

Consultation: Underwriting environmental, social and governance risks in non-life insurance business

The first ESG guide for the global insurance industry developed by UN Environment's Principles for Sustainable Insurance Initiative

Public consultation: 27 February to 30 June 2019

The public consultation version of the guide can be found at:

<http://www.unepfi.org/psi/underwriting-ESG-risks>.

The guide is primarily intended for insurance industry participants with non-life insurance business, particularly industrial and commercial insurance business. It is aimed at industry participants who intend to develop their approach to integrating Environmental, Social and Governance (ESG) risk considerations into their core insurance business processes and decision-making.

This guide is also useful for stakeholders who might need to assess or obtain information on ESG risks from insurance industry participants, and who would like to better understand the relevance of ESG issues to the insurance business and approaches to managing them.

This version of the guide is a public consultation document. The consultation period will be open from 27 February to 30 June 2019.

Feedback will be reviewed by members of the PSI project team. Interested parties can alternatively send any feedback for consideration to psi-underwriting@unepfi.org.

A full version of the guide will be published by December 2019.

Questions

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Guide

1. Does the guide help develop an ESG approach for insurance industry stakeholders and screening of non-life insurance transactions? How can it be improved?

The guidance is very helpful in raising awareness and in structuring the internal processes required to detect ESG issues and to develop companies' ESG policy, the dialogue with clients / brokers and the decision making. Marine insurers do already a lot to support ESG standards (e.g. loss prevention measures, compliance with regulations and class, reducing impact through proper claims handling). Insurers can also help clients in getting a better overview and understanding of ESG issues and work with them on avoidance and mitigation. In addition, government level support to help primary and secondary producing industries adapt their practices and operations would be valuable. This is particularly crucial in the transport industry where the drive for decarbonisation by 2050 will cause major changes in ship and aircraft design that will require official support and involvement.

The guidance should in IUMI's view take further into account the role and situation of small and medium-sized insurers and smaller, less advanced insurance markets in developing regions. Many stakeholders from the insurance industry who helped UNEP FI develop the PSI principles and the draft ESG guidelines come from multinational enterprises with sophisticated procedures and dedicated officers and responsibilities for ESG issues and related topics. However, this will not necessarily be the case for smaller companies and smaller markets. Experience shows that risks tend to find their way to entities being prepared to underwrite them. Accordingly, the ESG compliance in the industry can only be as strong as the principles of the weakest companies and markets allow. For this target group, the scheme as laid out in the guide might be too abstract and too specific. Non-compliance with ESG principles should not create competitive advantages. Instead, the opposite should be the case (see in this regard bullet points 4 and 5 to question 3).

Although chapter 6.8 explains detection procedures and chapter 9 gives guidance on entities being supportive in doing so, this is a significant increase of the workload to be done in the underwriting process. More client information has to be collected, and a better understanding of the clients' business models and closer cooperation are necessary to assess and mitigate potential ESG risks. This is an opportunity for both insurers and clients. While clients are responsible for their own actions and operations, insurers are well positioned to ask the right questions and identify potential ESG risks. In this context, a clearly visible ESG expertise would be a competitive advantage.

2. Is the guide clear and easily understandable? If not, which sections or areas need improvement and how?

The language could be improved to make it easier to understand.

- The guiding questions at the end of each (sub-) chapter are very helpful.
- Examples or short "case studies" could help to further enhance the guide and make it more tangible.
- The guidance could be improved by adding details of the GHG emissions by sector and country. This would help prevent duplication of effort as all parties would need to research this to inform any strategy they may adopt.
- In the introduction, there is an assertion that "the insurance industry plays an important role in promoting...sustainability". Since not all insurers are doing this it would be more accurate to state "can play an important role".
- An executive summary would also be helpful.

3. Are there any areas missing which should be included in the guide?

- Chapter 6.8 on detection reads well but it leaves much of the core work with the underwriting entity. One could, for instance, expand training for underwriters, time-management, and dialogue with clients / brokers.
- The term "ESG risks" could be misleading. Underwriting "risks" is the core business of the insurance industry. But the ESG issues are not "risks" in the technical insurance terms but risks for the insurer as such when underwriting them. The insurer is not underwriting "ESG risks". S/he is taking the ESG dimension into account when deciding on underwriting a "real risk". One could consider to replace this wording by "ESG factors" or "ESG dimension".
- Insurer / client (broker) cooperation plays an important role and may be subject to a dedicated (sub-)chapter. Marine insurance is often done through the broker as an

intermediary, therefore obscuring the direct contact between the insurer and the assured. An additional layer of complexity is added due to concept of subscription based insurance where several insurers write a share of a certain risk. One of the insurers is the lead underwriter who will be in charge of handling claims if there are any, while the co-insurers bear part of the risk but will not have direct access to information from the client.

- To address the implementation of ESG related underwriting principles for smaller companies and less developed markets, the guide could offer different levels: A “light” version with core key principles which is easy to understand and implement and guidance for more sophisticated procedures for developed markets and multinational insurance companies with dedicated ESG officers and departments.
- Reporting and transparency are important tools to indicate progress made by insurance companies. It should not however be required to conduct this in a fixed format as this may prove counter-productive.
- There are not currently outlined specific benefits to insurers nor a cost-benefit analysis. These could be helpful to further incentivise insurers to take ESG factors into consideration in their underwriting.

4. Is the format useful or would another format be better?

The format is suitable. In addition, a shorter version with the key milestones and questions which need to be considered to develop an ESG approach could be useful. Such a short version should include the key points:

6.5. Integrating ESG issues into your organisation

6.6. Establishing roles and responsibilities for ESG issues

6.7. Escalating ESG risks to decision-makers

6.8. Detecting and analysing ESG risks

6.9. Decision-making on ESG risks

6.10. Reporting on ESG risks

5. How frequently should the guide be updated (e.g. yearly, every two years)?

Annually appears to be a suitable cycle to take into account recent changes and developments.

6. Would additional training or information be helpful? If so, what form (e.g. webinars, training sessions, discussion forums)?

Online trainings, e.g. webinars could be a useful way to further raise awareness and spread the ESG guide among insurers. IUMI would be happy to host a webinar with UNEP PSI experts, possibly in cooperation with an ESG representative from one of our member associations or companies.

At this stage, in IUMI's view, raising awareness and better understanding of ESG factors is most important. The promotion of the principles and the guide should focus on this. The competitive advantages for insurers who have a sophisticated ESG approach with regard to their clients should be emphasised in this process. ESG expertise helps to match with clients' needs and demands and helps raising the profile of the individual insurers in enabling their clients to run compliant and ESG compatible businesses.

Heat maps

7. Are the heat maps clear and easy to understand?

- The lines of business related heat map differentiate "marine" and "cargo". We assume that with "marine" it is meant "hull"? Marine insurance usually differentiates between "hull insurance" (the vessel), "cargo insurance" (the goods transported or stored), "marine liability insurance" (P&I and similar like forwarder's liability, collision liability) and "offshore energy insurance" (upstream offshore business).
- "Animal welfare":
 - "Heat stress" could be added in the section about "Live transport over 8 hours or poor conditions".
 - "Checks by veterinary or similar" could be added to the risk mitigation examples and good practice. The same risk criteria "Live transport over 8 hours or poor conditions" could be red instead of orange when it comes to the sector "Transport/Shipping/Logistics". Add risk criterion regarding illegal and exotic animal trade (dead or alive).

8. Are there ESG risks which should be added or deleted? Please justify.

Non-admitted local insurance: For marine insurers, the problem of non-admitted local insurance coverage often plays a role. A particular insurer might not be allowed to underwrite particular risks in particular countries due to local legislation (which is constantly changing). In this context, fronting arrangements are an additional complexity. Fronting policies are a risk management method in which an insurer underwrites a policy to cover a specific risk, but then cedes the risk to a reinsurer. Such reinsurance arrangements will make it more difficult for companies to gain direct access to information. In line with the arguments stated above, this could be a topic for inclusion in the streamlined internal ESG procedures.

9. Are there risk mitigation examples and good practices which should be added or deleted?

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10. Are there economic sectors, which are material to ESG risks in non-life insurance underwriting, that should be added?

We would suggest to rename "transport/shipping" in "transport/shipping/logistics". Warehousing, minor manufacturing services, client contact in the supply chain etc. are nowadays to a large degree taken over by logistics service providers. Online shopping is a good example for this development.

Moreover, there is no reference to the action taking place in the banking or capital sectors. Without access to that money, projects and whole sectors will be effectively limited.

11. Do you have suggestions on the risk categorisation of specific ESG risks vs economic sectors? Please provide cell reference and explanation.

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12. Should some lines of non-life insurance business be added or deleted? Please explain.

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13. Do you have suggestions on the risk categorisation of specific ESG risks vs lines of non-life insurance business? Please provide cell reference and explanation.

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14. Are you aware of any additional ESG information sources that are relevant, of good quality and with international recognition? Please indicate them.

- The recently published “Poseidon Principles” which aim to integrate climate considerations into lending decisions to incentivize maritime shipping’s decarbonisation could be added to the climate change section.
- The International Maritime Organisation (IMO) issues many regulations and guidelines which are partially dealing with ESG factors relevant to the maritime industry. An example is the “Polar Code” which provides comprehensive guidance on arctic sailings in order to comply with environmental and safety requirements.

Additional comments

Please provide your any additional comments, input, questions or suggestions that you may have.

Chapter 6.8 states in the beginning that “Not all insurance industry participants are fully digital in the underwriting process”. UNEP FI should be aware that this is an understatement. The insurance industry is currently working on digital business models and is making good progress. As of today, the majority of the underwriting has not been completely digitalised and risk transparency is not at a level allowing complete ESG transparency. The reasons are not primarily missing hardware and software or a lack of training of the employees but rather a lack of access to clients’ information in a suitable digital format. Such lack of information is caused by reluctance of disclosure, by competition (the competitor doesn’t ask) or most important by legal provisions such as competition law or antitrust law. The guide should take into account that getting access to information continues to be challenging and an expensive task for most insurers. The broker as an intermediary and the concept of subscription based insurance (as mentioned above) further add to the complexity.

Additional background information specific to marine property insurance:

Hull & Machinery (H&M) Insurance: The H&M insurance is the vessel's property insurance and covers damage to the vessel itself, its machinery, the ship's proportion of salvage costs and the vessel's contribution to general average. H&M insurance is often covered by two or more underwriters (subscription based); with one lead hull insurer who is authorised to act on behalf of all followers. Co-insurers provide additional cover and are generally used when the amount of the subject-matter insured is too large for a single insurer to cover by itself.

For hull insurers, classification societies are a major factor to consider when underwriting a vessel or a fleet. Classification societies are bodies who set rules relating to the structure of a ship's hull and the reliability of the propulsion and other essential systems on board. Class is part of a wider framework to consider which includes amongst others the flag under which a vessel sails as well as the owners and operators. Cover automatically terminates if there are changes in the classification society, ownership, flag, management or bare boat charter.

Cargo insurance: Cargo insurance is also property insurance and covers all damages to the cargoes loaded on board and the cargoes' proportional share of general average (general average is a principle of maritime law whereby all stakeholders in a sea venture proportionally share any losses resulting from a voluntary sacrifice of part of the ship or cargo to save the whole undertaking in case of a claim). Cargo insurance can also be written on a subscription base. It provides coverage against all risks of physical loss or damage to freight during the shipment from any external cause during shipping, whether by land, sea or air. Cargo insurance covers transits carried out in water, air, road, rail, registered post parcel, and courier.