State of the Market 2023:

Incorporating ESG into P&C underwriting

Moody's

Contents

Introduction

For the second year, Moody's Analytics and Moody's RMS have conducted a comprehensive, independently run market survey to understand where the market is in its journey to implement environmental, social, and governance (ESG) risk factors into portfolio management and underwriting workflows.

THE TOPIC OF INTEGRATING ESG INTO UNDERWRITING HAS MOVED FASTER THAN ANY OTHER ISSUE IN THE PAST, INCLUDING IFRS 17 AND SOLVENCY II. THIS IS ALL THE MORE SURPRISING GIVEN THE LACK OF SPECIFIC REGULATION AROUND ESG DISCLOSURES.

The survey took into account the views of 36 senior individuals from P&C commercial (re)insurers, with gross written premium (GWP) ranging from $100 million to over $5billion, from around the world. All respondents were senior members in portfolio management and underwriting teams. The survey took place amid challenging market conditions. (Re)insurers are contending with macroeconomic factors, such as inflation rising to levels not seen in recent times, increasing interest rates and the war in Ukraine. These considerations, alongside other industry trends such as the evolution of automated underwriting processes have created pressures for (re)insurers across the world.

In this report, we present the key results from the survey and offer insights from some of the main findings, including:

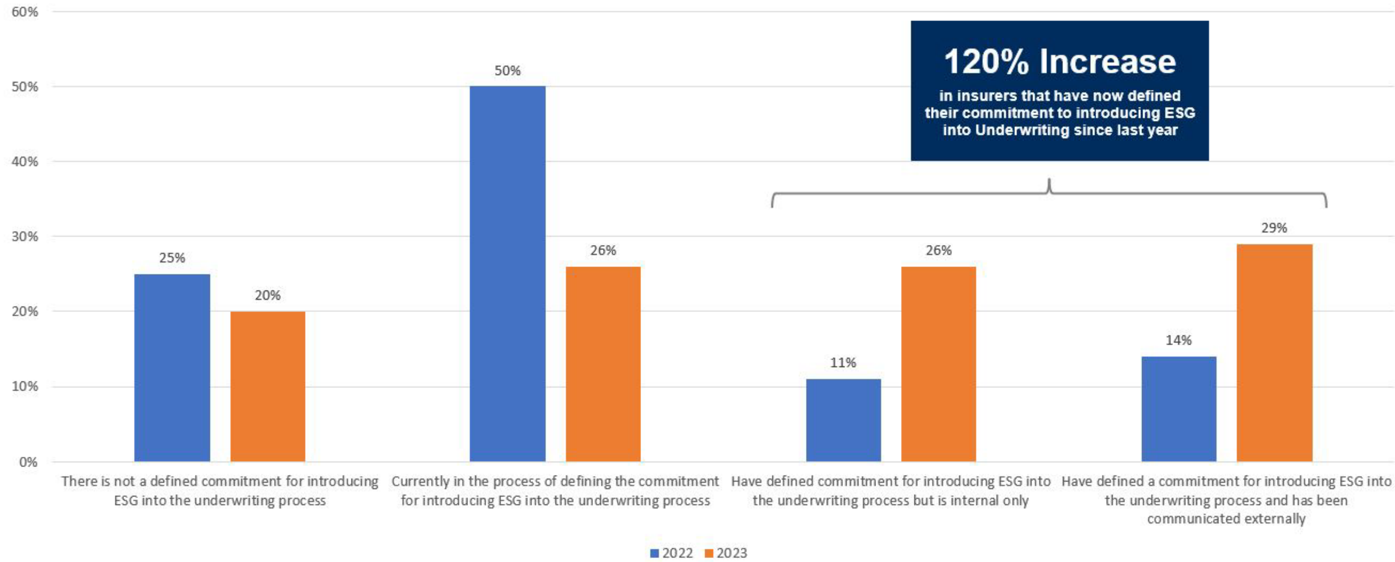
- Firms are continuing to prioritize ESG underwriting as a new capability to be incorporated into their portfolio monitoring process. There has been a 96% increase in the number of (re)insurers wishing to integrate ESG within the next six months, with the number of firms wanting to incorporate ESG right away doubling (from 14% to 29%).
- Bridging the gap between underwriting and sustainability teams presents unique challenges to operationalizing ESG underwriting. More than half of respondents (57%) identify their lack of sustainability expertise as a block to integrating ESG risk factors into underwriting workflows. Firms are also looking for partners that can offer more than just ESG data (71%). They want solutions that are tailored to the specific needs of their underwriting teams.
- The number one driver for ESG underwriting was risk management, suggesting that the market views ESG underwriting as a core risk management capability (91%). In addition, nearly half of respondents (40%) identify ESG underwriting as a potential competitive advantage that can help them create revenue opportunities with customers.

Commitment to integrating ESG risk factors into underwriting

We can see that there has been a significant increase in (re)insurers finalizing their commitment to introduce ESG into the underwriting process, with a rise of 120% in those who have defined their commitment year over year from the 2022 survey, shown in figure 1.

The increase shows that commitment to incorporate ESG into the underwriting process is gathering pace at a rate reminiscent of new regulation such as Solvency II or IFRS 17. This is impressive considering that there are not yet specific regulations around ESG.

Figure 1 What stage is a company like yours at with defining your commitment to integrating ESG factors in the underwriting processes?



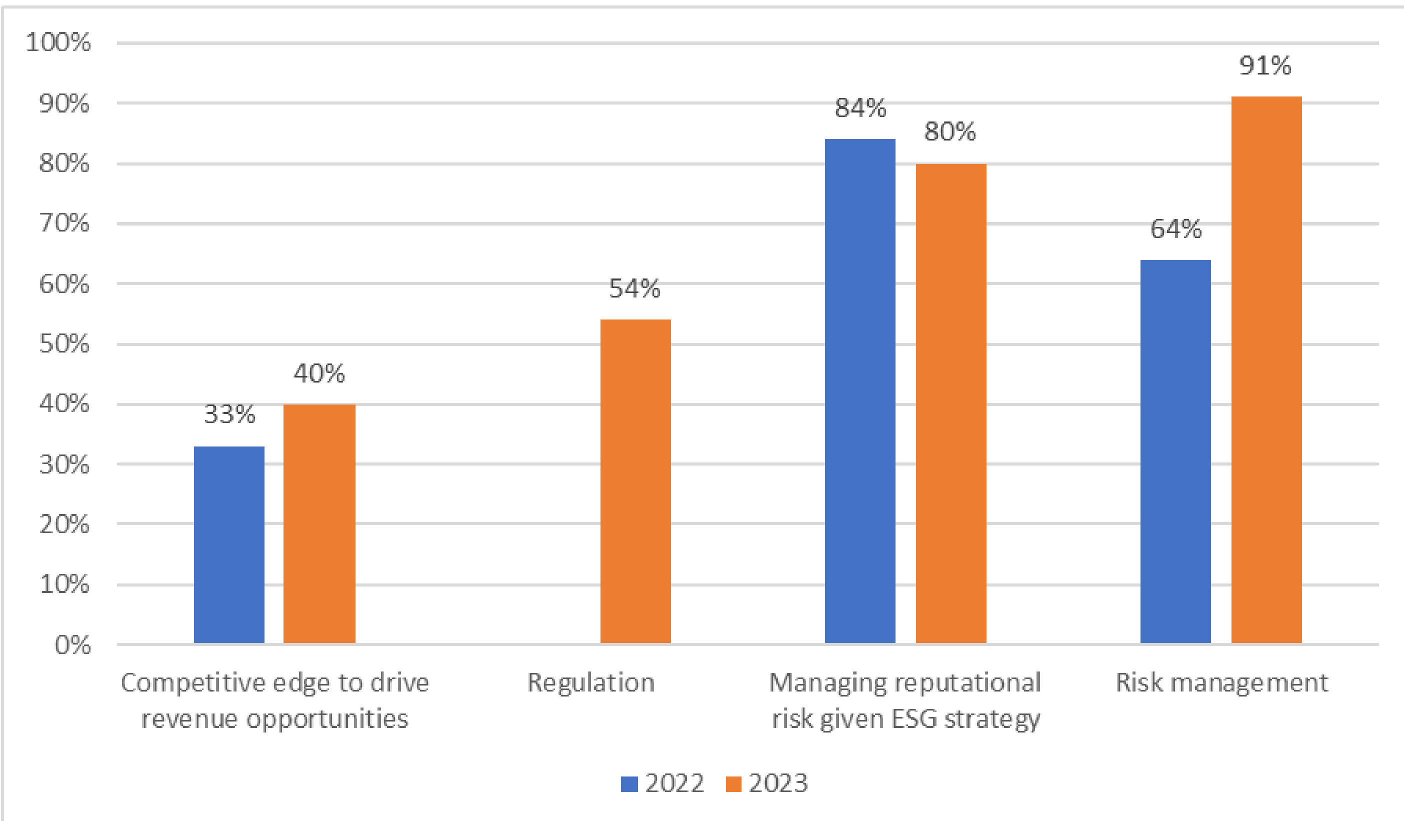
Drivers for integrating ESG risk factors into underwriting

When attempting to understand what is prompting the increase in (re)insurers finalizing their commitment to introduce ESG to the underwriting process, it is interesting to see that over 90% of respondents cite ‘risk management’ as a key driver. Suggesting that ESG risk is now a core risk management consideration for (re)insurers. The significant rise in ‘regulation’ as a driver, with over half of respondents viewing it as key, suggests that (re)insurers expect that regulation will become more stringent over time. There is also a rise in the number of respondents who believe that integrating ESG into the underwriting process can give them a competitive edge and create revenue opportunities, with 40% now stating this view.

The increase in (re)insurers who believe integrating ESG into underwriting can provide a competitive edge reinforces the view that ESG is an opportunity for the (re)insurance market rather than a constraint.

Opportunities for (re)insurers could include developing new products, insuring new sectors, differentiation in a crowded market, and attracting alternative capital.

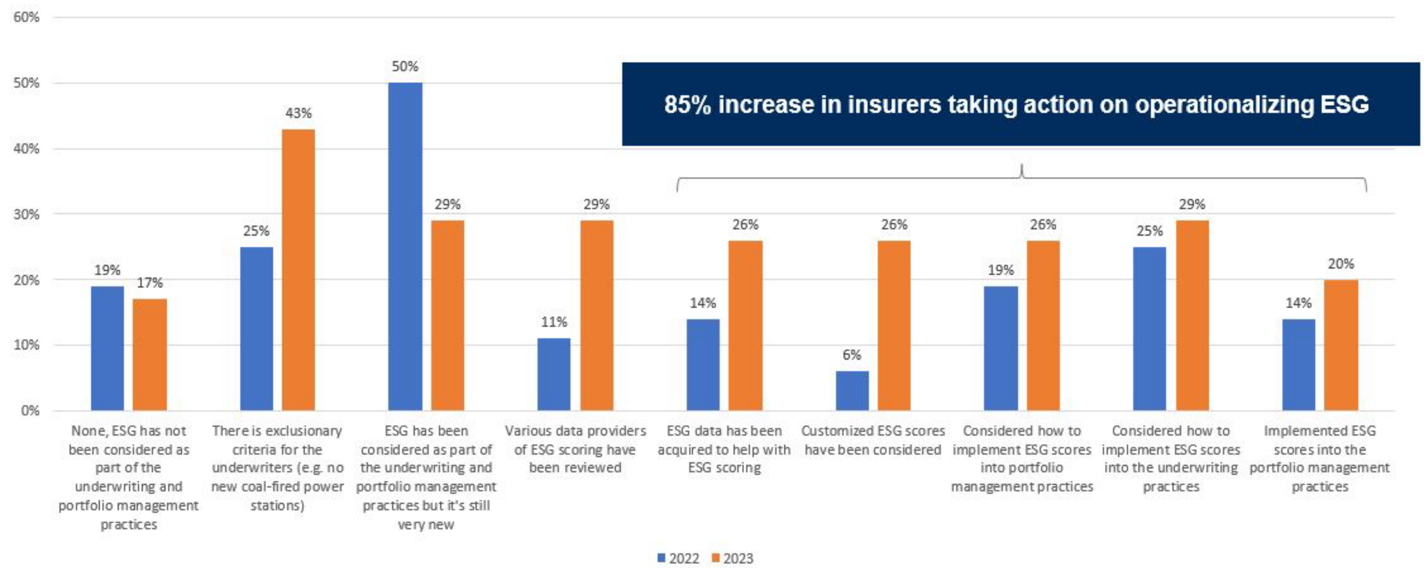
Figure 2 What are the drivers for integrating ESG risk factors in underwriting for companies like yours?



The practicalities of the journey to incorporate ESG into underwriting

(Re)insurers were asked how their company would score on implementing ESG scoring, figure 3. Responses show an 85% increase in operationalization, year over year. The increase appears to support the view that the insurance industry is taking practical steps to incorporate ESG into underwriting.

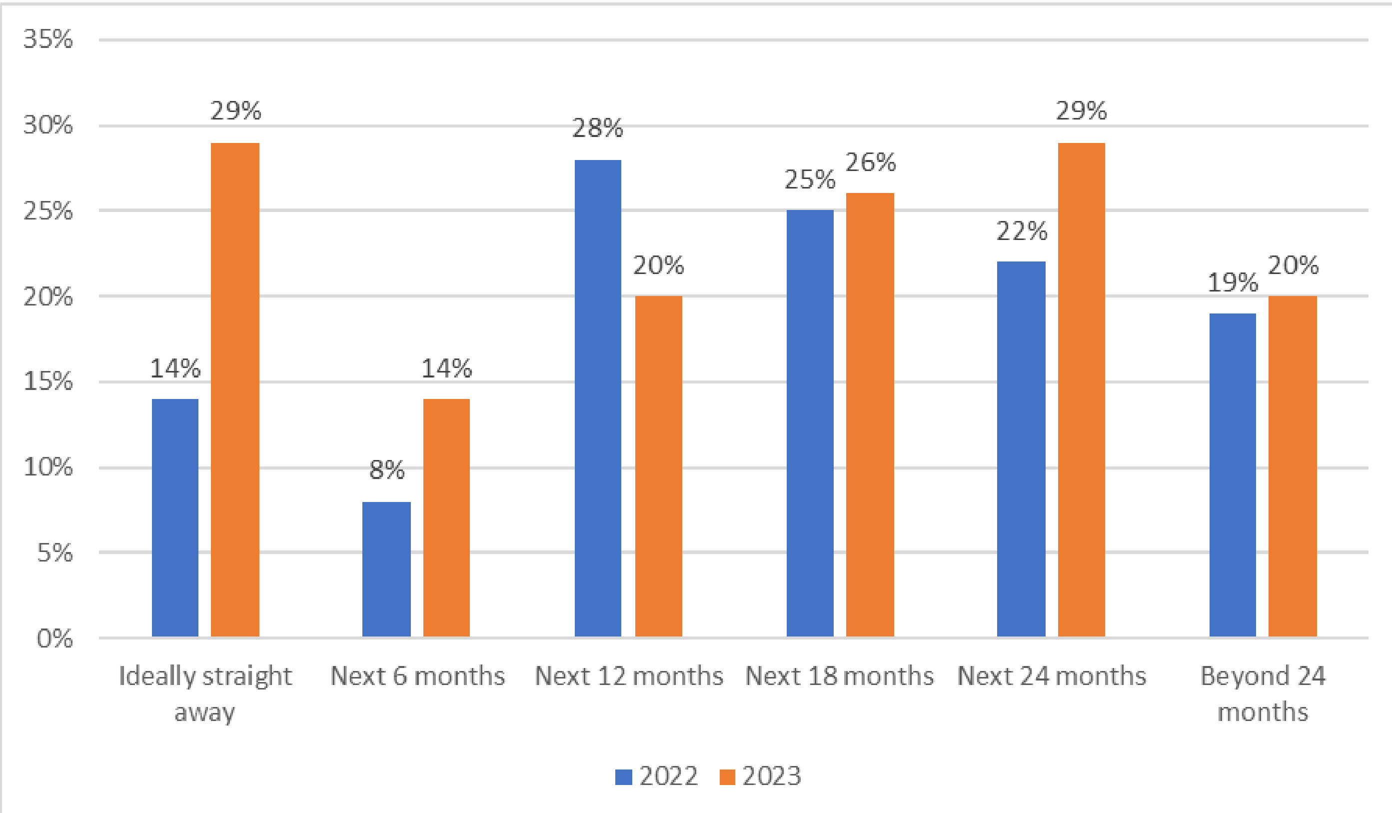
Figure 3 Where would a company like yours be in the implementation of ESG scoring for insurance business?



Increasing budgets and shortening timeframes

There is a 96% increase in (re)insurers who wish to integrate ESG within underwriting the next six months, and the number of (re)insurers looking to do so straight away doubling, figure 4. More than half of respondents want to implement ESG in underwriting within the next 12 months.

Figure 4 What's typically the urgency for integrating ESG for businesses like yours?

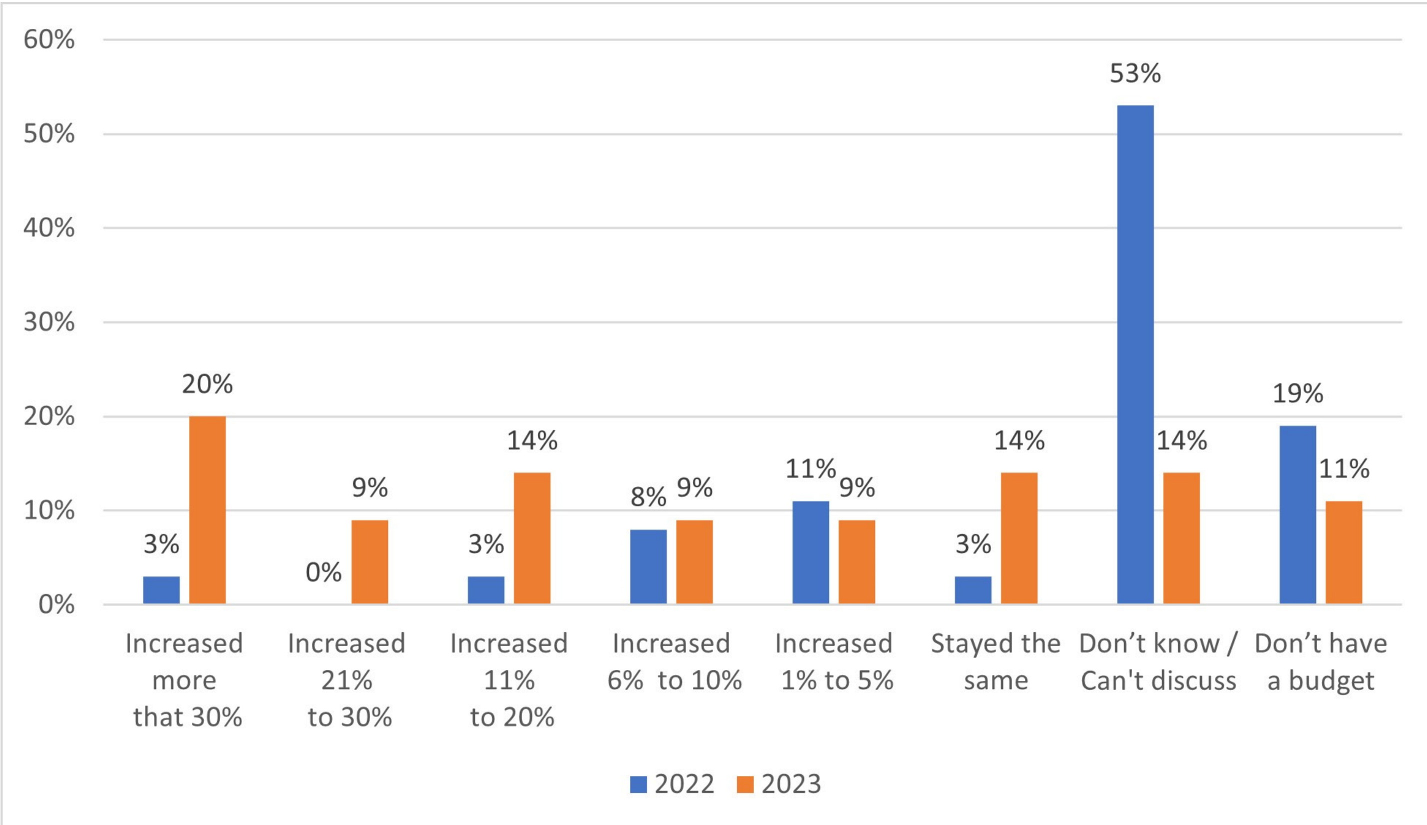


Reflecting the sense of urgency, the study shows that 60% of (re)insurers have increased budgets in the last two years, figure 5. This includes 20% of respondents who increased budgets by more than 30%.

The findings indicate that (re)insurers recognize the importance of practical insights on their ESG journeys, which necessitates the investment in ESG expertise, data, and analytical tools. Budgets are likely to maintain an upwards trend as ESG continues to gain importance.

THE INCREASING COMMITMENT TO ESG INTEGRATION IS REFLECTED IN INCREASING BUDGETS

Figure 5 Over the last two years, how has the budget for a company like yours changed for ESG data and products changed?

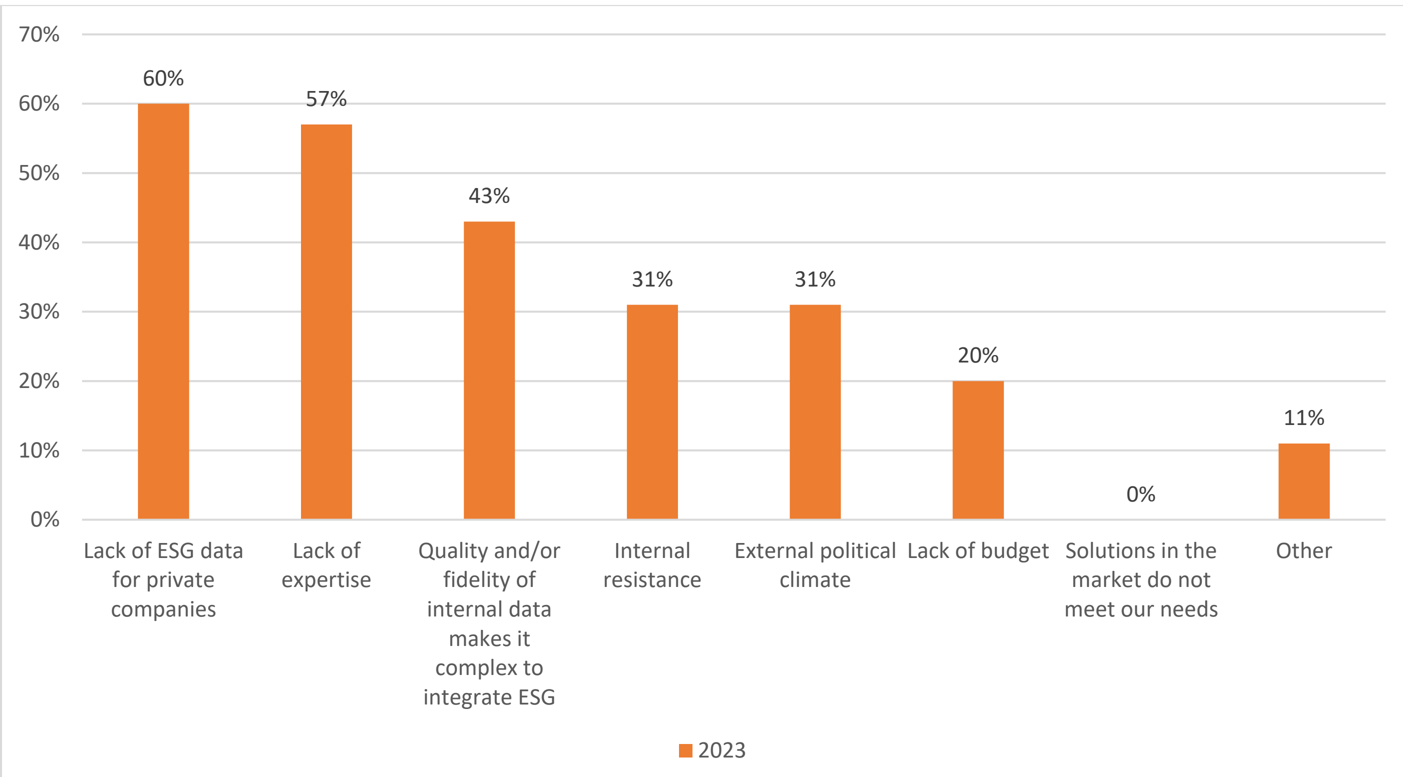


Challenges to integrating ESG into the underwriting process

In the 2023 survey we introduced a new question to understand blockers to integrating ESG'. into the underwriting process. There is clearly appetite to understand what might be inhibiting progress in order to take steps to make improvements. 60% of survey respondents cited a lack of ESG data for private companies as a blocker, figure 6. This is understandable when we consider the exposure many (re)insurers have to small and medium sized enterprises (SMEs). SMEs and private entities often comprise a significant proportion of a (re)insurer's portfolio. The second highest reason given, with almost 60%, is a lack of internal expertise. We are increasingly seeing (re)insurers hiring sustainability professionals to address this need. The next highest response raised concerns around the complexity of integrating internal data that may not be of high enough quality.

One third of (re)insurers cite internal resistance, which may be coming from underwriters who are concerned that integrating ESG could lead to a trade-off against growth or profitability. However, this finding is especially interesting when we also consider that 40% of responders, shown in figure 2, suggest that integrating ESG into the underwriting process could provide a competitive edge.

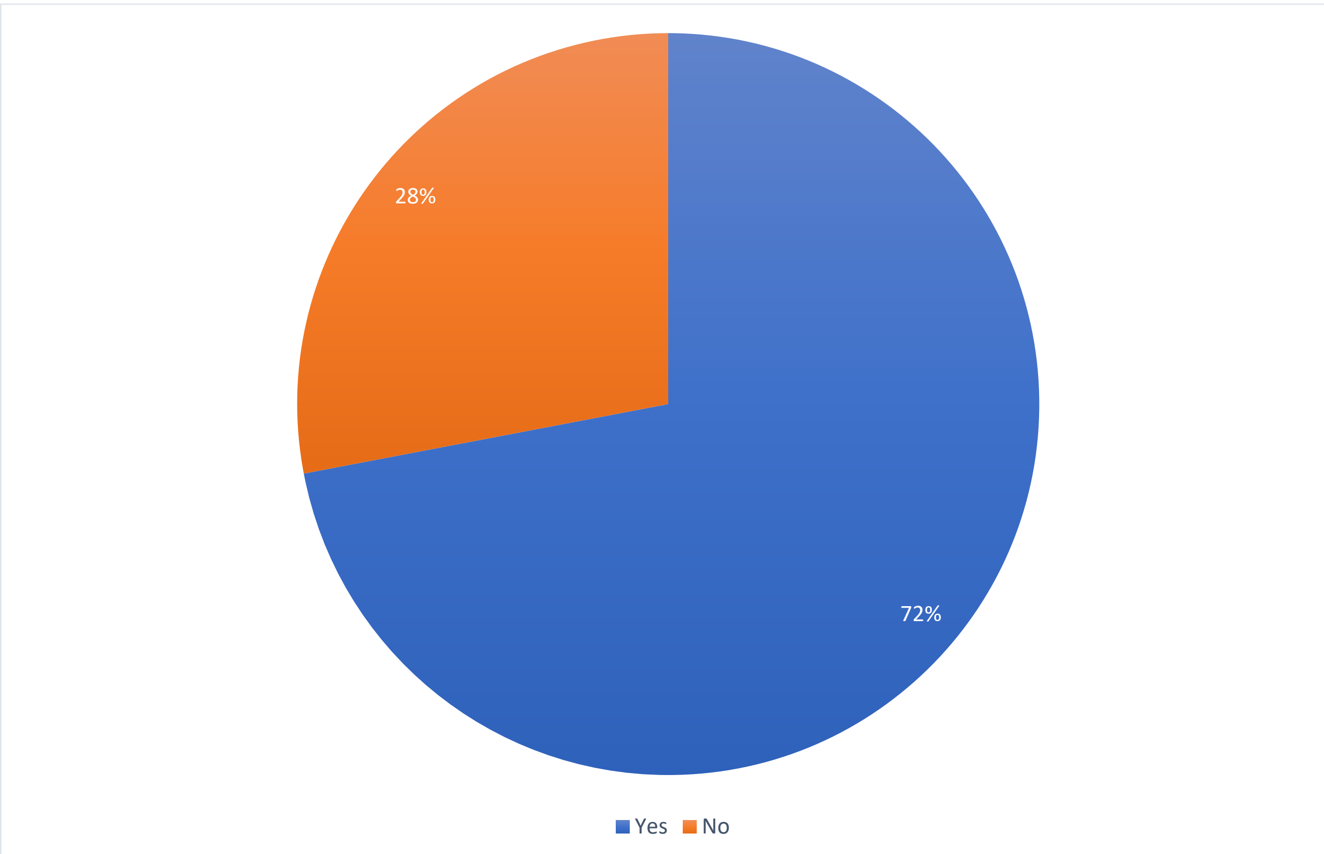
Figure 6 What are the blockers to integrating ESG risk factors in underwriting for companies like yours?



Appetite for a market standard

Nearly three-quarters, 72% of (re)insurers report that they would like a market standard clarifying the definition of ESG risk, figure 7. There are currently different views on what is covered by the 'E', 'S' and 'G' that comprise ESG. A common definition of ESG risk would give (re)insurers access to a consistent set of data points when analyzing companies. Such a standard could help streamline the conversation across the entire value chain. It would also help all market participants, including brokers, carriers and (re)insurers, take a consistent approach to ESG.

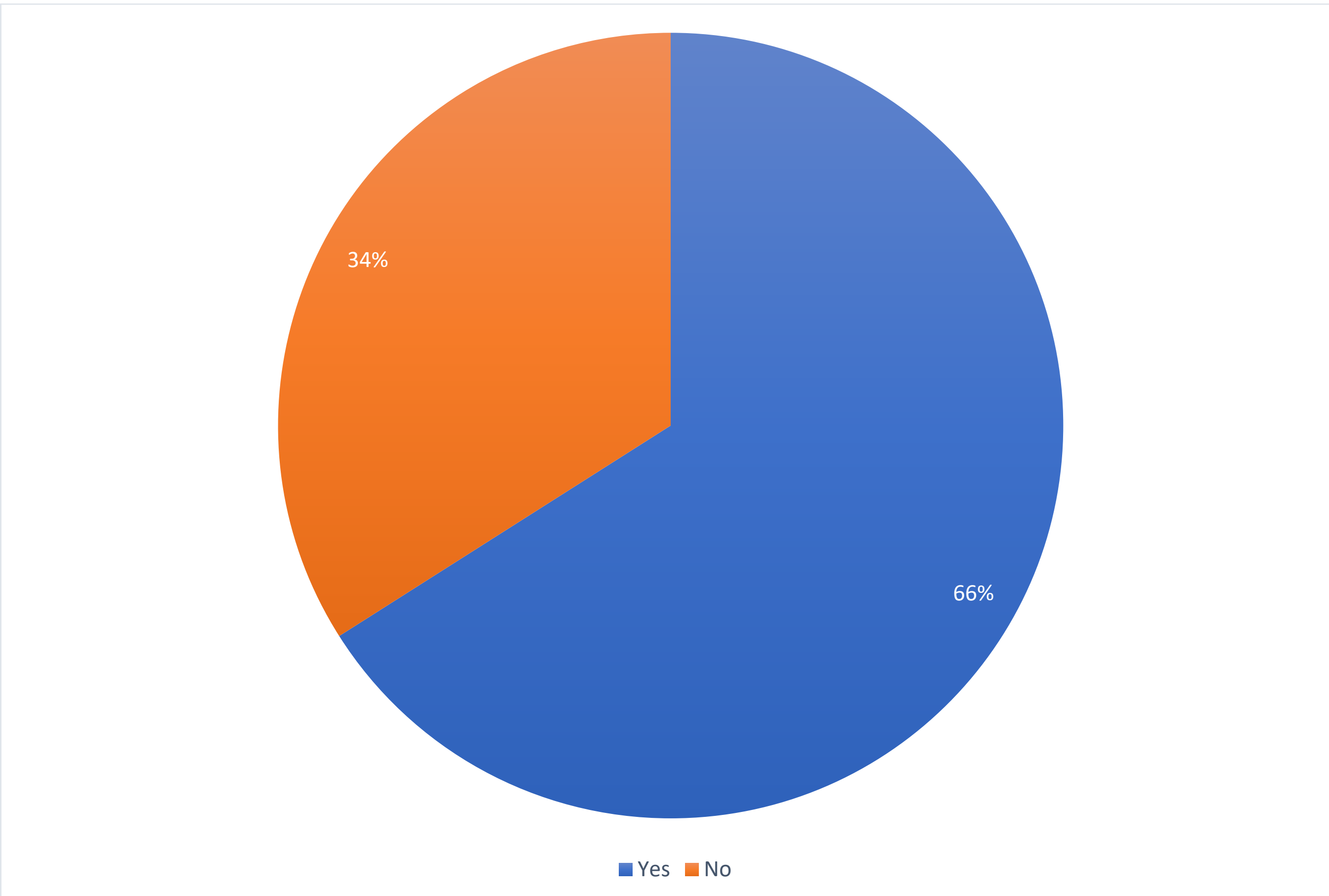
Figure 7 Do you want a market standard?



Appetite for customization of ESG scores

When asked if they would like the ability to customize ESG scores, 66% of (re)insurers said yes they would like the ability to customize ESG scores, figure 8. A 25% year over year increase from our 2022 survey . (Re)insurers will look to clarify their own views on ESG and then calibrate their ESG weighting based on those views. The ability to customize ESG scores enable (re)insurers to take ownership of their ESG processes and provide the additional benefit of aligning their view of ESG risk with their sustainability strategy.

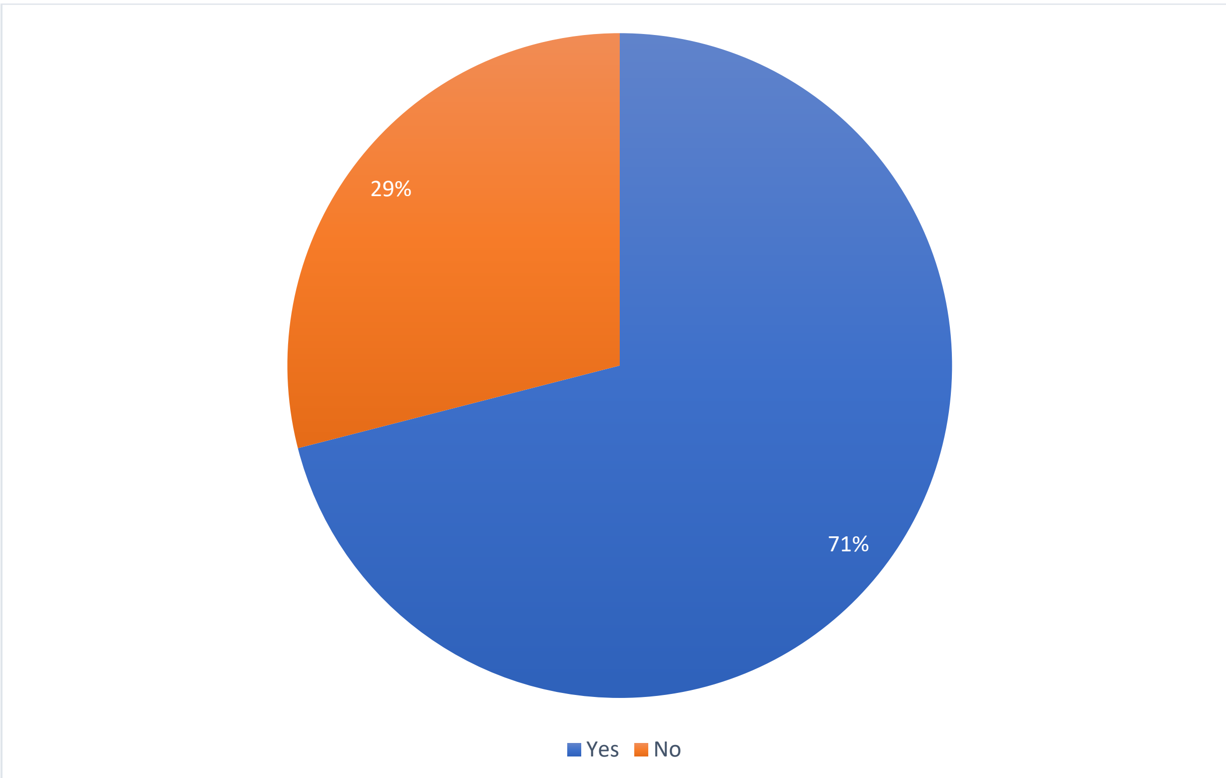
Figure 8 Would you like the ability to customize ESG scores?



Appetite for a vendor software application

71% of (re)insurers wanted or were interested in a vendor software application, not just data, figure 9. A 16% increase from our 2022 survey responses to this question. For nearly three-quarters of respondents, data alone is not sufficient to provide insight. Analytical tools can help firms operationalize ESG risk by converting data to insights. Helping to give portfolio managers a deeper understanding of their portfolio exposures, and enable underwriters to form their own perspectives on risk and also understand the marginal impact of new accounts and renewals at the point of underwriting.

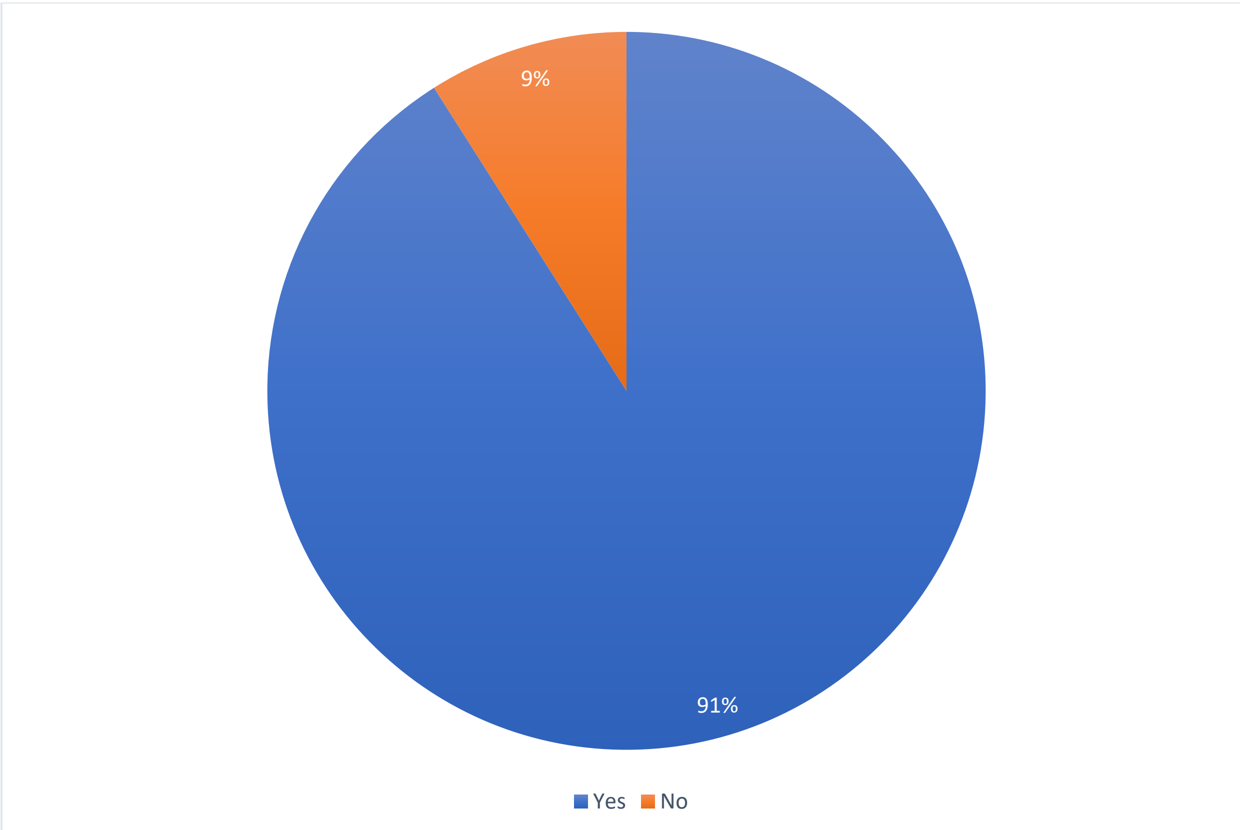
Figure 9 Would someone in your position consider a vendor software application for helping to integrate ESG?



A requirement for ESG data

91% of (re)insurers reported that they now would be open to ask insureds for ESG-related information, figure 10. An increase of 9% year over year, further supporting the view that (re)insurers are taking steps to integrate ESG into their underwriting process.

Figure 10 Would underwriters in an organization like yours be open to asking their insured for data that would help inform ESG scores?



Taking stock of progress on the journey to integrating ESG scores

The Moody's Analytics and Moody's RMS ESG in P&C Underwriting 2023 survey clearly shows that appetite for incorporating ESG into underwriting has increased over the last year. Although still at an early stage (re)insurers are now working to understand the sustainability impact on their business, and treaty books that will provide a transparent benchmarking approach across counterparties and the diverse risk classes.

The results of the 2023 survey results support the finding that the appetite for incorporating ESG into underwriting has increased wit the following results:

- 120% increase in (re)insurers defining their ESG commitments
- 96% increase in (re)insurers wanting to integrate ESG in the next six months or sooner
- 85% increase in (re)insurers taking action to operationalize ESG
- 60% increase in (re)insurers seeing rising ESG budgets over the last two years.

However, challenges do still remain, with 71% of respondents saying they need more than just ESG data for underwriting, 60% reporting that the lack of ESG data for private companies is a blocker and 57% citing the lack of internal expertise.

To continue progress on their path to integrate ESG into underwriting, (re)insurers need to take stock of exactly where they are on the journey, capitalize on the positive steps they have taken so far, and develop a plan to overcome the challenges they are still facing.

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