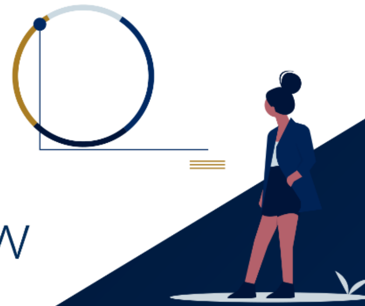
October 2021

Quarterly Review



By Ingrid Sapona | 22-minute read

In this issue we focus on two topics that have risen to prominence over the past year. The first article explores the benefits of having a risk management designation. Though risk management has always been central to insurance, Covid-19 helped focus businesses and governments on risk in ways that many hadn't before. We focus on the Canadian Risk Management designation and discuss how it provides valuable training and a recognized credential that can be valuable to your insurance career.

The second article is on the topic of climate change. More particularly, on the insurance industry's actions related to trying to achieve net-zero greenhouse gas emissions by 2050. In 2019 a number of insurers and re-insurers committed to transitioning their investment portfolios to net-zero. In July 2021 a group of insurers and reinsurers formed the Net-Zero Insurance Alliance, committing to transitioning their underwriting portfolios to net zero as well. In this article we focus on underwriting strategies that can foster the transition.

Career enhancement potential of a Risk Management designation

"Brokers are the bridge between underwriters and clients. So, the better we understand the risk profile of our customers, the better we're able to demonstrate to underwriters the position a client is in."*—Sara Runnalls, Vice President, Commercial Operations – GTA Region at Gallagher*

There's no doubt that over the past couple years there's been renewed interest in risk management. The pandemic helped focus businesses and governments on all sorts of

risks that were unforeseen to many, or that were considered so unlikely that they didn't warrant much attention before. Carol Fox, vice-president, strategic initiatives at RIMS, commented in April 2020 that she thought the pandemic would likely be an inflection point for risk professionals.
The hardening insurance market is another factor that has contributed to renewed emphasis on risk management.

As the chief risk and compliance officer at a French civil engineering construction company put it, "The focus has to be on risk mitigation. You have to do your best to reduce the risk because in a hard market, mitigation should be the way to achieve lower premium spend."
Indeed, Dirk Wegener, president of the Federation of European Risk Management Association (FERMA) spoke of a "new era for risk management" as a result of the "double whammy of financial pressure as organisations struggle in the pandemic and a hardening insurance market."

CRM designation

Earning a Canadian Risk Management (CRM) designation is seen by many as particularly valuable to insurance professionals. Sara Runnalls, Vice President, Commercial Operations – GTA Region at Gallagher, thinks having a CRM designation is a career enhancer, especially for commercial insurance brokers. "I'd say there are three ways in which having a CRM designation can enhance your career. First, since risk is so central to insurance, obtaining your designation demonstrates your commitment to the industry. It also shows a commitment to learning, which is important to employers. Second, it provides you with the building blocks necessary to understand the risks underwriters are concerned about and that helps you market clients to underwriters. Lastly, a CRM helps you communicate more effectively with clients."

"Brokers are the bridge between underwriters and clients. So, the better we understand the risk profile of our customers, the better we're able to demonstrate to underwriters the position a client is in," says Runnalls. "And on the other side, with risk management expertise, we can help clients better understand underwriting concerns. Being educated about risk management allows you to better understand what both clients and underwriters are talking about and are concerned about," she says. "Having an understanding of risk control tools and risk financing is also invaluable. You can help clients understand what drives premium and you can work with clients to improve their risk profile in ways that make them more attractive risks to underwriters."

Brian Kelly, Managing Partner, Risk Management, Financial Institutions and M&A Practice at BFL Canada, believes formal risk management training helps you understand all the factors that impact the cost of risk. "I'd say that a lot of time is spent on monitoring and discussing the insurance spend, rather than focusing on the various risk control and financing techniques that have a more holistic impact on the total cost of risk (TCOR). The CRM courses help students understand what comprises TCOR, how to monitor TCOR, and techniques that form part of a well-established, multi-pronged risk

management strategy," says Kelly, who has both the CRM and FRM (Financial Risk Manager) designations.

Risk management consulting opportunities

Lilli Chiu, Assistant Vice President and Senior Risk Consultant, HUB International, had her Canadian Registered Safety Professional designation and worked in occupational health before starting her insurance career.

"Going for the CRM designation made sense to me because I knew it would give me a really good overview. In the program you study principles of risk management, risk assessment, and risk financing – all things we deal with in insurance," Chiu says.

"Also, it's been valuable because it gave me more credibility for what I do and it shows you're committed to having the knowledge around the importance of managing risk and the strategies to help our clients reduce the impact on their organization's business goals," she says.

As part of HUB's International Risk Services Division, Chiu's work is different from a traditional role at a brokerage. "As part of the Risk Service Division, we provide risk management consulting to HUB clients. Our internal partners – brokers and account managers – pull us in to help clients in unique situations and at various times. For example, we may be pulled in mid-way through a policy year or as renewal is coming up, or if a client has had some sort of incident or operational change. We try to be proactive and offer strategy on ways clients can manage all sorts of risks. But we're also reactive, for example, if the client has had a significant loss we might be called in, or if there's a catastrophic event like a pandemic or natural disaster." Though Chiu's team's focus is primarily aimed at serving HUB's clients, they do occasionally offer risk management services on a fee for services basis.

Chiu loves working in risk services. "I'm able to apply my knowledge across a lot of different industries and I genuinely like working with people and companies. Plus, the requests that come in are always different and new. My work with a client can encompass best practices for risk management, reviewing and recommending controls, analyzing claims and loss reports for trends and seeking opportunities for overall improvement of operations with a focus on proactive risk control and that kind of thing," she says. "I really have to be on my toes. We're making sure everyone is making good business decisions and putting in place measures to prevent risk."

Chiu finds that the clients are happy to meet with and work with her. "We're there to make sure the client does the best they can. That's really the 'profitability' principle of our value proposition," she says. "They welcome our services because they know that our interest is them – the client – not the insurance company. So, for example, say the client finds out that their insurer wants to come to inspect them. In that case, we may be pulled-in to help the client through these inspections. We help them put the proper controls in place and ensure they have good documentation, and we educate them

about best practices. Our clients realize we're a resource for them, and they appreciate it," she says.

Helping clients navigate during a hard market

As noted earlier, the hard insurance market has brought many challenges and has focused a lot of attention on alternative risk management tools and techniques.

"In the current insurance marketplace, where clients may face higher retentions, more restricted terms, reduced capacity, higher premiums, and so on, it's especially important to be able to communicate to underwriters that a client is 'best in class'," says Runnalls.

"To get to that point you may need to help the client understand what measures they can take to eliminate or mitigate risks you know underwriters are especially concerned about. You can also help clients weigh alternative risk transfer possibilities. You may also have to help them understand particular subjectivity clauses an insurer may insist on, or the warranties an insurer may require of the insured," she says.

Chiu says HUB brokers are also bringing in their risk management consultants to help clients put their best foot forward to insurers. "Brokers and clients are really being challenged by insurance companies because of the hard market. Limits are being reduced, or coverages are not being offered. The insurance renewal process is getting more difficult and it's getting harder to bind insurance. As a result, brokers are coming to us, asking us to get involved to assist with the pre-renewal process and to identify any opportunities to help our clients manage their operations with a focus on implementing sustainable risk management programs. As I said, we're there to advocate for our clients and support them in their organizational goals with risk management practices," Chiu says.

The insurance industry's response to net zero

"When we do a risk-based assessment, we don't just rely on risk data. We analyze the data and look at the science, but there's the art of it too. You bring your judgment and you make choices based on a combination of the three: data, science, and art."*—Susan Penwarden, Chief Technical Underwriter at Aviva Canada*

Climate science makes it clear that global warming is proportional to the total amount of carbon dioxide human activities add to the atmosphere. Under the 2015 Paris Agreement, a legally binding international treaty on climate change, nearly 200 countries have agreed to limit global warming to well below 2°C (preferably 1.5°C) as compared to pre-industrial levels. To achieve this goal, global greenhouses gas emissions (GHG) must be reduced to net zero by 2050.

In addition to the countries that have signed on to the Paris Agreement, over 160 firms with US $70 trillion in assets have also agreed to "steer the global economy towards net-zero emissions and deliver the Paris Agreement goals."

It's widely accepted that insurers can have a significant role in the transition to net-zero emissions and in mitigating the risks associated with climate change. Until fairly recently, much of the discussion related to the investment side of the insurance business – in other words, insurers as asset owners. More and more, however, people are talking about ways commercial underwriting can impact climate change goals and how doing so might drive the change faster, given that most policies are for one year.

The Net-Zero Asset Owner Alliance and Net Zero Insurance Alliance

In September 2019 a group of pension funds and insurance companies formed the Net-Zero Asset Owner Alliance (NZAOA). NZAOA members recognize they are acutely vulnerable to the system disruptions of climate change, given their long-term investment horizons and liabilities.

With over US $6.6 trillion assets under management , NZAOA members have committed to transitioning their investment portfolios to net-zero GHG emissions by 2050. They have also agreed to regularly report their progress and to establish intermediate targets (at five-year intervals) in line with the Paris Agreement.

The UN-convened Net-Zero Insurance Alliance (NZIA) was launched in July 2021. The NZIA is comprised of insurers and reinsurers that have committed to individually transitioning their underwriting portfolios to net-zero GHG emissions by 2050. (Interestingly, all eight "founding" NZIA members are also members of the NZAOA.) NZIA members will individually set science-based intermediate targets (again, at five-year intervals) and will independently annually report on their progress.

Aviva is a founding member of NZIA and Susan Penwarden, Chief Technical Underwriter at Aviva Canada, is among those representing Aviva at NZIA meetings. "The NZIA's an important venue for the industry. It's sponsored by the UN and it has a lot of the biggest insurance and reinsurance companies.

It's a collaborative effort," she says. "In addition to the core group, there has been a lot of interest by others in the industry. Naturally, we want as many insurers as possible

committing to transitioning to net zero, but it's not clear just yet if the group will formally grow to include more. It's early days," she says.

Organizations like ShareAction, which rank insurers on environmental, social, and governance factors (ESG), have commented that insurers have taken a stronger stance on excluding fossil fuels from their investment portfolios than their underwriting portfolios. But, the gap appears to be narrowing, at least with respect to policies around coal. "I think we're seeing a closing of that gap. But there are still companies that have divested from coal that are still underwriting coal," according to Peter Bosshard, global coordinator of Insure Our Future, a coalition of NGOs.

In terms of whether insurers are finding it easier to move toward net zero on the asset side than on the underwriting side, Penwarden doesn't think that's necessarily the case. "I don't think aiming for net zero on the asset side is easier, but we have a clear 'engagement with teeth' process on the asset side, through the Aviva Investors Climate Engagement Escalation Program. On the underwriting side it's not as straightforward, even in terms of how you measure the carbon footprint of the underwriting portfolio," she says.

Though both the asset (investment) and underwriting side of the business are integral to the insurance industry, in this article we will focus on the transition to net-zero GHG emissions on the underwriting side.

Transitioning to net zero

Given that NZAI members have agreed to transition their underwriting portfolios to net zero by 2050, the issue of how to do so in a manner that's fair to insureds must be considered. The question insurers are grappling with is how to facilitate a "just transition". In other words, do insurers simply walk away from clients in certain industries, or do they stage the underwriting withdrawal over a particular time-frame?

"The industry is very concerned about having a 'just transition' and wants to ensure we are helping and supporting clients and sectors through that transition," says Penwarden. While the timeline for a "just transition" is undetermined, some regulators, for example, the U.K., have timeframes within which they expect insurers to make at least incremental progress, and these will impact the transition.

Some insurers have already announced reductions in coverage to fossil-fuel companies, for example. Zurich announced it was terminating business with its insured clients with exposure above previously announced ceilings to thermal coal mining or power generation, oil sands, or oil shale. Lloyds announced its plans to stop selling insurance for some types of fossil fuel companies by 2030.

Zurich's staged underwriting withdrawal from a South African state-owned power producer is an example of some ways insurers are trying to fashion a just transition.

According to Frank Streidl, Zurich's UK head of energy, marine, and construction, said that the insurer withdrew over two years to allow the client time to find replacement cover. "'Walking away is not a big bang thing, said Streidl. 'Some of these clients we've had for decades and they've not actually done anything wrong. The bottom line is that you want to make the transition as smooth as possible.'"

As insurers pull away from underwriting fossil-fuel companies, will they still provide other lines of coverage to them, such as D&O cover or employers' liability cover? Zurich, for example, has continued to cover employer liability even when clients fail to meet the emission thresholds. As well, there are many other industries, such as shipping, aviation, construction, that are also high GHG emitters, and it remains to be seen how insurers will deal with these industries.

Setting targets and challenges of measuring emissions

One of the commitments insurers have made under the NZIA is to set targets and report on them. Carbon footprinting methodologies have been applied by asset owners and asset managers for some time. But on the underwriting side, methodologies are still being developed and many challenges exist, such as a lack of common accounting guidance or frameworks on how to measure and report GHG emissions. NZIA has a working group looking at the issue of measuring carbon emissions.

Penwarden mentioned just some of the challenges around measuring emissions. "You have to look at what you're going to measure, as well as how hard or easy it is to measure these things. And then you have to assess what the information tells you. I think most people agree that, ideally, it would be best if there was agreement around common measurement methods. But it's very early days," she says. "At Aviva, we will work closely with the NZIA on the measures. To help with this we are running a pilot to look at what our insurance portfolio looks like in terms of carbon emissions. Until we've done the work, however, it's hard to set targets. But, we'll apply best practice and principles that align with where we want to get and we will set targets based on that," she says.

In terms of the internal governance around setting corporate targets and reporting them, at Aviva's it is part of their wider Environment, Social, Governance (ESG) reporting. "Setting this kind of target is a group-led strategy that management works on. Senior leadership decides what targets to set. We already report on ESG and so the target setting with respect to the net zero goal is part of that," says Penwarden.

Setting underwriting strategy to achieve net zero

Penwarden is in charge of setting the commercial underwriting strategy and direction at Aviva Canada. Setting a strategy that aims to be net zero by 2040 – 10 years sooner than most other founding members of NZIA – involves looking at things that encourage the portfolio mix to change. "For example, risk appetite is one of the elements that go

into our underwriting strategy. To move us toward net zero we have evolved our risk appetite of certain types of risks. So, for thermal coal, as an example, by 2022, we won't insure companies making more than 5% of their revenue from it unless the company has demonstrated that they are signed up to the Science Based Targets initiative. We also have a renewable energy underwriting strategy, which means we're targeting different types of renewable energy and industries that support it. We are also looking at new coverages enhancements that we can offer to customers who have electric vehicles. And we will look at insuring new technologies that are being developed to decarbonize. An important part of the strategy is to actively engage with clients and share about our ambition to get to net zero and look at whether there are policy add-ons that might help them move to net zero," she says.

Ways underwriting can impact transition to net-zero emissions

There are a number of ways underwriting can foster the transition to net zero, such as:
• By incentivizing policyholders to decarbonize their activities;
• Enabling net zero business models, technologies, and lifestyles through insurance solutions; and
• Aligning underwriting business processes to achieve net zero.

Incentivizing policyholders

Pricing and options are common ways insurers are using to incentivize corporate and individual clients to decarbonize. Here are a few examples:
• incentivising customers to reduce personal vehicle usage with cheaper rates for those who used their car infrequently;
• offering lower premiums to those who make low carbon choices – such as choosing electronic vehicles;
• lower premiums for implementing mitigation behaviours; and
• providing carbon offsetting options for personal travel insurance.

For clients with particularly carbon intensive activity, insurers have used both pricing and limiting coverage. Such actions send strong signals to product and service providers and can help deter others who might be considering undertaking such activities.

Aviva, which announced in March 2021 that it will have its work validated by the Science Based Targets Initiative, is encouraging companies that make more than 5% of their revenue from coal or unconventional fossil fuels to also sign up with the Science Based Targets Initiative. Aviva announced that by the end of 2021 it will stop underwriting certain types of insurance for such companies if they don't join the Science Based Targets Initiative.

Enabling innovation through insurance solutions

Most agree that to achieve net zero it won't be enough to simply curb emissions; new technologies and infrastructure will be needed. Insurance provides a mechanism for managing and mitigating the risks associated with technological innovation.

Coverage in the early stages of development will be especially important for carbon capture, utilization, and storage (CCUS) industries to attract capital, expertise, and attention. Underwriting of new technology companies can provide confidence to investors, thereby supporting the scaling of such technological solutions. Insurance solutions, for example, warranty insolvency protection, can provide investors with confidence that future warranty claims will be covered and that confidence can help lower the cost of capital to such companies.

Innovative products, like parametric insurance that pays when events happen within pre-defined parameters, can also help avoid potential climate risk protection gaps (the difference between total economic loss and insured losses attributed to climate change) and can help incentivize capital flows to new technologies. Catastrophe bonds designed around parametric triggers are fairly easy to understand and are transparent, so a growing number of institutional investors are finding them attractive.

Of course, the lack of historic data on which to base pricing could be a challenge to underwriters. On the flip side, in green industries that have been around for some time (such as offshore wind and solar energy) any increase in claims may be off-putting to conservative underwriters that may be reluctant to insure such projects, leading to a so-called green protection gap.

Aviva's Penwarden doesn't think underwriters will be reluctant to underwrite new technologies. "In my experience, most underwriters have a natural curiosity, so they will be interested in learning about new things. And just because there isn't vast data about something doesn't mean we won't underwrite it," she says. "When we do a risk-based assessment, we don't just rely on risk data. We analyze the data and look at the science, but there's the art of it too. You bring your judgment and you make choices based on a combination of the three: data, science, and art. As insurers enter new areas of exposure, they draw on all of these to adjust their risk appetite. The art involves drawing on all of the collective understanding insurers have, as well as drawing on the data, and external expertise as well as our own, for example, risk engineers, and of course our customers and broker partners. Once risk appetite is adjusted, our underwriters will receive guidance and training on that risk appetite, and risk assessment to underwrite these new exposures," she says.

Insurance may also play a role with respect to the retirement and decommissioning of some infrastructure assets – especially in fossil-fuel industries – and the restoration of

sites. For example, insurance products that provide first and third-party protection in support of decommissioning and restoration activities will be needed.

As well, the insurance industry can help support clients' transition to net zero via risk advisory services. Tapping into its risk expertise, insurers can help clients identify, measure, and manage all sorts of transition risks and opportunities.

Aligning business processes to achieve net zero

To achieve net-zero emissions, insurers will have to evaluate the entire underwriting side of the business and align all processes toward the goal. "We're looking at our whole supply chain, which means looking at how our suppliers are doing in terms of emissions. And in terms of claims adjusting, for example, there's the idea of building back better. For example, encouraging the use of building materials that are better able to stand up to future climate-related storms," says Penwarden.

There are a number of claims process improvements that can lead to lower emissions. For example, by simply encouraging the repair of windshields rather than replacing them, RSA is reported to have saved 1,500 tonnes of carbon emissions. Mainstreaming the retrofitting of homes/factories to use sustainable (decarbonized) materials and offering customers options to make greener choices when replacing damaged items when paying out a claim is another example of the ways the claims process can help reduce emissions.

The move to net-zero emissions will also require engagement with, and education of, staff and brokers about the pathways to net zero. "We definitely have a people plan," says Aviva's Penwarden. "It's led by the HR and the Sustainability teams. They're educating and communicating the work Aviva is doing on net zero. In the UK for example, we are also learning from employees who have insights into what coverages customers might want or need if they decide to buy an electric vehicle," she says.

For insurers to achieve net zero they may also need to bring on board staff with specialized skills and expertise. For example, they may need to hire – or partner with – engineers and other types of scientists that can interpret climate-related data, model climate-related risks, and evaluate new technologies.

Penwarden thinks that as underwriting portfolios change, insurers will look to evolve their expertise and skills. "In some cases, we may rely on outside experts but we will want engineers on staff to ensure we understand what to measure, as well as to understand new technologies. It's important to have in-house expertise because our experience is that both brokers and customers like to engage with someone who understands their business, so we'll need to evolve our expertise," she says.

Challenges and opportunities

One of the challenges related to measuring carbon emissions is that there is no single, generally accepted method for measuring carbon emissions. As a result, insurers may have a difficult time assessing a company's claims regarding its emissions. Accreditation frameworks are starting to emerge, such as the Climate Transition Pathways framework announced by Willis Towers Watson earlier this year , and a net-zero company benchmark product by Climate Action 100+.

Though there are clear challenges associated with transitioning the underwriting side of the insurance business to net-zero emissions, there are also up-sides. For starters, the loss history on some fossil fuel classes shows that insurers sustained roughly US$60 billion in losses from fossil fuel companies over a 30-year period. So, besides helping insurers achieve net-zero goals, exiting such business could save insurers tens of billions of dollars.

As well, estimates about the scope of the new industries that will be needed to get to net zero are breathtaking: some believe that by 2050 the carbon removal industry will be the size of today's oil and gas industry.

So, rather than seeing the transition to net zero on the underwriting side as a withdrawal from certain areas, perhaps a more productive outlook is to see it as merely a shift in the book of business