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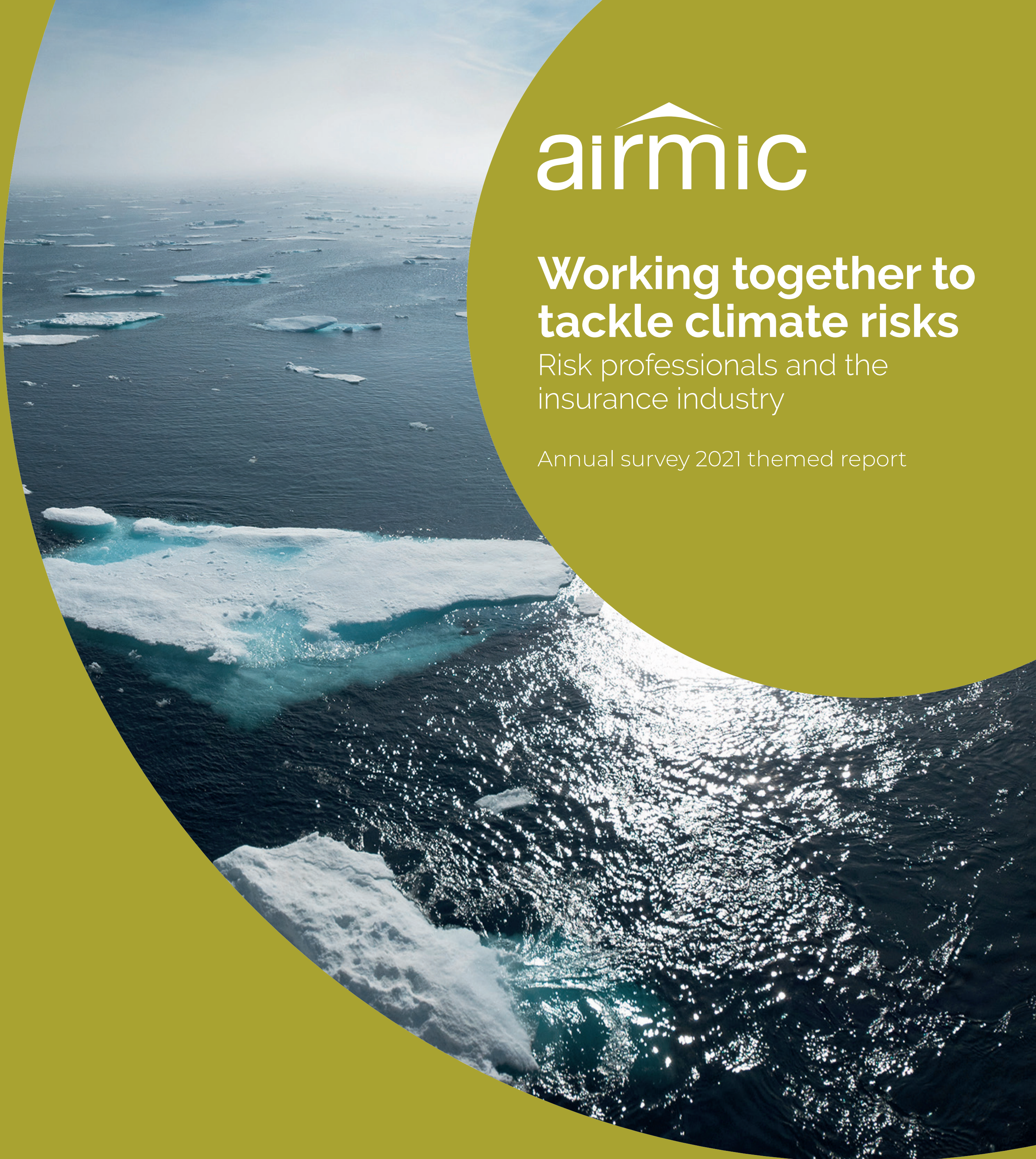


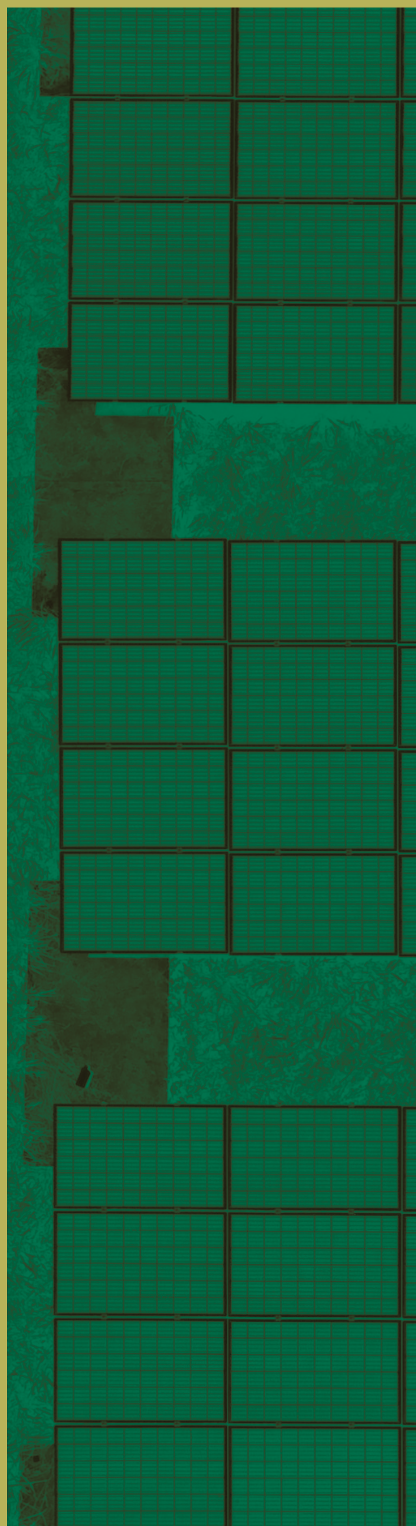
Working together to tackle climate risks

Risk professionals and the insurance industry

Annual survey 2021 themed report

KPMG

Contents



“The real challenge, for corporate risk managers and (re) insurers, will be balancing commercial profit against doing the ‘right thing’ for the planet. These objectives are not mutually exclusive, but need careful steerage using the right net-zero metrics and incremental targets.”

Foreword

Scientists, and now the media, are reporting that climate change is already upon us. All is not lost. We can collectively work together to reverse the trend and, in doing so, build a better more resilient and compassionate community. It's just a matter of whether we have the commitment.

The COP26 United Nations climate change conference in Glasgow in November will be the next test for world leaders, but we can all contribute to getting to net zero whether we are corporate risk managers (re)insurers, or brokers. Corporate risk managers can help raise, understand and suggest solutions within their individual firms, and (re)insurers and brokers can do likewise. The real challenge, for everyone, will be balancing commercial profit against doing the 'right thing' for the planet. These objectives are not mutually exclusive, but need careful steerage using the right net-zero metrics and incremental targets. The Net-Zero Asset Owners Alliance and Net-Zero Insurance Alliance (NZIA), set up by prominent (re)insurers, will assist asset managers and underwriters respectively in setting appropriate net-zero targets. However, these will need to be quickly adopted across the industry, in both large and small organisations, if they are going to make a real difference.

Net-zero targets will bring another challenge in terms of those businesses that are not moving fast enough to net zero and may therefore become so-called stranded assets in terms of insurance provision or/and investment. On the underwriting side, to date, (re)insurers have used exclusionary language to move towards net zero, but this will become more sophisticated once industry standard net-zero metrics start to emerge as part of the NZIA work later next year. However, what is clear right now is that corporate risk managers and (re)insurers will need to increasingly work together to understand the opportunities and the associated risks that will occur from transition – corporate risk managers in terms of understanding the new products, technologies, investment and ways of working that their businesses will need to adopt to survive, and (re)insurers in terms of the potential sectoral macroeconomic and physical risks that may occur. Sharing all this information between corporate risk managers, (re)insurers and brokers will enable our industry to have a real influence on stakeholders.

KPMG supports Airmic in its work with its members to encourage greater collaboration between (re)insurers, corporate risk managers and brokers, and in doing so, ensuring that our industry has a leading voice in the challenges ahead of moving the global economy to net zero.

Roger Jackson, Partner
Head of Insurance ESG,
KPMG LLP (UK)

Executive summary

Regulatory compliance on ESG matters emerged as the number one issue of concern for risk professionals in the Airmic survey this year. But ESG regulations and reporting requirements such as the Task Force on Climate-related Financial Disclosures (TCFD) could equally present an opportunity for firms to sharpen their focus on issues that matter to their business.

Of our survey respondents, 43.8% believe that climate change will start to have a material impact on their business within one to two years. Yet, in terms of their organisation's understanding of how the physical and transition risks of climate change will impact their business, a sizeable number of respondents have not taken quantification and management actions on climate, or have just taken initial actions on this.

Nevertheless, the case for taking greater action on climate risks is clear – most believe that being ethical and environmentally responsible has improved their organisation's resilience and profit margins.

Businesses have the opportunity to turn regulations and reporting requirements such as the TCFD to their strategic advantage. For instance, the TCFD readiness reviews align the organisation's key stakeholders on what the organisation wants to achieve from its TCFD project, and ensures that any relevant work performed across the organisation to date is taken into account from the start. Such a review can also compare the organisation's current business status against disclosure requirements and what its peers are doing.

Global challenges such as climate change call for ambitious initiatives. It is therefore admirable that the insurance industry has made commitments through various initiatives. However, more dialogue is needed between insurers, brokers, insurance buyers and risk professionals to ensure that these initiatives have the right intended consequences on the global economy and so that significant progress can be made towards net zero.

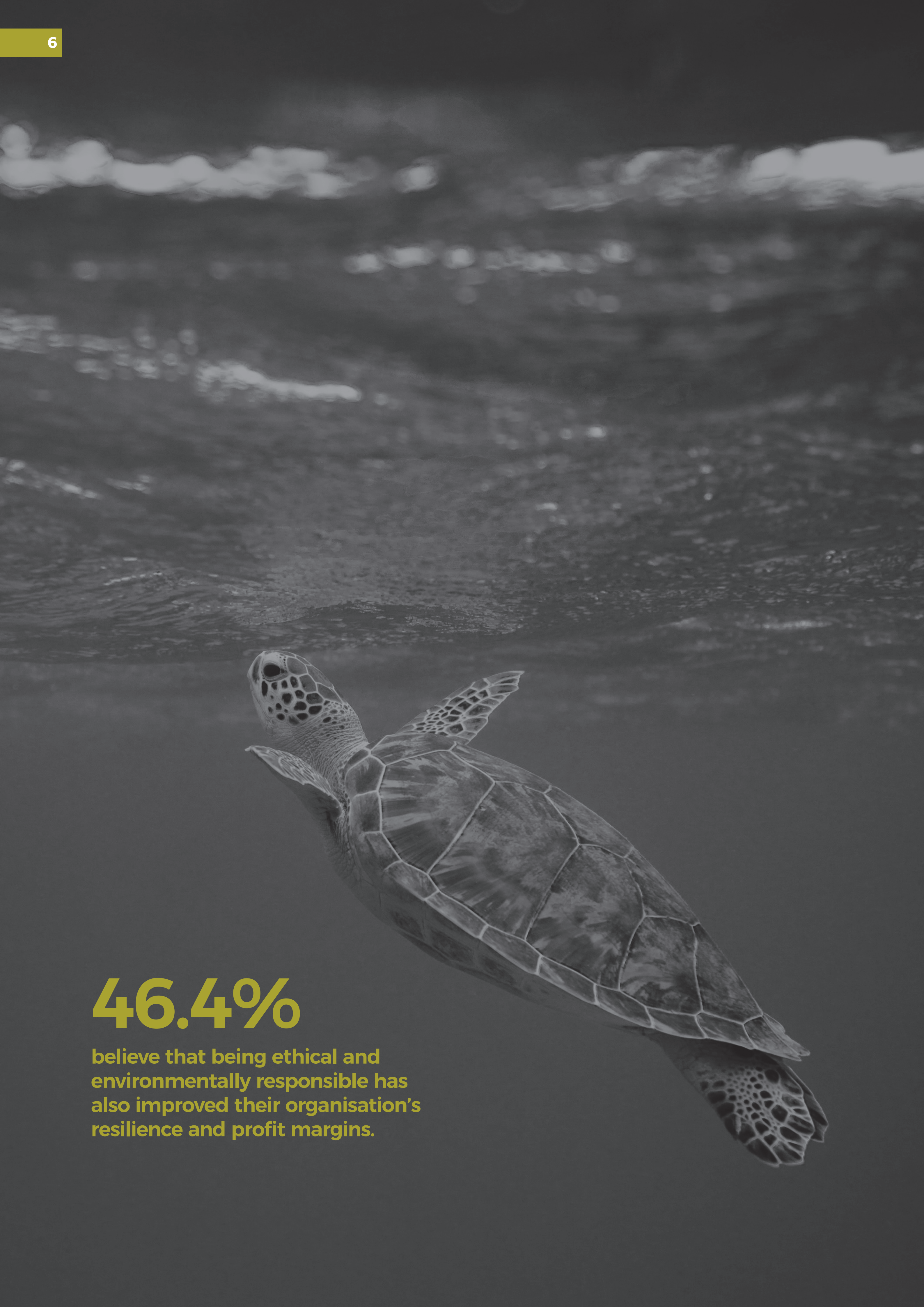
There needs to be more collaboration in the insurance industry on how to deal with climate risks, and on the measurement, management and risk financing of those risks, in view of the climate commitments insurers have made through the Net-Zero Insurance Alliance (NZIA) and other initiatives.

About this research

This study is part of a wider research around the 2021 Airmic annual survey. This is one of five thematic subreports, while the main survey report summarises the full findings of the survey.

Survey & research methodology

The report, produced by Airmic in collaboration with KPMG, is based on 226 responses gathered in a survey from 21 July to 2 September 2021. Subsequently, roundtables with Airmic members were held to gather qualitative responses. Full details on the survey and research methodology can be found in the main report of the 2021 Airmic annual survey.



46.4%

believe that being ethical and environmentally responsible has also improved their organisation's resilience and profit margins.

Introduction

Against the backdrop of net-zero carbon commitments and the COP26 United Nations climate change conference in Glasgow in November 2021, organisations in the UK and around the world have been stepping up action to address the climate risks they face.

Risk professionals have been integral to that process. How have they helped steer their organisations through the myriad of risks and opportunities related to climate change and the green economy? This report looks at the ***key areas of concern*** on climate issues for risk professionals within the framework of Environmental, Social and Governance (ESG) issues, and how they are working as part of their organisations to ***identify*** and ***prepare*** for the climate risks pertinent to them.

The report then looks at how risk professionals are using ***risk financing and insurance*** to mitigate climate risks for their organisations, in the context of initiatives in the insurance sector, in order to build climate resilience and accelerate the transition to a net-zero emissions economy. Leading insurers and reinsurers have been working together as part of the UN Environment Programme's (UNEP) Principles for Sustainable Insurance Initiative (PSI) to test various approaches that insurers can use to implement the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). In July 2021, eight insurers and reinsurers established the Net-Zero Insurance Alliance (NZIA), convened by the UNEP's PSI, committing to transition their underwriting portfolios to net-zero greenhouse gas emissions by 2050, consistent with a maximum temperature rise of 1.5°C above pre-industrial levels by 2100. The alliance will also advocate for governmental policies for a science-based and socially just transition of economic sectors to net zero.

Based on a survey of 226 Airmic members and risk professionals conducted in July to September 2021, and a series of roundtables with them, this report calls for greater collaboration in the insurance sector, as well as with risk managers, particularly in relation to the measurement, management and risk financing of those risks and especially in view of the climate commitments insurers have made through the NZIA and other initiatives.

Leading insurers and reinsurers have been working together to test various approaches they can use to implement the Task Force on Climate-related Financial Disclosures (TCFD) recommendations

1

Key areas of concern

Regulatory compliance on ESG matters emerged as the number one issue of concern for risk professionals in the Airmic survey this year.

Regulatory compliance may often be managed as a risk, in the sense that the organisation may potentially violate a law or regulation. But ESG regulations and reporting requirements could equally present an opportunity for firms to sharpen their focus on issues that matter to their business.

For reporting periods beginning on or after 1 January 2021, the UK Financial Conduct Authority (FCA) has mandated all premium listed companies to state in their annual financial reports whether their climate-related financial disclosures are in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), and explain if they are not. The eleven TCFD recommendations cover the following four areas: governance, risk, strategy, and metrics and targets. From 1 October 2021, occupational pension schemes with more than £5bn in assets and authorised master trusts will be required to report in line with TCFD (extending to those pensions schemes with more than £1bn in 2022). The Department for Business, Enterprise and Industrial Strategy (BEIS) consulted earlier these year on extending the TCFD reporting requirements to publicly quoted companies, large private limited companies and LLPs, while the FCA has recently consulted on extending such requirements to all issuers of standard listed equity shares, as well as requiring certain asset managers and life insurers to produce entity and product level disclosures.

Regulations and reporting requirements such as the TCFD do not just present compliance risks. Indeed, businesses have the opportunity to turn these to their strategic advantage. For instance, the TCFD readiness reviews, conducted by KPMG's Climate Risk and Decarbonisation Strategy team, align the organisation's key stakeholders on what the organisation wants to achieve from its TCFD project and ensures that any relevant work performed across the organisation to date is taken into account from the start. Such a review can also compare the organisation's current business status against disclosure requirements and what its peers are doing.

ESG regulations and reporting requirements do not just present compliance risks. Businesses can turn these to their strategic advantage.

Ranking	Topic	Sub-area	Average score (out of 5)
1	ESG	Regulatory compliance	**4.03**
5	ESG	Transition to a low carbon economy/net zero emissions	**3.71**
12	ESG	Extreme weather events and natural catastrophes	**3.50**
15	ESG	Climate change-induced shift in consumer sentiment	**3.44**
19	ESG	Waste and pollution	**3.35**
22	ESG	Biodiversity loss	**3.07**

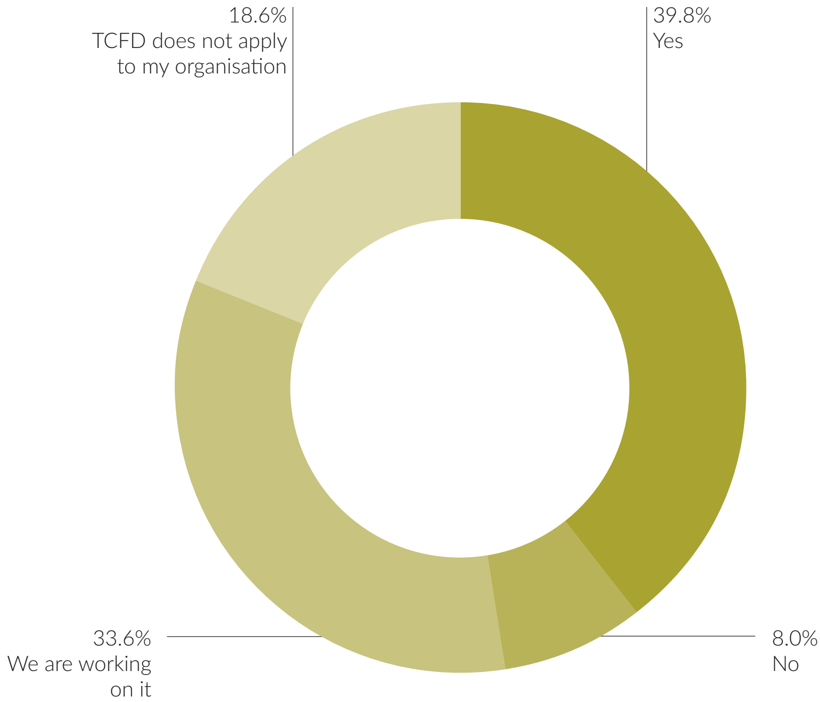
Source: Airmic annual survey 2021

KEY AREAS OF CONCERN

Nearly 40% of Airmic survey respondents said their organisations are ready for TCFD reporting for 2022, while a further 33.6% said they are working on it.

One risk professional in Airmic's member roundtables noted that, in the past 12 months, they had built climate models specific to their firm, in order to understand the financial implications of some of the scenario pathways they had been using for TCFD reporting. Their organisation is looking to run a similar exercise for the social risk elements of ESG. These models could then be used to help identify and assess potential opportunities as well.

Is your organisation ready for Taskforce for Climate Related Financial Disclosures (TCFD) reporting next year?



> An integrated approach to assessing the physical and transition risks would allow the insurance sector to address climate risks more holistically.

2

Identification of climate risks

Transition risks are now gaining more attention in addition to the more familiar physical risks of climate change.

Transition risks

When economies move towards more environmentally sustainable models, transition risks can occur – this means that some industries could experience increased costs of doing business or see major shifts in asset values. Yet, it does not mean that staying put makes sense for these businesses, because the risk of delayed action on climate-related measures could pose far greater costs to them ultimately.

Transition risks are now gaining more attention in addition to the more familiar physical risks of climate change. The final report on the project of the UN Environment Programme's Principles for Sustainable Insurance Initiative to pilot the TCFD recommendations, titled *Insuring the climate transition*, calls for an integrated approach to assessing the physical and transition risks. Such an approach would allow the insurance sector to address climate risks more holistically.

A suggestion made at one of Airmic's members roundtables was for the insurance market to offer bursaries to incentivise organisations to do climate change modelling for their businesses – the findings of such modelling would be equally useful for the business in future-proofing its strategy, as it would be helpful for insurers in assessing the future risks they would be underwriting. Some investors have already been asking the businesses they invest in how they manage different scenarios for rising global temperatures.

Incorporation into risk management

One risk professional shared at one of Airmic's members roundtable how their management of climate risks is integrated with their risk management framework for emerging risks, rather than managed as a standalone risk. However, they do not use the risk scoring mechanisms that are used in their normal risk process, because, to them, emerging risks by definition are lacking in the kind of precise, real data to allow for a truly meaningful assessment. Rather, they start the process through discussions with the executive leadership team, the board of governors, and the audit and risk committees, using findings from publicly available risk reports as the basis for discussion. They are asked to consider potential risks for impact on their business.

Once they have reached a consensus, the risk team works together with others – such as the strategy team – to understand and monitor those risks. They also share the information with 'risk champions' – employees whose primary role is not in risk management, but who are involved in monitoring and reporting risks at the departmental level. To them, the exercise is futile if a high-level only approach is taken, as people at the operational level also need to know what is being considered and what it might mean for their work.

Another risk professional shared that their organisation had conducted an analysis with a leading UK business school to understand the impact of various climate-related risks on their business. This analysis of climate risks was also not done in isolation from other emerging risks. Additionally, the risk media, and the media more generally, were their most trusted source of information on climate-related risks.

Physical risks

Many companies have started to understand the impact that changes in the physical climate will have upon their business and (re)insurers have also started to recalibrate their catastrophe models to allow for climate change, mainly due to the PRA's recent climate biennial exploratory scenario (CBES) exercise. However, the science of climate change will continue to develop, as will climate models, and so the challenge for businesses and (re)insurers will be not only to carry out an initial assessment, but to keep these models updated and increasingly incorporated into their business and risk management processes – most importantly business planning.

3

How are organisations preparing for climate risks?

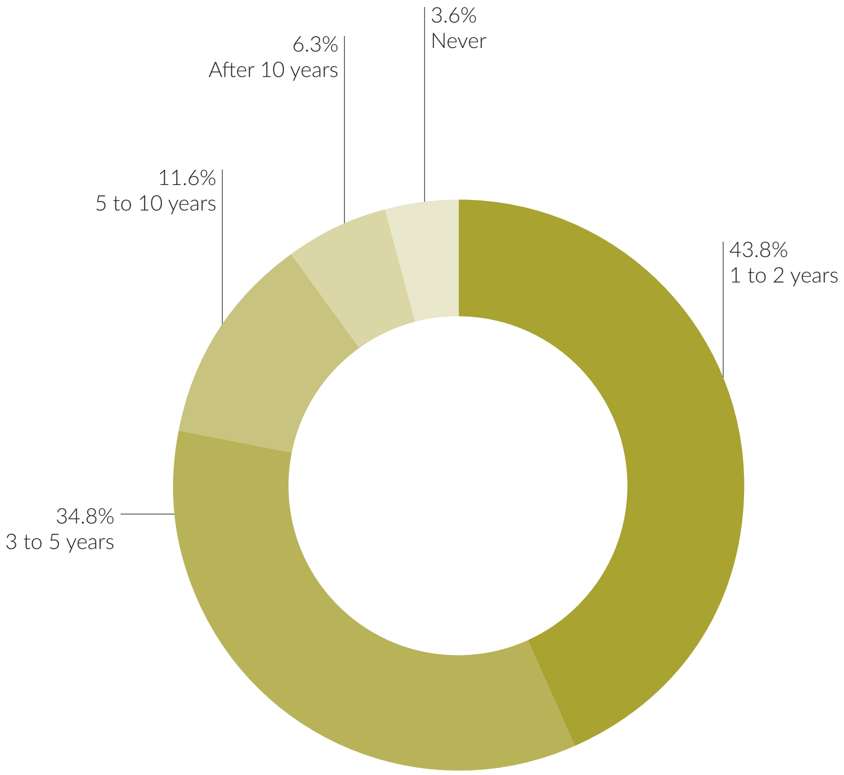
43.8% believe that climate change will start to have a material impact on their business within one to two years.

Of Airmic's survey respondents, 43.8% believe that climate change will start to have a material impact on their business within one to two years. These respondents were generally from the energy/utilities, food and beverage, and banking/finance sectors, while more than three-quarters of respondents in the professional services sector believe that climate change will only start to have a material impact on their business in three to ten years' time. Given the longer investment timelines often associated with the former group of respondents, it is maybe not surprising that they feel the need for change more urgently.

Yet, in terms of their organisation's understanding of how the physical and transition risks of climate change will impact their business, as many as 17% of respondents have not taken quantification and management actions on climate, nor have they even begun to consider such actions. A further 29.5% of respondents said they have just taken initial quantification and management actions. The respondents in these two groups tended to be from public and not-for-profit sectors.

Nevertheless, the case for taking greater action on climate risks, apart from regulatory compliance, is clear – 46.4% of respondents believe that being ethical and environmentally responsible has improved their organisation's resilience and profit margins.

When do you think climate change will start to have a material impact on the business?



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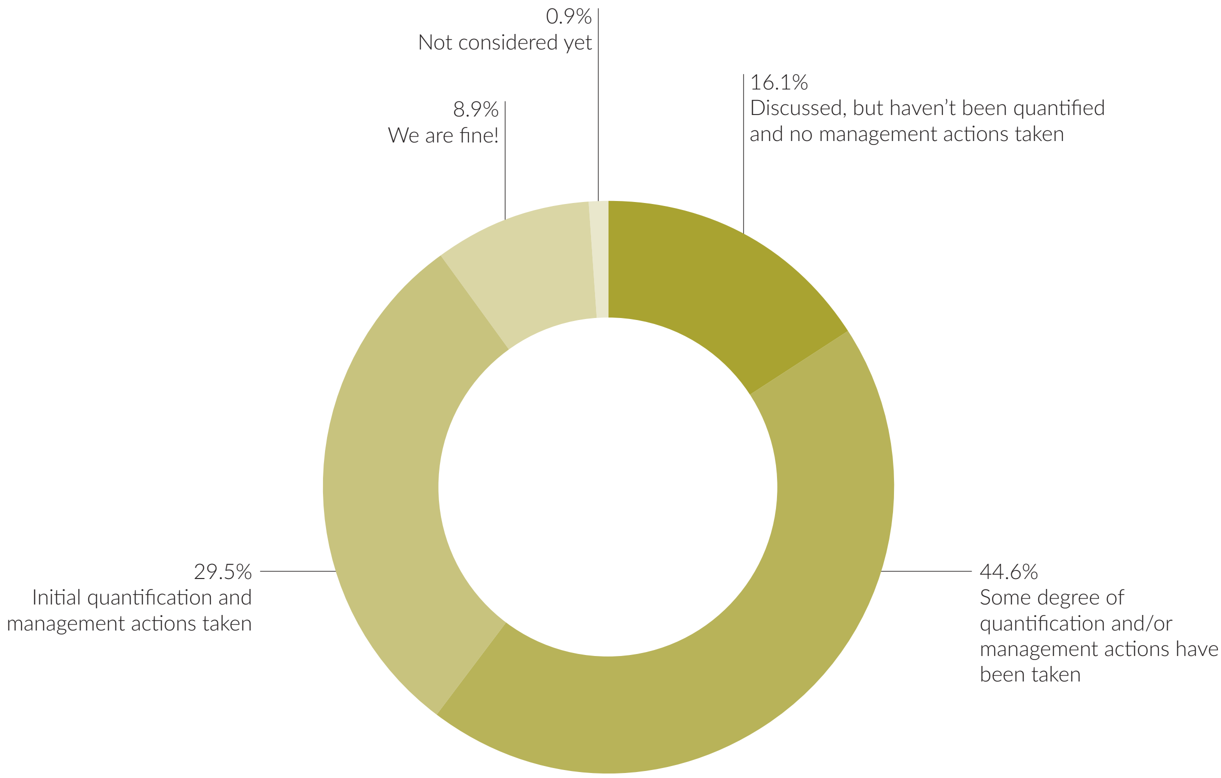
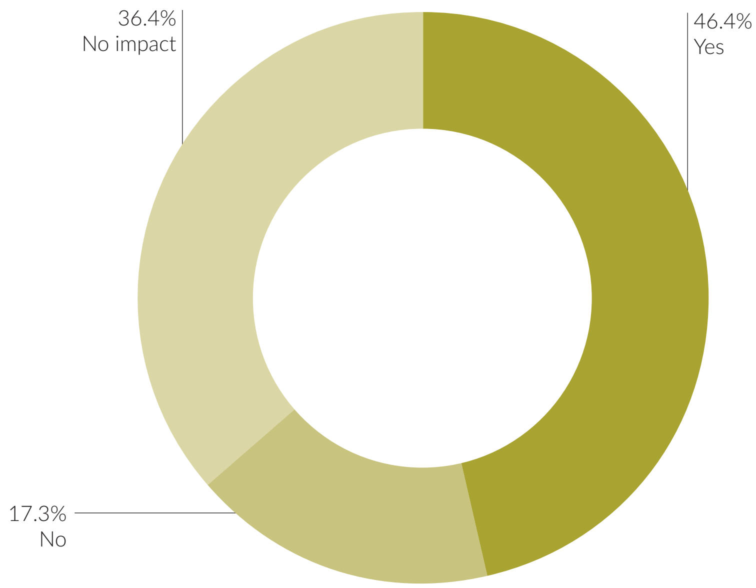
How well does your organisation understand how the physical and transition risks of climate change will impact your business?



Has being ethical and environmental improved your organisation's resilience and profit margins?



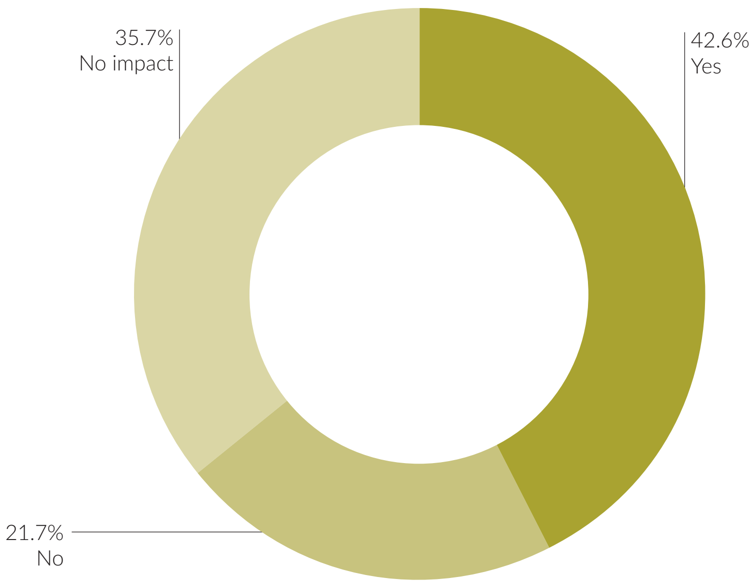
Of the Airmic survey respondents, 42.6% said their organisations belong to a sector-wide initiative or association or certification programme that was formed to promote ESG goals, such as Sustainable Fashion.

Organisations are certainly placing a high level of importance on climate and ESG issues. 60.5% of respondents belong to an organisation that has a senior colleague primarily responsible for ESG, signifying the importance that their organisations place on these issues. 85.2% belong to an organisation that has a Corporate Social Responsibility (CSR) programme – in many senses, the precursor to ESG, but whereas the CSR is a form of self-regulating initiatives, often involving philanthropy and volunteer efforts, ESG programmes provide indicators that can be quantified.

In summary, the Airmic survey suggests that although organisations generally understand the need for action on climate change, they need more guidance with identifying, quantifying and managing the climate risks that pertain specifically to them.

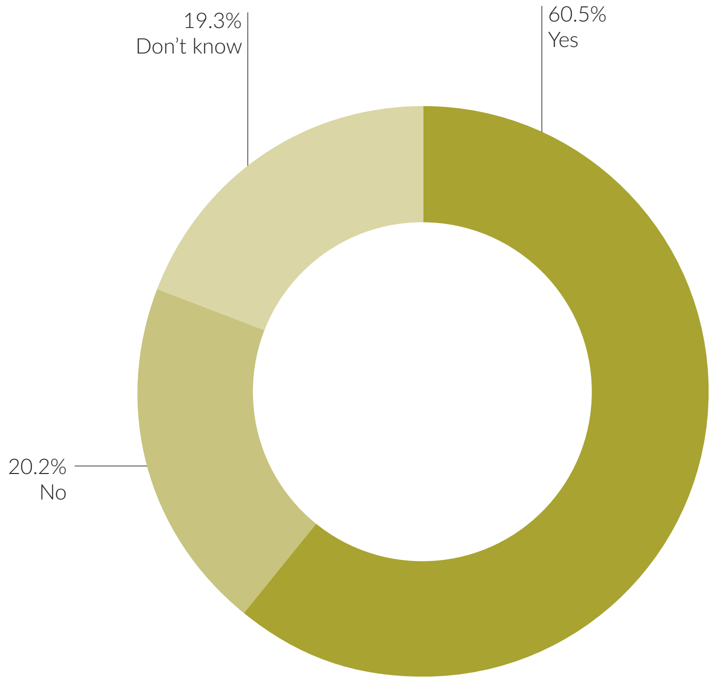
Financial institutions should look out for the findings of the Bank of England's Climate Biennial Exploratory Scenario (CBES), a stress-testing exercise on the financial risks from climate change, which was launched in June 2021. CBES is a learning exercise intended to measure the size of the financial exposures of the financial system to climate-related risks, to understand the challenges to the business models of financial institutions from these risks and to assist participating financial institutions in enhancing their management of climate-related financial risks.

Does your organisation belong to a sector-wide initiative or association, or certification programme, that was formed to promote ESG goal? (e.g. Sustainable Fashion)

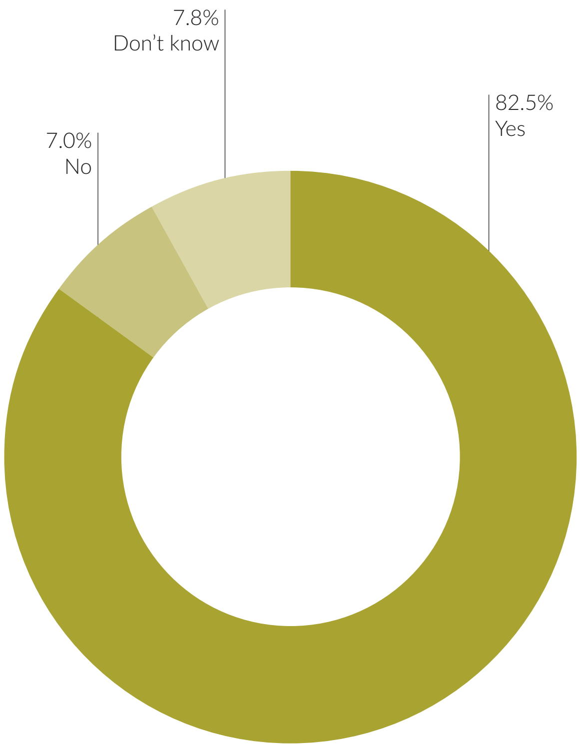


HOW ARE ORGANISATIONS PREPARING FOR CLIMATE RISKS?

Does your organisation have a senior colleague primarily responsible for ESG?

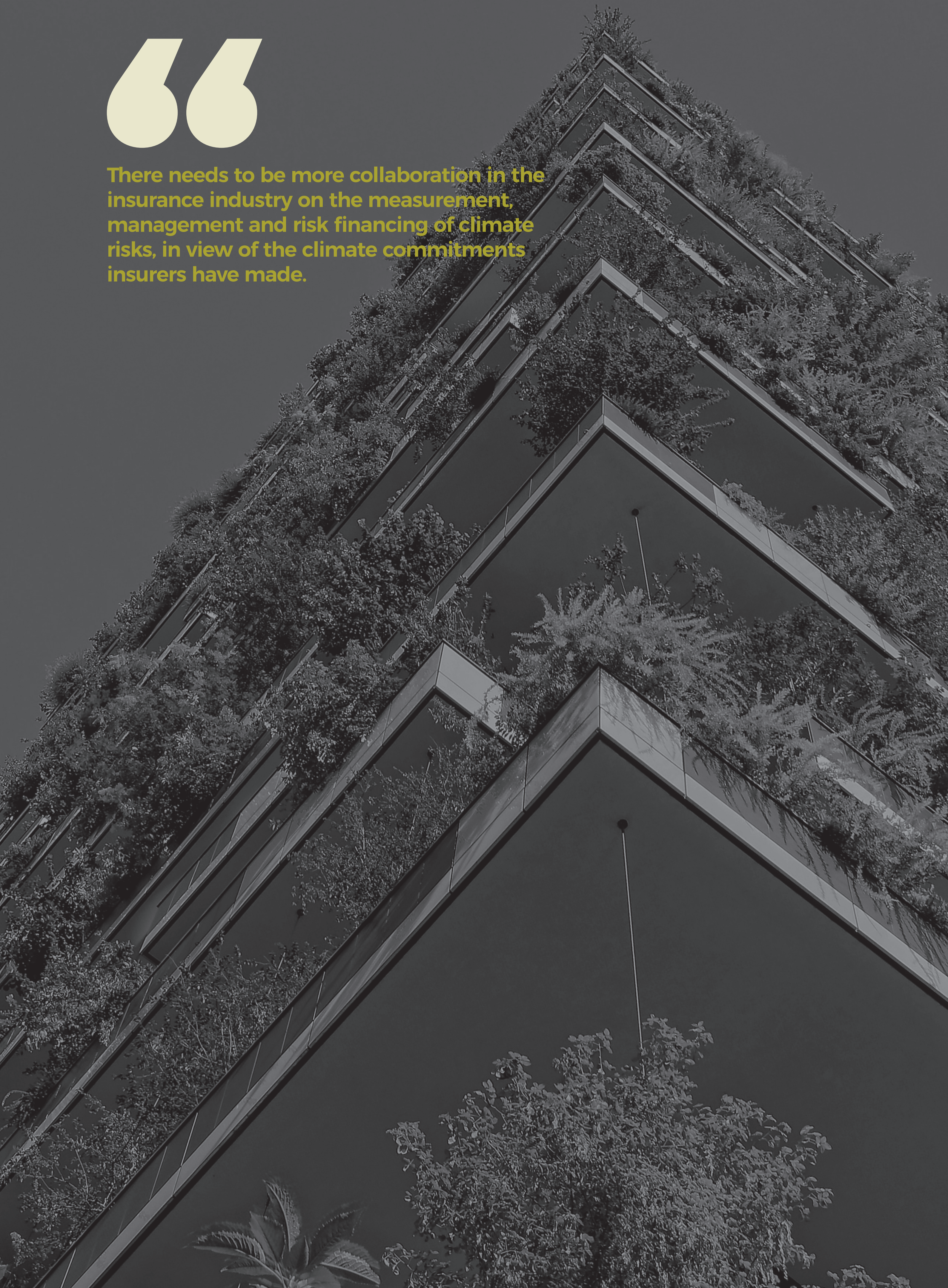


Does your organisation have a Corporate Social Responsibility (CSR)* programme?



*While they both have some factors in common, Corporate Social Responsibility (CSR) was the precursor to ESG which was a form of self-regulating initiatives (often involving philanthropy, and volunteer efforts), while ESG provides indicators that can be quantified.

> There needs to be more collaboration in the insurance industry on the measurement, management and risk financing of climate risks, in view of the climate commitments insurers have made.



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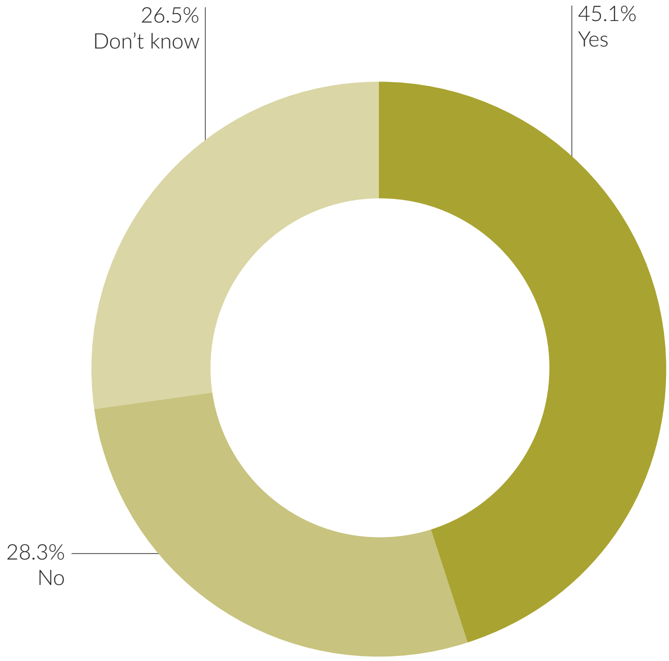
Risk financing and insurance for climate risks

Greater engagement is needed between insurers, brokers and insurance buyers

Insurers are starting to integrate environmental and social factors into their underwriting processes. Policy positions have been adopted – for example, one insurer has said it no longer provides insurance to single coal-fired power plants and coal mines, and will phase out insurance relating to coal exposure completely by 2040. This constitutes part of its commitment to keeping global temperature increases to below 1.5ºC , by supporting the transition to a low-carbon economy. Ultimately, it all pays off for this insurer by reducing overall risks for its customers and other stakeholders.

In Airmic's survey, 45.1% of risk professionals said they have considered ESG factors as part of their strategy for risk financing, including the purchase of insurance. Airmic also held a roundtable with its members in September 2021 to discuss their experience in buying insurance for climate risks. Some of the key points emerging from these roundtables are discussed below.

Have you considered ESG factors as part of your strategy for risk financing (including the purchase of insurance)?



4

When major insurers decline to insure carbon-intensive industries

Participants in Airmic's roundtables observed that while it is admirable that the major insurers are taking the lead in 'greening' their portfolio of risks, for example by declining to insure carbon-intensive industries, they are in fact offloading the coverage of those industries to smaller insurers that may be less well equipped to address any fallout from climate risks. The overall result is that the insurance of carbon-intensive industries does not change fundamentally. What is needed therefore is a better strategy of 'greening' the whole landscape of industries, where carbon-intensive industries are offered more help in managing the transition risks to a green economy.

Codifying means of measuring carbon footprint for underwriters

Some participants in Airmic's roundtables said there could be better linkages made between the insurer's commitments at the corporate level to lower the carbon footprint of its portfolio of risks over the medium term and the insurer's underwriting team. There has not yet been a codified means for underwriters to measure the carbon footprints of the businesses they are looking to underwrite and to factor those into the climate commitments of the insurer – albeit this is one of the objectives of the Net-Zero Insurance Alliance (NZIA) over the next year.

In the meantime, organisations have held ESG briefings for their investors, to which underwriters from the organisation's own insurance were also invited. These have included question-and-answer sessions between just the underwriters and the organisation's executive team, to address questions specific to the insurer that arose from the ESG briefing.

Irrespective of the outcome of the NZIA work, some Airmic members who are insurance buyers believe that now is the time for greater dialogue with (re) insurers and their underwriters, if the insurance sector is to assist organisations in taking action on climate change. This in turn will assist organisations in developing their own ESG corporate strategy, enabling them to start to plan their own ESG communication strategy.

Using the Principles for Sustainable Insurance

One Airmic member went through an exercise with his broker, who took the UN Environment Programme Finance Initiative's Principles for Sustainable Insurance and mapped them onto the organisation's risk portfolio, while assuming its potential insurer had committed to those principles. It helped the organisation to codify in advance the questions that insurers were likely to ask.

The problem of addressing decades-long physical risks

A risk professional shared their organisation's experience with a reinsurer who carried out a climate modelling exercise for them and found that the impact of climate change for their organisation would be felt the most over 10 to 20 years away. Wildfires such as those in Australia and northern California, for example, were predicted to only start to become critical for this organisation in about 30 to 50 years' time. The problem with such a time horizon is that an organisation is hampered by how much it can feasibly achieve, given that such time frames are far beyond normal corporate planning cycles. One of the problems for organisations and their risk professionals is that they could potentially carry out a lot of work on such climate risks, without being able to do anything substantive about these risks for some decades.

Risk professionals and insurance buyers also worry about a perverse scenario where all their work on such long-term climate risks would lead the market to increase prices for these risks even though they may not realistically become an issue for decades to come.

What is needed therefore is a better strategy of 'greening' the whole landscape of industries, where carbon-intensive industries are offered more help in managing the transition risks to a green economy.

Conclusion

Global challenges such as climate change call for ambitious initiatives. It is therefore admirable that the insurance industry has made commitments through various initiatives. However, more dialogue is needed between insurers, brokers, insurance buyers and risk professionals to ensure that these initiatives have the right intended consequences on the global economy and so that significant progress can be made towards net zero.

There needs to be more collaboration in the insurance industry on how to deal with climate risks, and on the measurement, management and risk financing of those risks, in view of the climate commitments insurers have made through the NZIA and other initiatives.

With the rise of reporting requirements such as the TCFD, regulatory compliance in the context of ESG has understandably risen to become the top issue of concern to risk professionals this year. Rather than just being a regulatory risk, an organisation's ESG and related climate strategy should be seen as an opportunity and a differentiator that buttresses its position in its respective markets.

Rather than a regulatory risk, an organisation's ESG and related climate strategy should be seen as an opportunity and a differentiator that buttresses its position in its respective markets.

About KPMG
KPMG in the UK is one of the largest member firms of KPMG's global network of firms providing audit, tax and advisory services. In the UK we have 631 partners and 15,864 outstanding people working together to deliver value to our clients across our 22 offices. Our vision is to be the clear choice in professional services in the UK. For our clients, for our people and for the communities in which we work. KPMG's core business is to help your organisation work smarter, evaluate risks and regulation and find efficiencies. We do this by providing deep insight into market issues, transparency in everything we do, and using innovative technology to tackle complex problems. We are focused on the issues that keep our clients awake at night and responding to them as One Firm. To do that, we strive to create a high performance culture, guided by our values, where our diverse talent feels included and excels.

www.kpmg.com

About Airmic
The leading UK association for everyone who has a responsibility for risk management and insurance for their organisation, Airmic has over 450 corporate members and more than 1,300 individual members. Individual members include company secretaries, finance directors, internal auditors, as well as risk and insurance professionals from all sectors.

Airmic supports members through training and research; sharing information; a diverse programme of events; encouraging good practice; and lobbying on subjects that directly affect our members. Above all, we provide a platform for professionals to stay in touch, to communicate with each other, and to share ideas and information.

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