Time to Act:

Sustainability in the Korean Insurance Industry

ECCK INSURANCE COMMITTEE 2021

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INTRODUCTION

The key challenge of our time is to find more sustainable paths of living for the future. It will require commitment and actions from all parts of society, to turn unsustainable trends and coming up with new ways of building a more resilient future.

Amongst the various challenges we are facing today, the threat of global warming is maybe the most decisive issue. It will only be curbed through effectively reducing Green House Gases 'GHG’ (including CO_2) in the coming decades. Exactly how each sector will adapt its products, and processes as well as how managing externalities are still forming, but the required outcome is defined; -keep global warming below 2 degrees Celsius- as declared in the United Nations Framework Convention of Climate Change (Paris Agreement/COP25). Still, this will require further knowledge sharing and intensive collaboration across all involved parties to be possible.

For the insurance industry, the concept of sustainability is quickly evolving, some of the already established practice is for example restrictions of risk financing for specific carbon-intensive production methods and active support of new energy technologies. The experience from the COVID-19 pandemic has further emphasized business operations’ resilience in the light of unexpected events, and the importance of health, safety, and wellbeing became central to the resiliency and sustainability discussion for any business.

Although the Republic of Korea has committed to the Paris Agreement and confirmed carbon neutrality by 2050, the concrete actions and the commitments in its insurance market are still only minor. The early discussions and initial activities are clustered under the title of ESG. There is now a significant opportunity for the Korean Insurance industry to lead the way for the needed transition and form long-term objectives, cementing its position as a true societal risk mitigator.

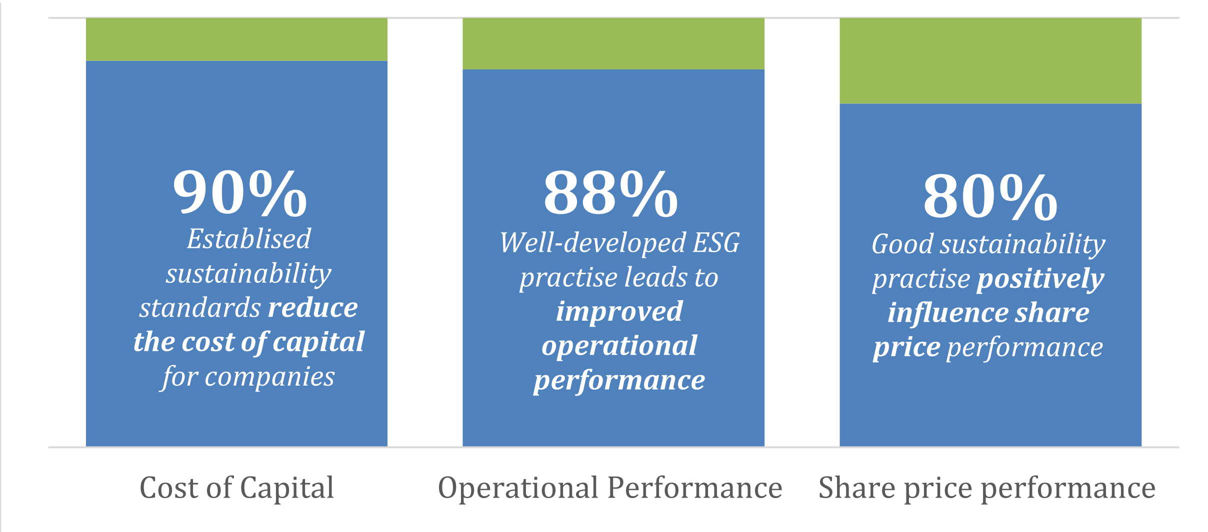
This paper aims to share some of the learnings and experiences the members of ECCK Insurance Committee have with regards to sustainability. It aims to inspire and raise further questions on practical aspects of the common global issues we all stand in front, accelerating climate change. The only thing that we are sure about with regards to sustainability is that it will have a material impact on the insurance industry and that the time to act is now.

GLOBAL CORPORATE TREND ON SUSTAINABILITY

Today, many companies around the world are recognizing the importance of a well-designed and executed sustainability strategy. A recent article from Institute for Management Development (IMD) indicated that 62% of corporate executives consider a sustainability strategy necessary to be competitive today, and another 22% think it will be in the future.

Not only executives are driving these changes; a 2018 study concluded that about half of US consumers are willing to adjust their habits to reduce the negative impact on the environment, and sustainable product sales have grown by nearly 20 percent since 2014. Furthermore, millennials, a growing important consumer group, are willing to pay more for products and services containing sustainable ingredients or products with social responsibility objectives.

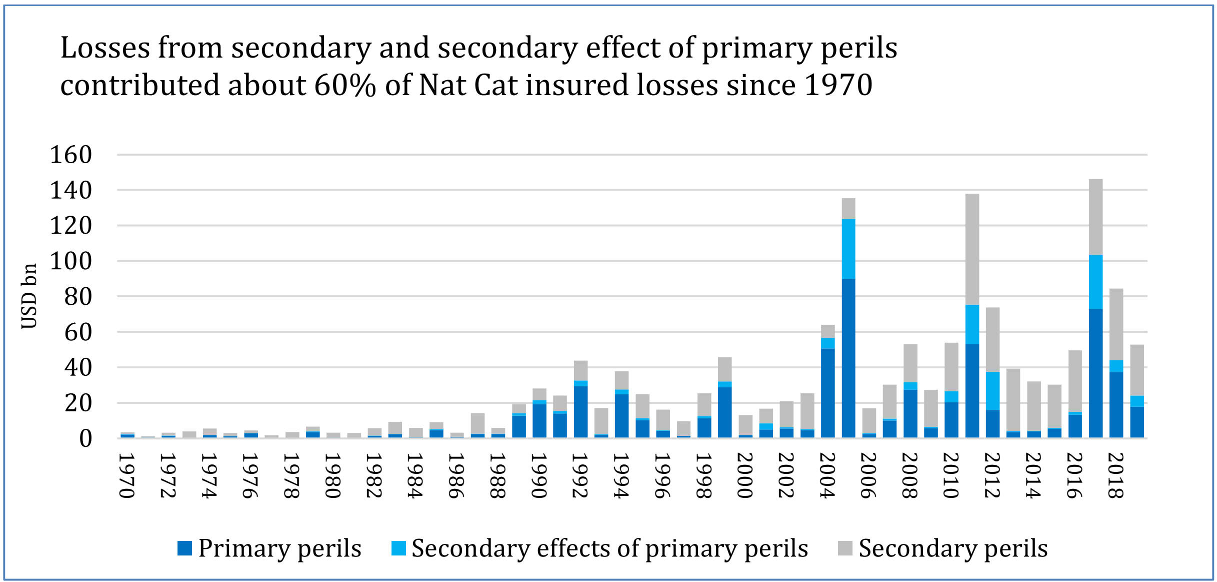
In short, a sustainable business strategy aims to positively impact future business results, including managing GHG emissions and thereby helping address some of the world's most pressing problems related to global warming. Sustainability does not mean sacrificing profits or putting financial success on the backburner. Instead, it has become a crucial element in any organization's successful strategy. Many studies show a business model that does not factor in sustainability risks to be less successful in several operational and financial measures, as presented by Oxford University.



Percentage of studies showing;
Source: BNPP AM, University of Oxford, "From The Stockholder To The Stakeholder, 2015"

IMPACT ON THE INSURANCE INDUSTRY

As climate change yields traction as a global issue in most sectors, the insurance industry is now weighing in on the debate and its role. Sustainability risks and opportunities are of increasing relevance for insurance companies with a solid potential to impact the way business is conducted and add to the risk types covered today.



Source: Swiss Re Institute

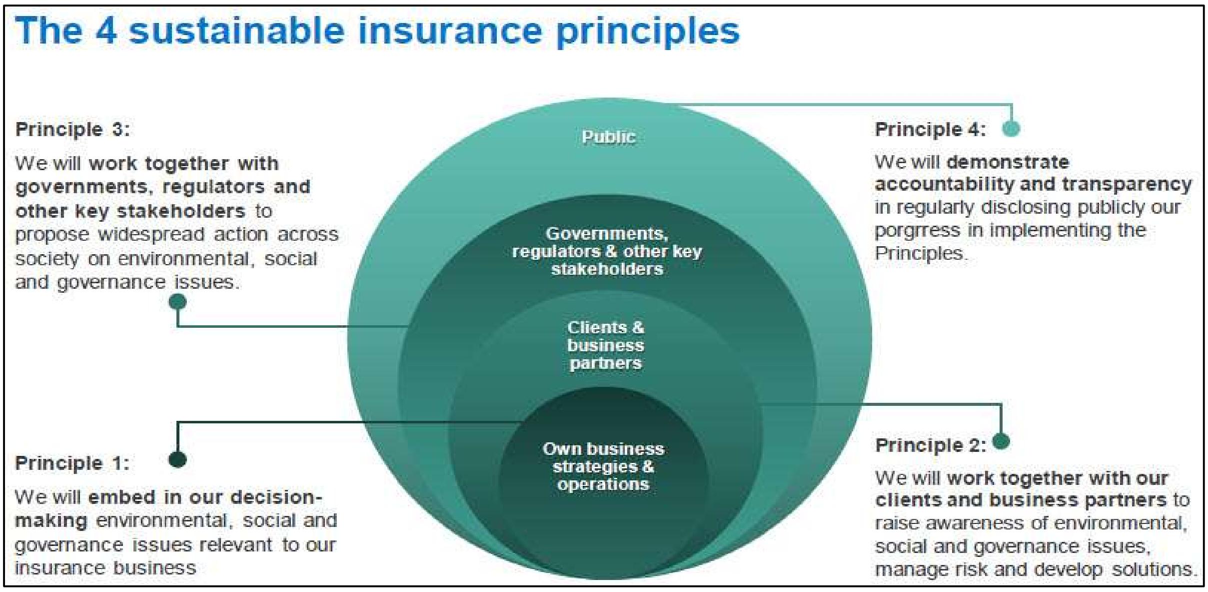
Opportunities can arise from the increasing demand for risk management and mitigation related to change in risk patterns caused by climate change. The details of products and services will differ dependent on market structures, risk behaviours, exposure, and the ultimate impact of changing conditions. Ultimately, insurance companies' capabilities to innovate and adapt will be put to the test during this transformation. Besides the product and services, insurance companies can also adjust and benefit through incentivizing low-carbon-related purchases/assets by offering insurance premium differentiation or being transparent on risk and claims performance when underwriting low-carbon assets such as green buildings.

Simultaneously, the direct impacts of climate change are undoubtedly a significant aspect of the liability side of an insurer's balance sheet. Other factors such as social and governance issues might also play a role in, for example, Directors and Officers policies and reputation risk insurance contracts, and social risks in the context of an aging population.

The results of the Geneva Association survey highlight some key risks and opportunities by insurance companies in practice:

- Limited access to risk information and related risk pricing difficulties
- Public policy, regulatory and legislative issues
- Lack of awareness about insurance
- Weakness of domestic insurance markets
- Limited take-up of disaster insurance
- Regulatory barriers to access global reinsurance
- Scalability and sustainability of insurance programs

Against the backdrop of insurers' significant investment volumes, which exceeds over USD 30 trillion today, sustainability risks and opportunities on the asset side are also highly relevant. In contrast, risks can arise from investing in firms that are vulnerable to the consequences of future climate change. Opportunities occur by focusing on resilient companies to such a development, as already emphasized. They point out that such an analysis is highly relevant for climate-sensitive sectors, including real estate, municipal bonds, and infrastructure funds. Any identification of investment opportunities in sustainable firms and projects should also consider the investment time horizon with a forward-looking approach.



Source: UNEP FI Princples for Sustainable Insurance

The insurance industry is aware of the importance of its role in coping with climate change. As early as 2012, the UNEP FI Principles for Sustainable Insurance launched to focus on embedding environmental, social, and governance issues in insurance decision-making, raising awareness of the same with clients and business partners, and promoting action with governments and regulators, and key stakeholders. Many insurers are signatories to these principles, and some of the most forward-looking ones have also committed to becoming carbon neutral by 2050 or even before.

SUSTAINABILITY IN KOREA

In a recent report from the PEW Research Centre, the citizens of South Korea place the climate crisis highest in their list of potential national threats. Of those surveyed, 86% agreed it is a 'major threat to our country, higher than even North Korea's nuclear program, which 67% viewed as a significant threat. Korea is championing low-carbon development in the Asia Pacific, with strong support from the government and regulators. While it is one of the top seven emitters of CO_2 globally, only time will tell if the country will become a leader in the region.

Over time, the government aims to become a leading exporter in green research and technology. In line with this plan, Korea has passed a USD 30.7 billion stimulus package to support its green ambitions. Including renewable energy resources, energy-efficient buildings, expanding railway systems, and improving waste management. Projected benefits include increasing employment in green sectors, improved income, and energy security, and significantly reducing GHG emissions.

Green New Deal KRW 1.4trillion – Invest a total of around KRW 12.9 trillion by 2022		
1	Eco-friendly management of cities & infrastructure	KRW 370 billion
	● Create zero-energy public facilities	
	● Lead 100 projects to create smart green city	
	● Build a smart & clean water management system using ICT	
2	Promote green industries & eco-friendly manufacturing	KRW 480 billion
	● Selected 100 enterprises & 5 industries to lead green new deal	
	● Build low carbon & eco-friendly complexes to create key manufacturing industries greener	
3	Promote low-carbon & distributed generation technology	KRW 580 billion
	● Build advanced smart grid	
	● Promote new renewable energy production	
	● Replace old public vehicles with eco-friendly one	

On the private investor side, South Korea is still in the early stages. However, led by the most prominent investors, including Korea National Pension Service and Korea Investment Corporation, ESG investing is becoming increasingly relevant in the investment process. The aim is to generate sustainable returns with a long-term view and invest in companies that can demonstrate commitment to sustainability.

Also, the insurance industry is also impacted by these changes. Most recently, Financial Services Commission Chairman Eun Sung-soo highlighted that the emerging environmental, social, and governance trend could provide local insurance firms with new business opportunities.

EUROPEAN INSURANCE INDUSTRY

Most European insurance companies have, over the last few years, concerning sustainability strategy, gone from complying with the rules to recognize it as an essential business element for survival. Insurers are uniquely positioned to help people, companies, and communities recognize the need for more protection and to close the massive natural catastrophe-related protection gap that currently exists.

As risk management shows some limits, insurers must play a more significant role on the risk prevention side. And work with government, public bodies, and municipalities in developing climate risk-resilient infrastructure and nudging them toward disaster protection. Below we have listed some recent examples of how European Insurance companies have adapted to these new challenges and offered their expertise to provide solutions in the following area.

I. Investments: investing in green assets, divesting from specific carbon-intensive industries (coal and oil sands), climate-related shareholder engagement, climate risk analysis with a long-term view;
II. Insurance: underwriting restrictions on the coal and oil sands industries, “green/sustainable” products in both Property & Casualty and Life & Savings ranges, promotion of new insurance solutions designed for developing countries (typically parametric insurance);
III. Operations: direct environmental footprint targets covering energy & carbon emissions, water, and paper;
IV. Risk measuring for solvency and stress test. As the topic of climate change increases the attention from investors and regulators, insurance companies needs to ensure proper reflection and quantification of the related risk in their risk measures

Selected case studies from European Insurance companies are below

Case 1 – Investments

Positive Impact Investments – BNP Paribas Cardif

BNP Paribas Cardif has announced their plan to invest an additional five billion euros in activities with a positive environmental and social impact, bringing its total commitment to 11.5 billion euros by the end of 2024. This is in addition to the 6.5 billion (as of 2019) of existing positive impact portfolio. The targeted of investments areas includes:

- Green bonds that finance projects with environmental objectives: mitigation of climate change, adaptation to climate change, preservation of natural resources, preservation of biodiversity and pollution prevention and control;
- SDG Bonds , which finance projects that contribute to the UN Sustainable Development Goals;
- Environmental theme funds to finance the energy transition, energy efficiency, sustainable food and agriculture, waste management, etc.;
- Employment theme funds: workplace well-being, job creation, inclusion, etc.;
- Social theme funds: education, sustainable mobility solutions, customer satisfaction, social and solidarity economy, etc.;
- Real estate assets that have obtained environmental performance certification or conformity with recognized standards, and/or which have a positive impact on employment or society in general

Case 2 – Insurance

Coal Exclusion Policy – AXA

AXA has been in the forefront for actively reducing exposure to coal mining and coal-based energy production in the investment operations. Burning coal has significant implications for air and water pollution, but its most serious long-term impact is on global warming. Coal is responsible for around 45% of anthropogenic emissions, the largest single source of the global temperature increase. Since 2019 this ambition is also reflected in insurance operations as follows:

- Any insurance for development of new coal capacity is banned by ending Construction covers for any new coal plant and new coal mine, whichever the region or client (regardless of investment blacklist). This includes Marine Project Cargo policies related to the construction of new coal power plants or coal mines.
- The operation of existing coal projects is restricted by ending Property covers for existing coal plants when these are included in coal-only risk packages. This does not apply to emerging countries where access to energy remains a concern for local populations, and baseload energy alternatives are not yet in place.

The underwriting policy does not exclude the refurbishing or retrofitting of an existing power plant in order to improve its energy or thermal efficiency. Insurance related ESG risks and opportunities also benefit from a specific governance, notably the Group Underwriting Committee, which defines underwriting restrictions.

Case 3 – Business operations

Sustainability in Business Operations – Allianz

Through the Global Sustainability Function, with direct reporting to the Board of Management Allianz quickly integrating sustainability into core business. This work is supported by our network of more than 60 Local Environment Officers worldwide, who continue to drive lighthouse initiatives to inspire others to continuously improve the environmental performance. Allianz is operating carbon-neutral since 2012 and have since 2006 measured and reported its environmental performance.

Going forward the company is firmly committed to further minimizing the environmental impact in line with its published Group Environmental Guidelines, the share of green electricity in business operations will be increased to 100 percent by 2023, currently it represents around 57% and the use of single-use plastic and paper will be further reduced. Most recently this have resulted in 62% of reduction of greenhouse gases per employee since 2010.

In its social engagement, Allianz has committed to clean oceans and coasts, biodiversity conservation and sustainable fishing practices most recently by partnering with the international marine conservation organization Sea Shepherd Global. Concretely four Allianz companies are providing the funding for the newly acquired ship "Sea Eagle" and its crew, who will be active on the disposal of illegally-left fishing nets – a problem little known to the public.

Case 4 – Measuring risk

Climate Risk and Targets – Swiss Re

Sound risk management, underwriting and asset management lie at the core of the re/insurance business. This enables us to use our existing processes and instruments to address climate-related risks.

Swiss Re's full, proprietary integrated risk model is an important tool for managing the business: we use it to determine the economic capital required to support the risks on our books as well as to allocate risk-taking capacity to our different lines of business.
For example, annual expected losses for weather-related natural perils can be used as an indicator for our average current climate-related risk exposure, where the four largest perils are currently:

- North Atlantic hurricane
- US Tornado
- European windstorm
- Japanese tropical cyclones

As climate risk is an evolving matter, appropriate management of transition risks and assess potential impacts a monitoring system has been set up, that combines expertise in risk management and casualty underwriting, as well as for relevant legal developments.

AREAS FOR CONSIDERATIONS FOR THE KOREAN INSURANCE INDUSTRY

As we have argued in this paper, the insurance industry is uniquely positioned to help people, companies and communities recognize and address the need for actions to solve the emerging threat of changing climate. The Principles for Sustainable Insurance aim to focus on embedding environmental, social and governance issues in insurance decision-making, raise awareness of the same with clients and business partners, and promote action with governments, regulators and key stakeholders. In Korea the insurance industry is converging strategies and priorities along these principles, but it is still early. Below we have listed four immediate areas where the potential for impact is material, and the case for success is high.

As we have argued before there is no one right approach to address the common challenge of climate change. Instead, collaboration across industry players will be of importance, where learnings and ideas are widely shared.

Recommendations:

1. Establishing policy/industry standards; an industrywide directive is a key starting point to cumulate the effort and ambitions. Today several global initiatives provide collections of steering documents and other resources, both in relation to exclusion and inclusion methods. Through the established industry associations in Korea, these can be further refined and adapted, to fit the unique market characteristics in Korea.
2. Commitment to transparency; any ambition of this magnitude needs measures that can be communicated to its stakeholders. One broadly recognized framework is the Task Force on Climate-related Financial Disclosures under the G20 and Financial Stability Board. It aims to provide stakeholders with informative evidence on the impact and outcome of sustainability strategies. It includes both recommendations and financial impact analysis.
3. Product development; developing and offering new products related to climate change and the related economic transitions is a must do for the insurance industry. With willingness and commitment to lower the hurdles for trial and inventions, potentially through regulatory acceptance of sandboxing and piloting. New products explicitly targeted to create loss-prevention solutions and products that will reduce climate change related losses for consumers, government, and themselves.

4. Reflection in Regulation/Stress Tests; as important as it is to support the overall plans to address climate change, insurance companies need to ensure appropriate resistance and anticipate these threats. A growing use of climate stress test has been observed in other jurisdictions, aiming to measures climate changes effect on individual companies and the sector overall. The methodology aims to capture temporary shocks by linking financial institutions and the day-to-day functioning of the economy, between solvency and liquidity problems, between governments and financial institutions, and among financial institutions themselves.

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