MOODY'S ANALYTICS

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Integrating ESG into portfolio management and underwriting workflows: the state of the market

As insurers move towards automation and further digitization of their underwriting processes, accurate data and sophisticated analytics are becoming increasingly important. One area in which this is particularly important is Environment, Social, and Governance (ESG). ESG factors and scores offer insurers new insights into risk and decision-making, but they also bring new data integration challenges. Insurers that meet these challenges can benefit from considerable competitive advantage.

To understand more about the Commercial Property and Casualty (P&C) Insurance industry's journey to implement ESG scores, Moody's Analytics and RMS, a Moody's Analytics Company has undertaken a comprehensive, independently run market survey. The results of this survey, alongside insights from our experts, help validate the current state of the market and identify any pain points.

Taking the temperature of the market's progress on ESG implementation

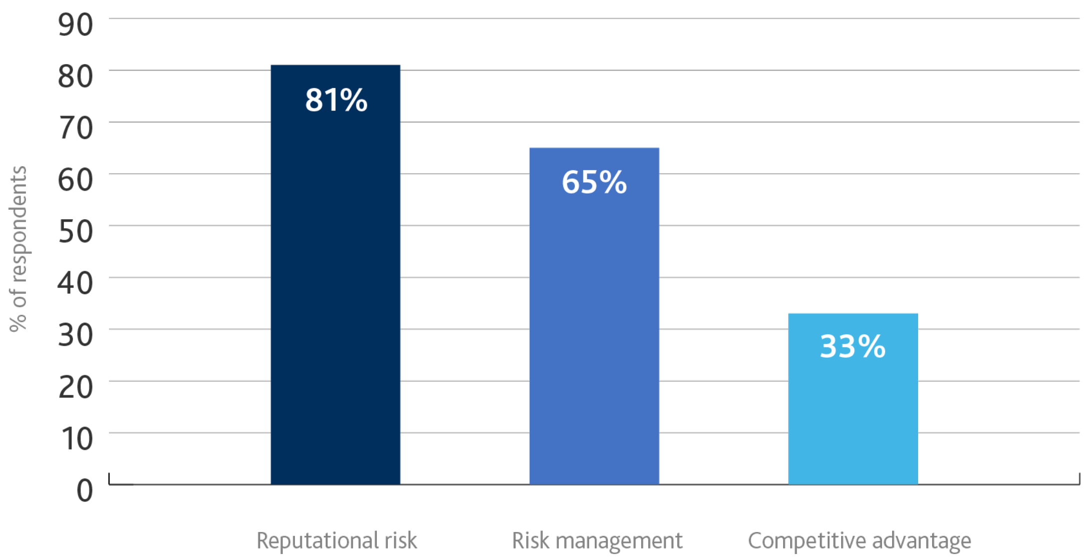
Our survey received 36 responses from Commercial P&C (re)insurers, all from individuals engaged with portfolio management and underwriting functions. The respondents were from a broad range of institutions with Gross Written Premiums (GWP) ranging from $100m to more than £5bn. Almost 80% of the individuals who responded were Directors or more senior, including 14% at C Level. The survey was global with most respondents having operations in North America.

Table of Contents

Why integrate ESG into your business?

The survey results present some interesting data on the key drivers for Commercial P&C insurers to integrate ESG into their business. As we can see from Figure 1, 65% of respondents identified risk management as a key driver with 81% identifying managing reputational risk in particular. While we expected this given where many insurers are in their ESG journey, we were encouraged to see that one in three respondents also saw potential for unlocking new revenue opportunities. We believe that this number is likely to increase as insurers start to realize value and see the opportunities that they can derive from using ESG as an additional risk factor in risk selection, pricing, and product development. Survey respondents were asked about the key drivers for integrating ESG into their business and were able to select more than one answer.

Figure 1 The key drivers for integrating ESG data

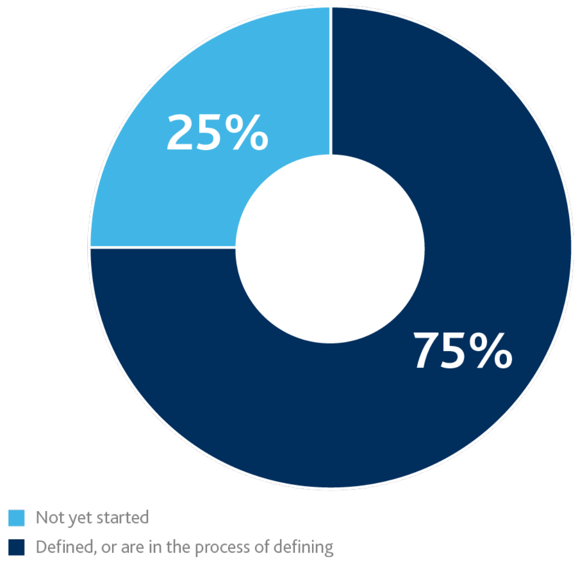


Plans for ESG integration: speed is of the essence

These survey results offer a valuable insight into the importance insurers place on integrating ESG into the business. As seen in Figure 2, a clear majority are, at minimum, making progress on their ESG strategy.

This aligns with our observations from our wide market engagement of the speed of change in the industry. We have noted a significant increase in the number of insurers looking to obtain data and analytical platforms in order to integrate ESG into underwriting over the last 12 months. In addition, insurers have also started to move beyond crude exclusionary approaches to more holistic, balanced approaches to sustainability.

Figure 2 Status of ESG strategy



Taking a phased approach to provide solid foundations for an ESG-centric business model

Our conversations in the market suggest insurers have appetite for rapid progress in integrating ESG into the business. However it is imperative that insurers take an iterative, phased approach, rather than rushing towards full integration.

The first phase involves defining an insurer's vision for sustainability and creating a strategy that, importantly, includes sustainability targets or commitments. Defining targets is critical to creating a vision that can be deployed throughout the business. Insurers need rigor around any new data sets and to be able to understand the scores and data sets they use to build the scores.

The second phase requires companies to understand their current ESG footprint by performing an analysis of their insurance portfolio and measuring against a set of ESG metrics. Through this, they can identify areas of concern and develop strategies to improve the overall ESG performance of the portfolio. At this stage they can also start the first iterations of defining ESG risk appetite and tolerances for the short and medium term.

Insurers can use portfolio heatmaps to start reporting to stakeholders on the current position and the gap to the targets defined in phase 1. They can then communicate the strategy for achieving those targets and commitments. What-if scenarios on the portfolio, for example non-renewal of accounts, run-offs of business lines can help identify the best strategy.

They can also leverage these heatmaps to start thinking about their 'own view' of ESG risk, which utilizes third party and proprietary data, but reweights metrics based on the insurer's own sensitivities and view around ESG risk. An insurer's own view of risk is central to its strategy and the development of this is crucial to its success.

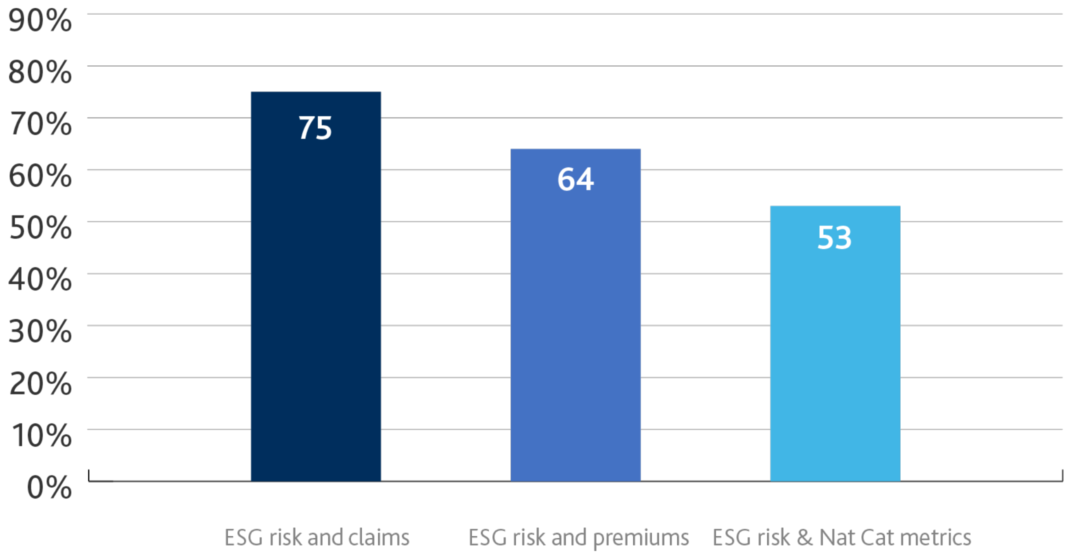
At this stage, insurers can start investigating correlations between ESG risk and various other performance metrics, such as loss ratios and claims data. Should correlations be identified, ESG factors can then be incorporated into pricing models, creating a new risk dimension for underwriters.

Once companies have understood their current ESG footprint and defined targets and tolerance, they can then start integrating ESG risk at the point of underwriting including marginal impact of new or renewed accounts. This will also include engagement with insureds regarding their plans to improve ESG scores, and the support the insurer can provide on this journey.

The importance of understanding correlations

Figure 3 demonstrates how important understanding correlations between metrics are to the market. Survey respondents were asked which correlations they wanted to understand further and could select more than one answer. We can see that three quarters of respondents want to understand correlations between ESG risk and claims, almost two thirds want to understand correlation between ESG risk, and premiums, and more than half want to understand ESG risk against Nat Cat model results.

Figure 3 Appetite for understanding correlations

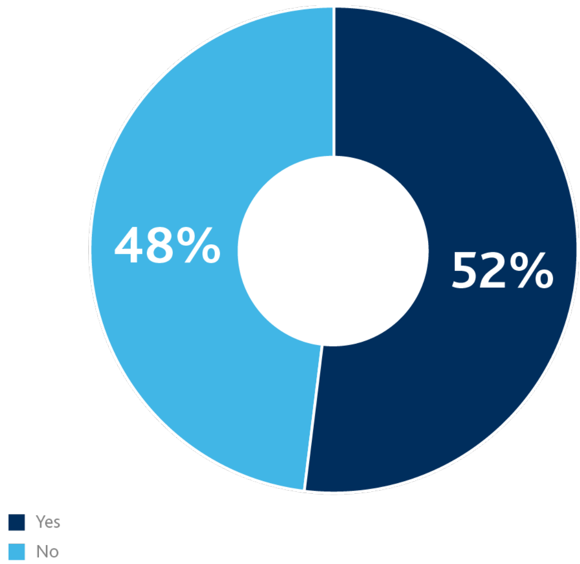


This is consistent with a broader, emerging theme around correlations with performance metrics. Insurers may find they have multiple exposures around the same event, for example a Nat Cat event caused by heavy pollution may then incur litigation as well as the impact of the event itself. It is important here to take a holistic view of ESG. The initial focus has often been on environmental factors and carbon reduction. Insurers should make sure that they are also considering Social and Governance factors. For example, there are clear correlations between poor governance and claims. Diversity and Inclusion should also be carefully considered when looking at 'S' scores. A low 'S' score can correlate to poor results as it can be an indication of how a company treats people and therefore how many claims they may receive. Transition plans are also important in creating a nuanced assessment and consistency with an institution's risk appetite.

The opportunity to personalize the view of ESG risk

We can see in Figure 4 that 52% of respondents are considering whether to personalize the view of ESG risk. This could include blending multiple data sources or weighting data elements important to the strategy and vision. We expect this figure to increase as insurers get ahead of the problem, develop frameworks, assign responsibilities, and include ESG into their decision-making process.

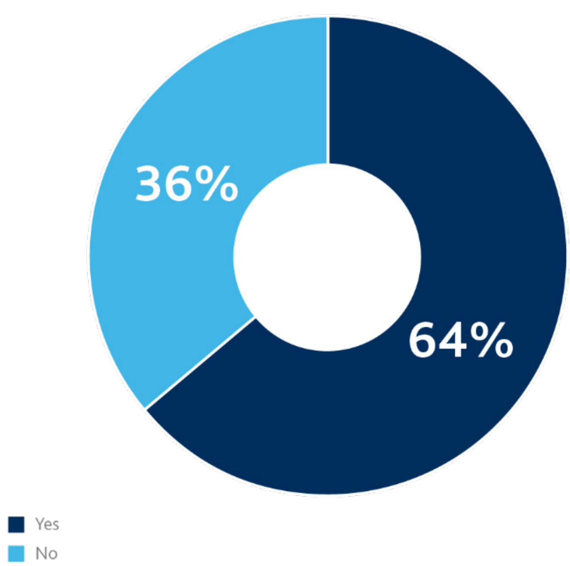
Figure 4 Personalizing the view of ESG risk



Following consistent market standards

The Commercial P&C market often exhibits an approach where there is safety in numbers. The direction of travel is likely to be similar for many participants. As Figure 5 shows, almost two thirds of the respondents indicated that they would like to be able to leverage a market standard ESG framework which further supports the peer consistency which is important in the Commercial P&C market. This confirms our observations that insurers would welcome a standard framework that helps formalize the assessment process, but crucially still allows them to impose their unique view of the risk. This is 'own view' of risk is critical for competitive purposes. We believe that the market standard should be consistent across the insurance value chain, including brokers, carriers, reinsurance brokers, and reinsurers as well as retro capacity providers.

Figure 5 Market standard ESG framework



Highlighting the need for accurate and reliable data

It is clear that to achieve the aims uncovered by the survey, insurers need accurate data that they can rely on. Good quality data on the insured is key for insurers to achieve their aims, and ESG is no different. Insurers need to understand more about who their insured are and where they are based, as well as more about other risk dimensions particularly when reputational risk is such a priority. Gaps in coverage need to be identified and filled as a priority.

Taking stock of progress on the journey to integrating ESG scores

We can see that Commercial P&C insurers have aims of full integration of ESG scores, and most of them are making progress. To achieve these aims of integrating ESG into their portfolio management and underwriting workflows, insurers first need to take stock of exactly where they are on the journey. Then they can assess the challenges they are facing now which may become blockers in the future and develop a plan to overcome them. For any insurers who have not yet started, or who have severe budgetary constraints, it would be prudent to look carefully at their objectives and make a realistic assessment of how they can start working towards these aims.

We have been engaging with the market and taking a partnership approach with our commercial P&C customers to develop a solution that considers ESG in the risk selection process. To find out more about how Moody's ESG Insurance Underwriting solution can help your business, contact us today.