



Episode 24: The journey to net zero – an insurer's guide to navigating climate risks and opportunities

TIM ANTONELLI: My suggestion would be, stop waiting for a standard universal guidance, as it's not coming. So develop your own approach and commit to it.

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SPEAKER 1: You're listening to (Re)Thinking Insurance, a podcast series from Willis Towers Watson, where we discuss the issues facing P&C, life, and composite insurers around the globe, as well as exploring the latest tools, techniques, and innovations that will help you to rethink insurance.

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CARRIE KELLEY: Welcome to (Re)Thinking Insurance, I'm your host Carrie Kelley. On today's podcast we will be discussing the findings of the Willis Towers Watson and Wellington Management report on climate change. My guests today are the three co-authors of the report, Tim Antonelli, an insurance strategist at Wellington Management. Welcome Tim.

TIM ANTONELLI: Hello, great to be here.

CARRIE KELLEY: Ying Chuang the deputy head of Cat Analytics for International at Wills Re. Welcome Ying.

YING CHUANG: Thanks Carrie, happy to be here.

CARRIE KELLEY: And Adhiraj Maitra, a director at Willis Towers Watson. Welcome Adhiraj.

ADHIRAJ MAITRA: Thank you Carrie, good to be here.

CARRIE KELLEY: All right, I'm happy to have all of you on the show. Now, as you may know, we like to learn a little bit more about our guests before we jump into our main topic. I'd like to know from each of you what someone would actually find if they Googled you and what you wish they would find. So maybe we'll start with you Tim.

TIM ANTONELLI: Sure. So, I think if folks were to actually Google me they'd find a lot of insurance asset management content, which hopefully they'd find useful. But what I wish they would find would be pictures of my recently adopted puppy, who is far better for viewing than myself.

CARRIE KELLEY: Well, congratulations on being a new puppy owner. Ying, how about you?

YING CHUANG: Yeah, hopefully a bit of material related to climate change, such as we're doing at the moment. Unfortunately, I don't have a puppy like Tim, to get in front of people. But hopefully nothing embarrassing. And something to do with travel, which I'm very passionate about.

CARRIE KELLEY: Nice. And Adhiraj?

ADHIRAJ MAITRA: Yeah, I mean, I'd say, if you Google me because I'm the global lead for climate change, you'd probably find a lot of articles and stuff. But, I order my coffee beans from Berlin, and I'm crazy about cycling. And to carry on the sort of puppy theme, I've got a five-year-old dog who barks every time someone knocks on the door. So, if you hear any barking, I do apologize in advance.

CARRIE KELLEY: OK, so let's jump into talking about the report. So you describe the report, The journey to net zero, as an insurer's guide to navigating climate risk and opportunities. What drove the development of this paper, and why did you think the industry needs it now?

ADHIRAJ MAITRA: So, the conversation about the paper started a long time ago, about a year or so ago when we were sort of getting used to working from home and the sort of, you're in lockdown from the pandemic.

And Tim, Ying and I, we were having this discussion. And we were thinking about what is one single thing if we could convince the insurance industry to do, would help them solve this puzzle and challenge around climate change and ESG? And what we all kind of agreed was a holistic approach.

Often, as insurers or as people in the insurance industry we end up taking a very siloed view. So, a marine underwriter will not talk to probably the casualty underwriter or the underwriting function might not talk necessarily to the claims team or the risk team or even the investments team.

So, when are you thinking about climate change and ESG one thing to remember or note, is it can affect, or it is likely to affect every part of your business. Whether it's operations, whether it's investments, whether it's employees, whether it's underwriting, et cetera.

So, one thing to really sort of think about is to take a holistic view. Think about the entire company and then take decisions around enterprise risk management. And we thought, although there is a lot of interesting useful material available online, but there wasn't a paper that really talked about both the asset and liability aspect of a balance sheet. And that's why we thought we should think about writing a paper.

TIM ANTONELLI: Yeah. And I mean, I would say, it's crazy to think about when that conversation happened, because on the one hand, it feels like yesterday, because we're living in this perpetual state of work from home. On the other hand, I'm keenly aware that it's been over a year and a half ago. Quite simply, when we were having that kickoff conversation it really started off as just a casual conversation about climate.

You know, what's in the market right now, I would divide into two buckets, right? So you have the bucket of super high level, unactionable, climate change is real, be aware of climate change. And then on the other end of the spectrum, you have, here's all this great content that's powered by the scientific research element of climate change. And what we felt like was, if you're a c-suite member of an insurance company, what do you do with either of those?

So I think thankfully we recognize most are aware of climate change at this point, and recognize it as an issue, but don't know where to begin. And then also they don't have the time or desire to really get into the science, and understand the so what. And I think we thought our two firms coming together could really work to fill that void that we recognized in the market.

And I guess the last thing I'd say on that front which continues to fascinate me, is the appreciation that while it's a dire subject, right? No question. It's fascinating in that there's no

shortage of information about calculating climate risk and understanding climate risk in the market.

Yet, if you think about asset pricing, which is the world that I live in, at least as it relates to physical risks, asset prices aren't reflecting any of this information. And in a world with big data, it's still amazing to me that, that has yet to occur.

YING CHUANG: And I guess to follow on, on the point about the balance sheet strength as well, as part of our target audience being the executives at the more senior levels of companies, they would normally be more concerned with the overall financial performance of their companies.

And while from my perspective I come from the reinsurance side, all of the business that we do probably deals with the liability side of the balance sheet, and Tim obviously comes from the asset side. Climate's one of those challenges where it impacts both sides of the balance sheet.

And in order to get it under control and make sure that your balance sheet is strong, and also not just address the risk but also the opportunities that might come from being one of the first movers in this space, yeah, that's a big area that we can all focus on together, and bring some combined insight to our audience.

CARRIE KELLEY: So throughout the paper, you talk about climate scenarios. What exactly are they, and how do they relate to the scenarios that insurers might be more typically familiar with?

YING CHUANG: So this is a point I think that we've come across quite frequently in the work that we do, in the insurance reinsurance space. From my perspective, looking after the CAT modeling, normally, we would have insurers with their portfolios that they model in order to get an idea of what the risk is from their exposure of the business that they're underwriting.

So, as part of regulatory returns as well as normal sort of stress testing for capital adequacy, they will look at things like what we call loss scenarios, which are sort of either synthetic or historical version of an event that might have occurred. And then have a look at what sort of losses might come up for it to make sure they're prepared in the event it may occur.

So when we talk about climate scenarios however, what people focus on is the science. So climate scenarios actually relate to greenhouse gases and the concentration that you might find in the atmosphere of them, and the corresponding temperature changes.

So, what this means is we're using the word "scenario," to both describe something that relates to science-- the climate part, as well as loss, which is the financial metrics that the company might normally use.

So we need to be a little bit careful with our terminology and be able to link the scenarios that are coming from the science. So the greenhouse gases to the temperature, be able to convert that into something that relates to loss metrics, so that companies can actually use it in the various assessments that they have of their business.

ADHIRAJ MAITRA: And probably sort of one thing to add is, so there are sort of two or three different ways to assess risk. So you can take a stochastic approach, or you can take a deterministic approach. And often when there isn't a lot of data, a deterministic approach or scenario analysis can often be very useful in getting a good understanding of the risk.

Now, one thing to sort of note is when someone's using or carrying out scenario analysis, it's important to understand what the purpose is. So in some cases, the purpose could be understanding the downside risk or tail risk. In some cases, it could be around product development. So understanding the "why" is quite important as well.

CARRIE KELLEY: So you also discuss in the paper, multidimensionality of climate risk, and how this is driving the need to evolve traditional business practices. What exactly do you mean

by this, and what changes do you think we will see as a result?

TIM ANTONELLI: So perhaps I can start with a subject near and dear to my heart and that's strategic asset allocation. So if you think about this from a high level, it's a time tested process that has been involved with asset management or investing for quite a while. It's historically backward-looking and is very well-defined in terms of the inputs, constraints, and then the outputs.

And in my mind it's a great example of something that needs to evolve in many ways, to reflect both climate risk and opportunities. So, you need to evolve from the perspective of including forward-looking scientific impacts and research.

And also I believe you need to place a heavier weight on being more thematic, and also thinking about implementation at another level. So just walking through a couple of those. As part of this, we're in the process of developing climate-aware capital market assumptions.

Now this includes multiple transition pathways or scenarios that capture the transition risk. And then also includes a view of acute physical risk, adjusted for increased probabilities of events that are provided by our external partner, The Woodwell Climate Research Center.

So as you think about that as an input, now how will optimization involve? Optimization can shift to more on location, it could extend to physical peril specifically. So, as an example, optimize returns based on asset price risk and exposure to coastal flooding, which was something that SAAs have never done.

It could include more tilts towards green assets or asset classes that have the largest potential for driving change, in which the private markets or illiquid markets are likely to have a significant role to play here. And then it'll also create return hurdles for the most at risk assets. So, if I'm going to invest in real estate that's exposed to hurricane risk, I'll need x basis points over properties without that type of risk exposure.

So I guess the last element here are that KPIs or Key Performance Indicators, are going to become more important as the last step of an SAA. So no longer is your quarterly performance statement going to be enough in understanding if your goals are being achieved as it relates to climate risk over time. So really, you're rethinking the entire SAA.

And within the paper we've divided it up into subjects that relate to individual executives. We often describe things in a table format easy to digest the status quo, and then what would be required from a climate modify perspective to achieve some of these goals.

ADHIRAJ MAITRA: And probably worth adding, again, going back to the point, what is the purpose of any kind of analysis and modeling, et cetera? And if you're kind of thinking about downside risk you can probably do some top-down scenario analysis, NPV projection at sector level, et cetera, et cetera.

But if you are trying to embed it in your investment strategy, that's when you need to think about different approaches. And some of the approaches could even be to sort of think about Climate Transition Index. So-- and that might give you a good insight into what might you sort of consider when you're looking towards the future.

YING CHUANG: And on the physical risk side of things where I think a lot of insurers are quite familiar with the process of already putting their portfolios through models in order to get an idea of the exposure that they have to certain perils, that's something that of course will continue.

And it's pretty important in forming a baseline view of risk. Yeah, I think what we would expect to see going forwards is that there will be a bit more volatility in what comes out, or what the types of outcomes that you might expect going forwards.

So perils such as fire and freeze, where traditionally they may not have been causing that large

loss, will become more and more towards the forefront of people's minds, as these events become less infrequent.

And yeah, so for the example of the fires in Europe, as well as the recent freeze event in the US I think are some examples. They were probably a little bit unexpected, and that people are asking a few more questions about now.

CARRIE KELLEY: That makes sense. So you also talk about change needing to be a balance sheet approach with implications for both the asset side and the liability side. Can you talk us through this?

TIM ANTONELLI: Yeah, so I would just say Adhiraj's point earlier about two different underwriters not communicating with each other across product lines is something that we find all too frequent as it relates to climate change.

And I would argue, that the dawn of enterprise risk management which really started to take shape after the financial crisis, should be the starting point for how climate risk should permeate throughout the entire organization.

And instead, what we're seeing are underwriting functions that are maybe thinking about one set of scenarios. And if the investment side's considering climate change, they might be thinking about something entirely different. I think what we argue for in this paper, and I think you've heard a couple of different times throughout some of the discussion today, is that you can't be siloed.

And you really need a consistent view of scenarios across each function, to create a holistic view of how the business is impacted. And I would say, this to me generates a climate risk footprint of sorts, where you're considering things across peril, across region, across time, and you're looking at the business holistically and not just saying, OK, we have a climate expectation of x on our investments, and a different calculation results on the underwriting side. Just because the duration of your underwriting and the duration of the assets might not line up perfectly, doesn't mean that the climate exposure isn't something you should calculate consistently across both.

YING CHUANG: And I think there are also various tools and models that are available that have traditionally been used on the liability or the underwriting side of things for people to quantify risk to their portfolios. So that's something that can be adapted for use, for climate purposes as well.

If you're looking at an underwriting portfolio, people are quite well aware of what the risk is to their exposure from various perils, you know, depending what location they're in, what perils they might be exposed to.

But on the investment side, I think as Tim mentioned earlier on, there's very little of that sort of physical information that's taken into account when people actually decide what they're investing in. So these types of tools and models that are sort of in with the people doing the exposure management could well be adapted on the investment side of things.

So we should be exploring that a little bit more widely. Obviously taking into account that there might be certain uncertainties or limitations to these models and to make sure that new users of the models are also aware of those.

ADHIRAJ MAITRA: I didn't have much else to add to that. But maybe some examples, in the sense that as we sort of look at research and we are doing research around that as well, so around mortality and morbidity. So investments is a big part of a life insurer. And if there is any impact of climate change on these factors, that can impact the duration of the investments. And that's why you need to think about it together.

At the same time, I think even on the sort of P&C side what's happening is we're thinking in terms of, OK Nat Cats or other types of losses or litigation blah blah blah, can that have an

impact on your attritional claims versus your large and cat claims? So if you're getting more attritional claims that might be more frequent et cetera, et cetera. And then you might need to manage your assets accordingly. So that's why it's important to think about it together.

CARRIE KELLEY: OK. One final question for each of you. If listeners were going to take away just one action from this podcast what do you think that should be?

TIM ANTONELLI: I guess I'll jump in my suggestion would be, stop waiting for a standard universal guidance, as it's not coming. So develop your own approach and commit to it. As we've said here and we say in the piece, the information is available, the scientific research is available. And you can still be an early adopter if you follow our roadmap, we hope.

What we're seeing from even the most progressive regulators in their stress tests and requests for information, is that they want to see what you're doing they're not telling you how to do it. So asset prices aren't reflecting physical climate risk yet it's in large part. And there still are huge opportunities on developing new climate related insurance products as well. My view would be, just get moving.

YING CHUANG: Yeah and I guess to sort of add to Tim's points, you know, don't be too worried about coming out with an entirely new thing. Because there are lots of things that are currently being in use in insurance that can be adapted for these purposes you know, tools, models, processes, risk management frameworks or all out there. So I don't think there's an expectation for people to start from the ground up. So no wheel reinvention to some extent.

But also to make sure as Tim pointed out, to make sure that what you've got works for you. So it needs to be material to your business. So whatever you prioritize needs to be something that makes sense for you. So yeah, that's something that's pretty important to emphasize, I think.

And also it's new for everyone. Some regulators are further along than others and they have requirements that might be a little bit more prescriptive than others, and others are still kind of coming along the trail.

So yeah, so, I think everyone's still learning. And I think the most important thing is to demonstrate that you're thinking about it and you're actioning a few things with regards to your risk management plan. And I don't think there's a right answer here.

ADHIRAJ MAITRA: And just to sort of echo what Ying and Tim said, there is no-- remember, there is no off the shelf solution. So you probably find a lot of scenarios available publicly. But what you have to do is make that relevant for your risk profile.

Second thing would be, do not just think about downside risk, think about the opportunity. So it's not just financial risk but strategic risk as well. Regulators are exploring the options across the globe. And hence you see-- you're probably seeing a lot of regulatory expectations coming from different parts of the globe.

And you have-- the insurers have and as practitioners, as the industry, we have the option and opportunity to shape the regulatory environment. So by acting early, by sort of thinking about the risk, thinking about the problem, we can help the regulators and the industry.

And the final point would be company wide engagement. So of course, there is sponsorship needed from the c-suite, but we need to kind of manage change management properly from the top to the grassroots level, and communicate and take everyone on this journey. So those would be my points. Sorry Carrie I didn't give you just one point.

CARRIE KELLEY: That's OK. That definitely works. All very good points. So thank you Tim, Ying, and Adhiraj for joining me today. It has been a very informative conversation. And thank you everyone, for listening to (Re)Thinking Insurance.

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