policy, litigation, technological, market sentiment and reputational risk. (Some authoritative bodies, like G20 and UNEP, use litigation as a separate risk driver). Physical risks are risks that arise from the physical effects of climate change, including both acute physical risks, like events such as storms, floods, fires or heatwaves; and chronic physical risks, which are longer-term changes in the climate, such as temperature changes, rising sea levels, reduced water availability, biodiversity loss and changes in land and soil productivity.

EIOPAs key suggestions include:

- **Authorities should require undertakings to integrate climate change risks (Physical and transition risks) in their system of governance, risk-management system and ORSA, including both short-term and long-term risks.**
- **Authorities should expect undertakings to identify the materiality of exposures to climate change risks through a combination of quantitative and qualitative analyses.**
- **A quantitative analysis could be used to assess the exposure to transition risks and physical risks.**
- **Authorities should expect undertakings to subject material risks to at least two climate-scenarios, one scenario where global temperature increase remains below 2°C, and one where global temperature increase exceeds 2°C.**

Data should be collected through the regular supervisory reporting, most notably the ORSA supervisory report. EIOPA will start monitoring the application of the opinion by the competent authorities two years after its publication.

Transcendent Group recommend that both (re)insurance and insurance companies should start early with thinking about how climate change can affect current business models, and how climate change risk can be integrated into risk management processes. While several insurance companies have sustainability-related policy documents, these tend to focus on being a responsible corporation, rather than outlining how climate change risk is managed. We are here to help you. We recommend the follow process our **3M Approach**:

1) "You can't manage what you don't measure". For most actors, a mapping of existing risks, as well as an assessment of the processes in place for managing them, are a natural first step. Our experienced consultants have a proven track-record in this field, and can help with the following first steps:
    a. Gap analysis incoming regulation & market best practices. We help you take stock of where your organization stands in relation to international best practices, expected sustainability-related regulation and taxonomy-eligibility for non-life insurance products.
    b. TCFD reporting. The TCFD is an internationally recognized framework aimed to help organizations understand, measure, and manage climate related risks and opportunities. With experience in risk management and governance, as well as calculation of metrics, we are uniquely positioned to help conduct such an analysis for insurance industry players.
    c. Materiality assessments. A key part of a sustainability strategy is to identify key stakeholders, and which sustainability factors are most material to them. In these assessments we ensure the integration of "double materiality", to ensure that both potential impacts and sustainability-related risks are factored into the strategy.
2) Merge some key ESG principles in existing processes and governing documents

    a. ESG strategy implementation. We can assist with project management and the implementation of a systematic and unified approach to sustainability and climate change risk, across departments and with leadership.
    b. Policies. Implement sustainability-related policies or update existing policies to include sustainability-related risks.
3) Materialise ESG risks in the risk management system (ORSA, etc.)
    a. Scenario analysis preparation. Assist in identifying suitable climate scenarios and data for climate-related scenario analysis.
    b. Ensure effective governance of sustainability risks and processes

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