KPMG

Sustainable Finance (ESG)

Presentation to Insurance Ireland

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With you today…

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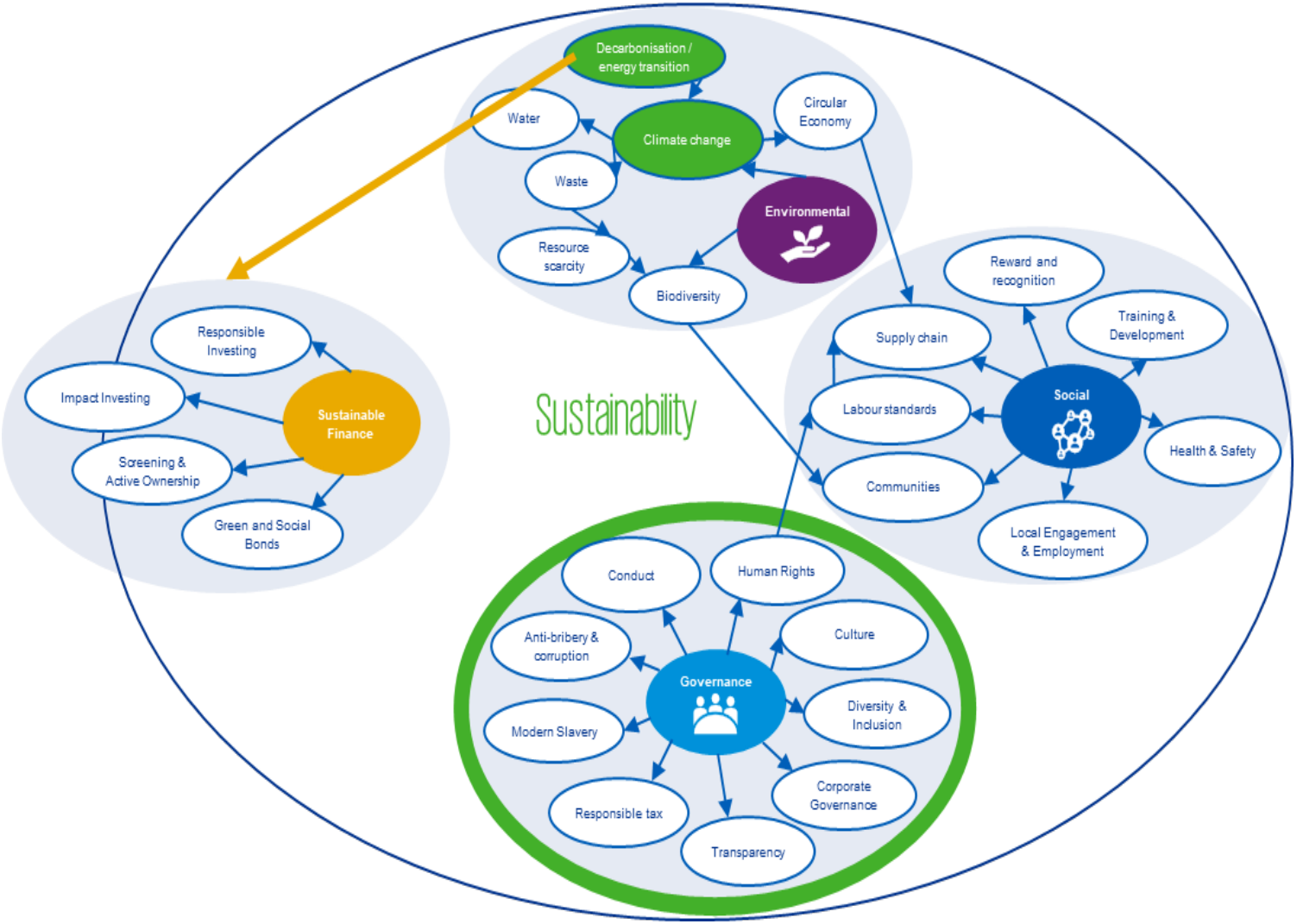
Overview of landscape

It is a broad subject...



KPMG Sustainable Futures

Definition of Sustainable Finance?

'Sustainable finance' generally refers to the process of taking due account of **environmental**, **social** and **governance** (ESG) considerations when making investment decisions, leading to increased investment in long term and sustainable activities.

For example…

E — Environmental issues:

- Climate change
- Carbon emissions
- Air and water pollution
- Deforestation
- Water management
- Water scarcity

S — Social issues:

- Human rights
- Labour standards
- Social inclusion
- Date protection and privacy
- Gender and diversity

G — Governance related issues:

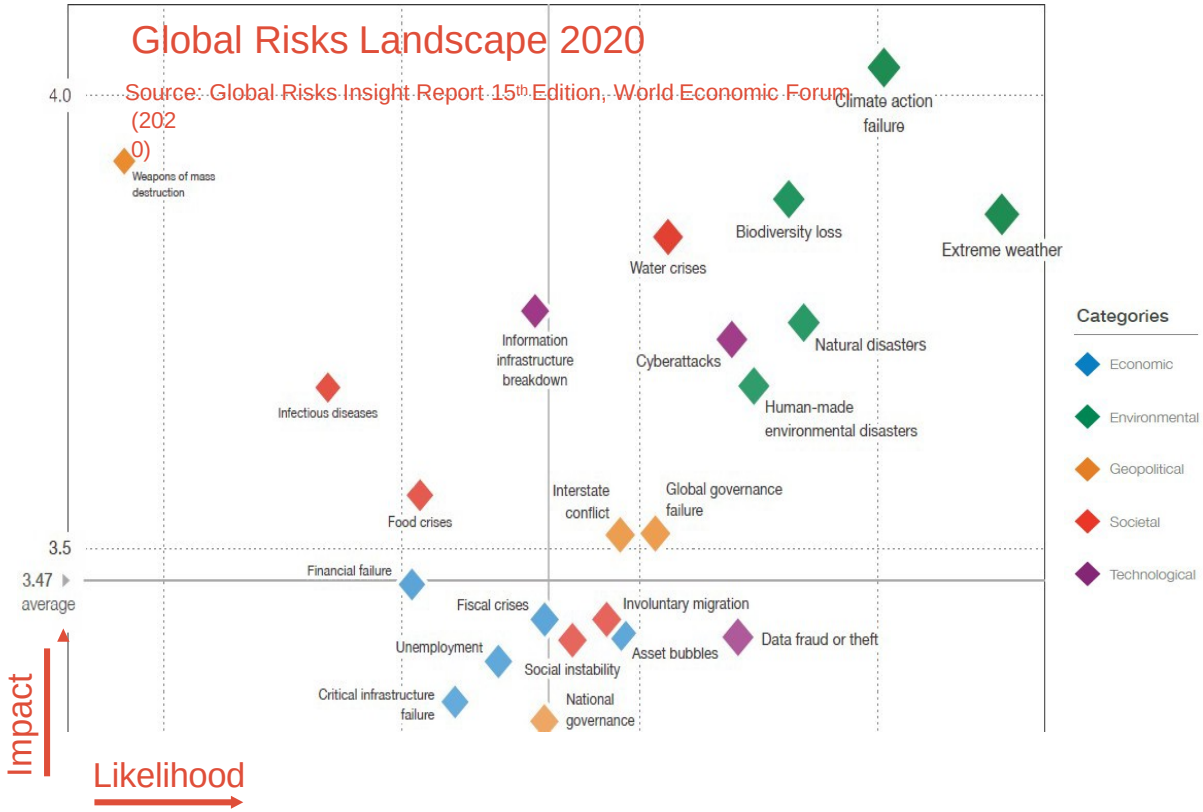
- Executive remuneration
- Risk management
- Boards and committee composition
- Whistle-blower policy lobbying

Why Act? Why Sustainable Finance?

Top Global risks in terms of likelihood and impact include……..

- Climate Action Failure
- Biodiversity Loss
- Extreme Weather
- Water Crisis
- Natural Disaster
- Cyber-Attacks
- Human-Made Environmental Disasters (pollution)
- Global Governance Failure
- Interstate Conflict
- Involuntary Migration

Environmental risks occupy the top right quadrant of the Global Risks Landscape of 2020



ESG strategies

Comparison of strategies/approaches…..

ESG investment - Where do we stand?

Chart 1: Compared to five years ago, how important has sustainable investing become to you?

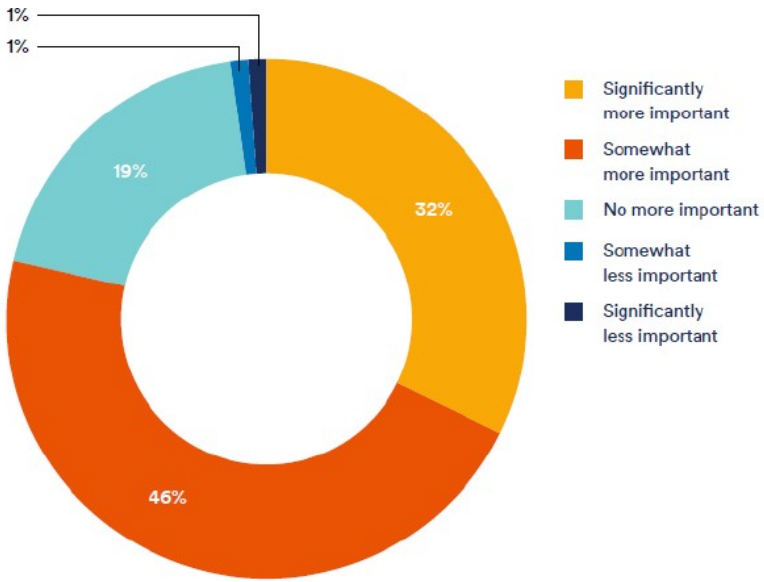
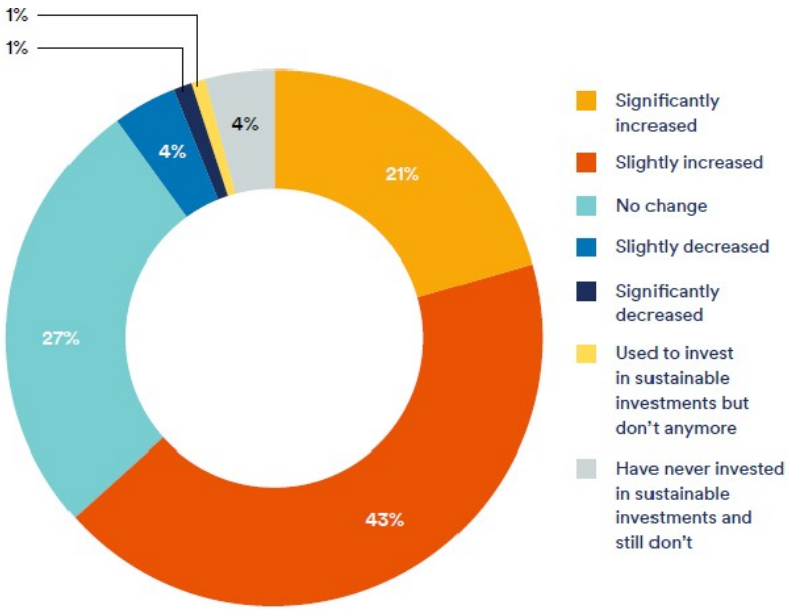


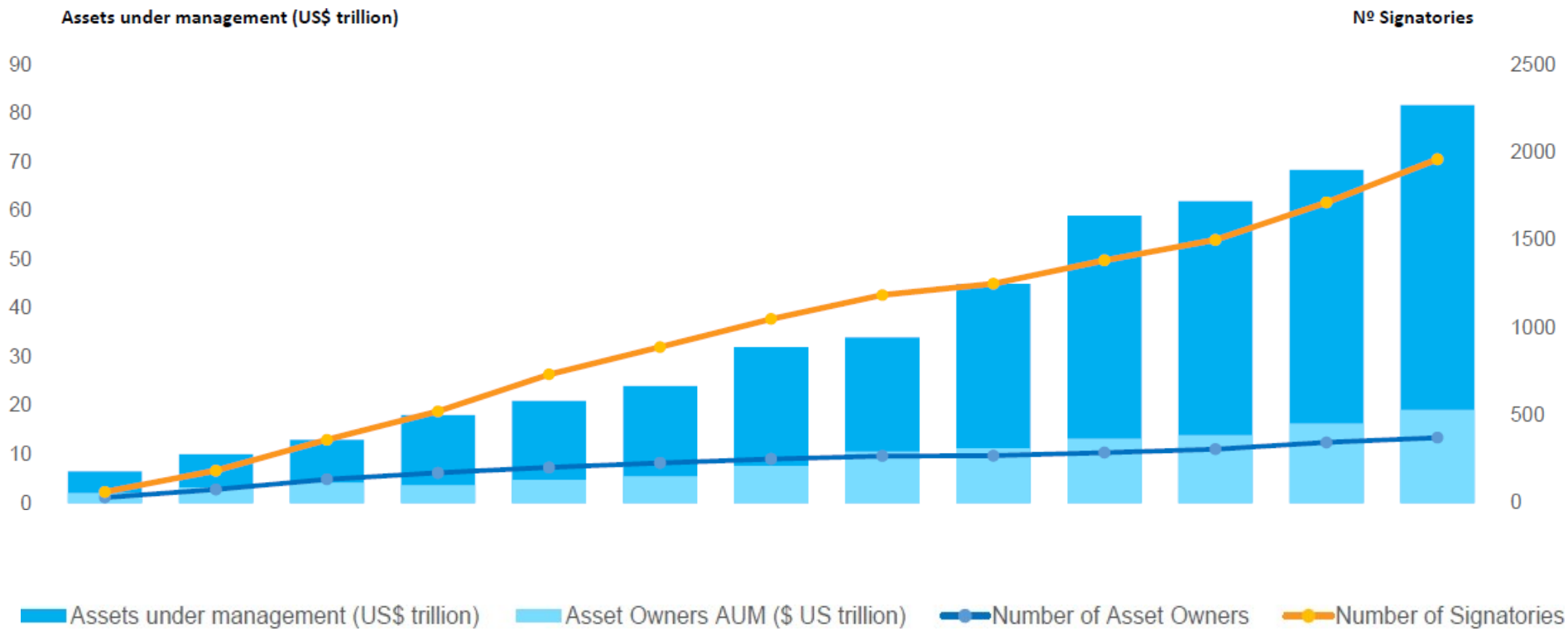
Chart 2: Compared to five years ago, how have your investments in sustainable funds changed?



Source: Schroders Global Investor Study 2017

ESG investment - Where do we stand?

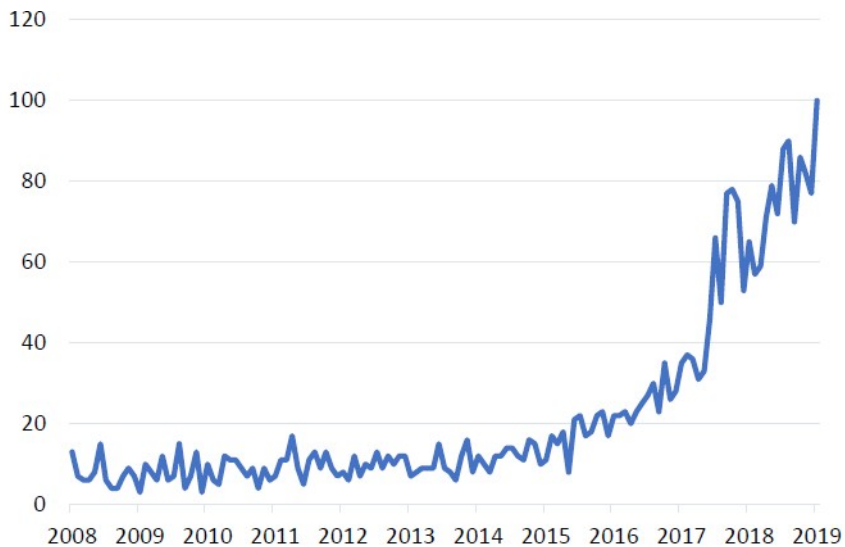
Huge global investor commitment: $82 trn AuM of PRI Signatories – roughly 40% of the total global outstanding bonds and equities…



Source: PRI 2019, The World Federation of Exchanges 2019, BIS 2019

ESG investment - Where do we stand?

Relative Google Search Volume of topic "ESG" in Finance context, globally: 10-times increase in the last 5 years.



Regional concentration of relative Google Search volume of topic "ESG" in Finance context.

Numbers represent search interest relative to the highest point on the chart for the given time. A value of 100 is the peak popularity for the term. A value of 50 means that the term is half as popular. A score of 0 means that there was not enough data for this term. The regional point score of 100 is given to the location where the highest popularity was achieved in proportion to the total number of search queries.

Source: Google Trends 2019

Engagement and Voting

Proxy voting: Topics on AGM'S, ESG on the rise

Amongst investor's top 5 priorities in 2018@ Increased attention to climate risk and the environment (EY 2019)

Climate change is a "significant risk factor"

Enhanced reporting needs to be a priority (over changing strategy, practices)

Changes to company strategy need to be a priority (over enhanced reporting, changing practices).

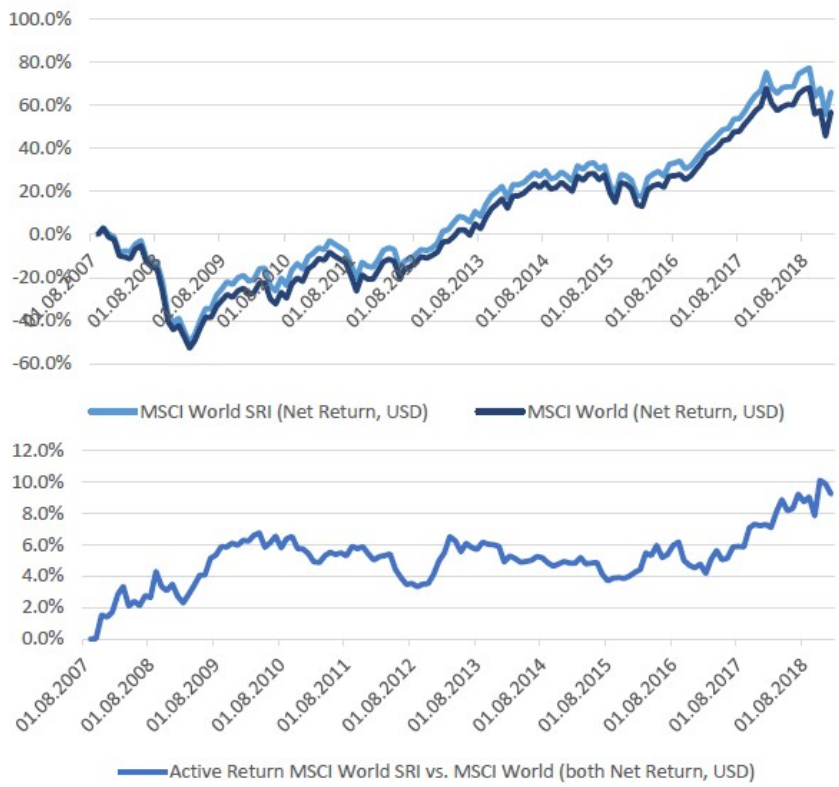
Most common shareholder proposals submitted in 2017.

Proposal	Proposals submitted	Proposals withdrawn
Adopt/amend proxy access	157	36%
Review/report on lobbying activities	53	21%
Appoint independent board chair	49	10%
Review/report on political spending	49	35%
Address human rights	40	33%
Review/report on greenhouse gas emissions	36	53%
Review/report on pay inequality	34	44%
Address corporate EEO/diversity	32	48%
Report on sustainability	31	55%
Review/report on climate related risks	29	31%

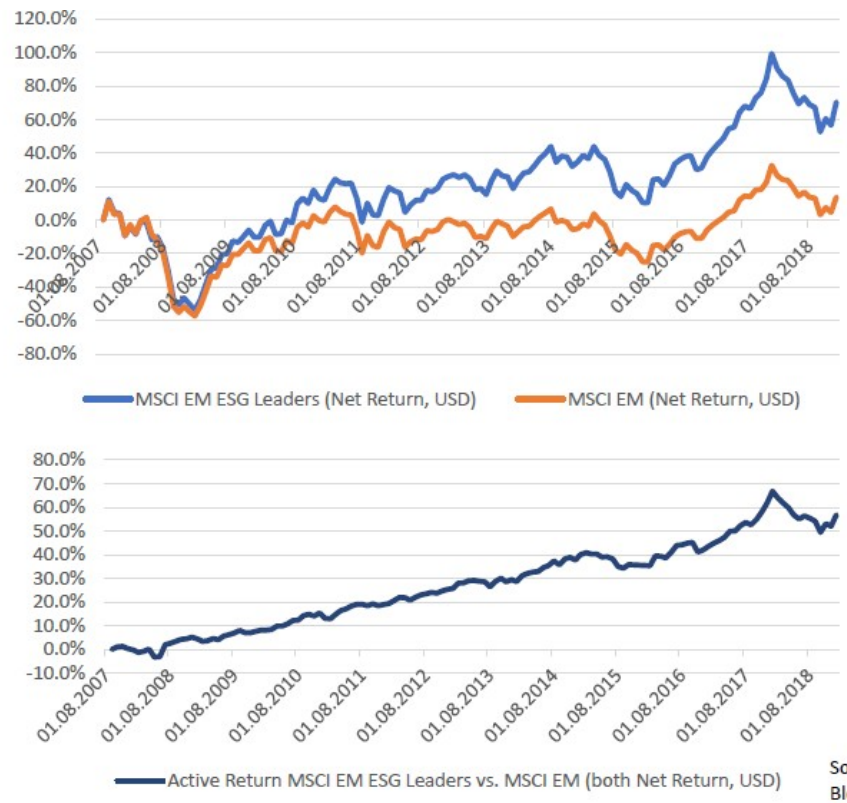
Source: EY (2019)

Empirical evidence about ESG and performance.

MSCI World SRI vs. MSCI World (since inception).

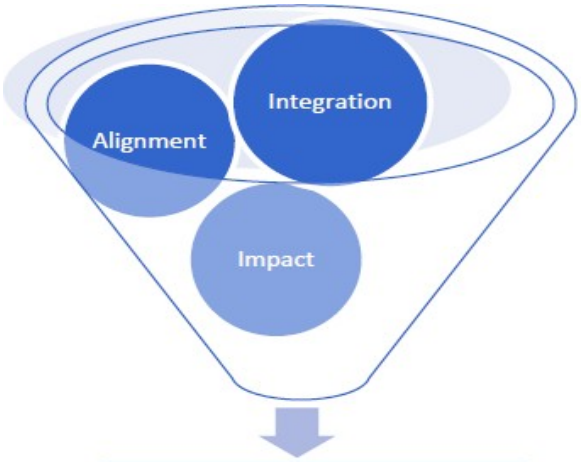


MSCI EM ESG Leaders vs. MSCI EM (since inception).



Source: MSCI, Bloomberg

Integrating ESG into Asset Allocation



- A top-down process:

- ESG objectives (financial and non-financial)

Investment Strategy

- A high-level strategic plan for achieving investment objectives (based on understanding of fiduciary duty, investment convictions, beliefs, principles).

Investment Policy

- Stakeholder Communication tool; outline of investment objectives; guidance on investment processes; guidance on standards for measuring success/performance.

Asset Allocation

- Allocation of investment capital across asset classes/categories.

Source: Sustainalytics (2019)

Why integrating ESG is relevant to insurers?

- We are currently witnessing a growing appetite of financial actors to understand the relationship between ESG factors and entities' improved performance – the insurance industry is no exception.

- As the largest institutional investor group in Europe — and operating within long investment horizons — insurance companies play a major role in financing the move to a low-carbon economy.

- As risk managers, insurers play a central role in identifying and measuring material ESG risks – particularly climate.

- Consequently, to remain competitive, insurers need to adapt and innovate while factoring the above-mentioned risks into their strategic decision-making process.

ESG is becoming more mainstream in Insurance with the development of ESG methodologies and frameworks.

Pressure has been mounting on insurers to further consider ESG issues to meet their financial objectives.

- Credit rating agencies such as Moody's are including ESG factors into their ratings to better evaluate companies' risk of default.
- As a result, they have identified high exposure and extensive vulnerabilities in the insurance sector.
- Given insurers' broad asset range of portfolios, their exposure to ESG risks such as climate change is increasing, potentially damaging their value drastically.

Insurers are beginning to respond to the changing landscape.

- In 2019, the PSI and Allianz launched the first guide to managing sustainability risks in insurance underwriting – providing guidance on how to integrate ESG risk consideration into due diligence and core business decision making.
- Other entities have followed suit.

ZURICH

Aberdeen Standard Investments

Allianz

AXA

Profit or purpose? Both!

Financial Motive

Primary motive: ‘Use ESG-Information for better valuation and investment-decisions’

Sustainability Motive

Primary motive: ‘Generate an effect/impact through sustainable & responsible investing practices’ (e.g. health improvement, sustainable land use, reduction in poverty) – social preference and social signalling.

Secondary motive: ‘Earn at least market-conform returns with sustainable & responsible investing solutions’ (risk and return)

Regulatory developments

Tackling Climate Change is now at the core of EU policy

Policy Drivers

- Climate science
- Paris Agreement
- UN 2030 Agenda for Sustainable Development

Action Plan on Sustainable Finance

1) Re-orient capital flows through sustainable investments
2) Mainstreaming sustainability risk into risk management
3) Foster transparency and long-termism in markets

Globally or Asia

?

Coalition of the willing, gathering Central Banks and Supervisors, working on climate and green finance issues

ESMA EIOPA EBA

EU Action Plan on Sustainable Finance

Key challenges	Actions
No common definition of “sustainable investment”	EU classification (taxonomy) for sustainable activities
Risk of “greenwashing” of investment products	Standards and labels for ‘green’ financial products give investors certainty
Banks and insurers often give insufficient consideration to climate and environmental risks	Study if capital requirements should reflect exposure to climate change and environmental risks
Investors often disregard sustainability factors or underestimate their impact	Clarify institutional investor duties to consider sustainable finance when allocating assets
Too little information on corporate sustainability-related activities	Enhancing non-financial information disclosure

EU Action Plan at a glance

1. Regulation creating "green" classification system for economic activities ("Taxonomy Regulation")

2. Regulation on disclosures relating to sustainable investments and sustainability risks ("Disclosures Regulation")

3. New low-carbon benchmark indices (via amendment to Benchmarks Regulation)

4. Integration of sustainability in risk management, organisational requirements, operating conditions and target market assessments

5. Better advice to clients on sustainability

The Disclosures Regulation

Disclosures Regulation

- The **Disclosures Regulation** requires AIFMs and UCITS management companies (amongst others, but for the purposes of these slides, we focus on investment funds and their managers) to consider and disclose in a consistent and harmonised manner how ESG factors are adopted in their decision making processes. It aims to harmonise disclosure standards among EU member states to facilitate the comparability of different financial products and services. **Many of the provisions of the Disclosures Regulation apply to all asset managers, whether or not they have an express ESG or sustainability focus.** The Disclosures Regulation applies different requirements and implementation timeframes in respect of disclosures on websites, in prospectuses and in periodic reports.

When will the Disclosures Regulation apply?

- The main provisions of the Disclosures Regulation apply from **10 March 2021**. The requirements relating to disclosures in the **periodic reports of ESG-focused** products are stated to apply from **1 January 2022**, which would appear to suggest that reports published after that date (as opposed to reports relating to periods starting on or after that date) should include the required disclosures, but this may be clarified in the technical standards.

Disclosures Regulation

Disclosure Obligations Applicable to All Funds

Website	What's required?
Sustainability risk policies	Information about their policies on the integration of sustainability risks in the investment decision-making process.
Adverse sustainability impacts	Publish and maintain on website: • a statement on due diligence policies regarding the principal adverse impacts of investment decisions on sustainability factors; or • clear reasons why they do not consider the adverse impacts of investment decisions on sustainability factors.*
Remuneration policies	Include in remuneration policies information on how those policies are consistent with the integration of sustainability risks and publish this information on website.

Prospectus Disclosures

Sustainability risks and sustainable investments	**Firms must disclose:** • **the manner in which sustainability risks are integrated into their investment decisions;** • **the results of assessments of the likely impacts of sustainability risks on the returns of the financial products they make available; and** • **where the manager considers principal adverse impacts of investment decisions on sustainability factors, whether, and if so how, each financial product considers principal adverse impacts on sustainability factors.****

Marketing communications must not contradict any information disclosed under the Disclosures Regulation.

* From 30 June 2021, financial market participants with more than 500 employees or which are parent undertakings of large groups with more than 500 employees must publish and maintain on their websites a statement of their due diligence policies with respect to the principal adverse impacts of investment decisions on sustainability factors.

** This requirement applies from 30 December 2022.

Disclosures Regulation

Additional Disclosure Requirements for Expressly ESG Focused Products	
Products promoting environmental and social characteristics	**Prospectus** should disclose: • **information on how those characteristics are met**; • where an index has been designated as a reference benchmark, information on whether and how the index is consistent with those characteristics; and • information as to where the methodology used for the calculation of the reference index can be found.
Products that have sustainable investment as their objective	Where a financial product has sustainable investment as its objective and an index has been designated as a reference benchmark, the following will need to be included in the prospectus: • information on how the designated index is aligned with the objective; • an explanation as to why and how the designated index aligned with that objective differs to a broad market index; and • information as to where the methodology used for the calculation of the reference index can be found. Where no index has been designated, pre-contractual disclosures will include an explanation of how the sustainable investment objective is to be attained.
Products promoting environmental and social characteristics and products that have sustainable investment as their objective	**Website to provide** the following information: • a description of the environmental or social characteristics or the sustainable investment objective; • **information on the methodologies used to assess, measure and monitor the environmental or social characteristics or the impact of the sustainable investments selected for the financial product, including its data sources, screening criteria for the underlying assets**; and • the relevant sustainability indicators used to measure the environmental or social characteristics or the overall sustainable impact of the financial product. **Periodic reports to include the following information** • the extent to which environmental and social characteristics are met; • the impact of sustainable investments by means of relevant sustainability indicators; and • where an index has been designated as a reference benchmark, a comparison will be needed between the overall sustainability-related impact of the financial product with the impacts of the designated index and of a broad market index through sustainability indicators.

The Taxonomy Regulation

Proposal

- The proposal to create a sustainability taxonomy was devised to provide market clarity on what economic activities should be considered “sustainable”.
- The Taxonomy Regulation aims to develop a taxonomy for climate change and environmentally sustainable activities so that the classification system can be used with respect to labels, standards and benchmarks recognising compliance with environmental standards across the EU.
- Importantly, the Taxonomy Regulation does not establish a label for sustainable financial products. It sets out criteria for determining if an activity (not a company or asset) is environmentally sustainable, including whether the activity contributes to, or does not significantly harm, one or more specified environmental objectives.

Scope

- The Taxonomy Regulation applies to a broad range of financial market participants, defined to include AIFMs, UCITS management companies, and financial products (including AIFs and UCITS).
- For the most part, the Taxonomy Regulation will be relevant to asset managers who make available a financial product, such as an investment fund, which either: (a) has an objective of environmentally sustainable investment; or (b) “promotes environmental characteristics”. However, even managers of out-of-scope financial products will need to make the negative disclosure set out overleaf confirming that the product is out of scope of the regulation.

When will the Taxonomy Regulation apply?

- Political agreement on the Taxonomy Regulation was reached in December 2019 and the agreed text was published on 18 December 2019.
- The Taxonomy Regulation will apply, with respect to activities that substantially contribute to **climate change mitigation and adaptation, by 1 January 2022.** The regulation will apply with respect to activities that substantially contribute to the **other environmental objectives by 1 January 2023.**

The Taxonomy Regulation

Interaction with the Disclosures Regulation

- The Taxonomy Regulation is closely linked to the Disclosures Regulation. While the Taxonomy Regulation provides a common language for firms and investors to identify which economic activities are "**environmentally sustainable**", it also includes supplemental disclosure obligations to those set out in the Disclosures Regulation.

What additional disclosures are required by the Taxonomy Regulation?

- Where a financial product has "**sustainable investment**" as its objective within the meaning of the Disclosures Regulation, the information to be disclosed in the prospectus and annual report must include:
  - information on the environmental objective or environmental objectives to which the investment underlying the financial product contributes; and
  - a description of how and to what extent the investments underlying the financial product are invested in environmentally sustainable activities. This description must specify the share of investments in environmentally sustainable economic activities, including details on the respective proportions of enabling and transition activities, as a percentage of all investments underlying the financial product.

Where a financial product "**promotes environmental characteristics**", the prospectus and annual report should include the following statement: "*The "do no significant harm" principle is applied only for the investments underlying the product that take into account the EU criteria for environmentally sustainable investments. The investments underlying the remaining portion of this financial product do not take into account the EU criteria for environmentally sustainable investments."*

Where a financial product is not: (a) a financial product with sustainable investment as its objective; or (b) a financial product that promotes, among other characteristics, environmental or social characteristics within the meaning of the Disclosures Regulation, the prospectus and annual return must include this statement:

"The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable investments."

FMPs are defined in Article 2(1) Disclosure Regulation

Uses and Users of the Taxonomy

	Disclosure Obligations	Optional Additional Uses

Asset Management	• UCITS Funds:
	  • Equity funds
	  • Exchange-traded funds ("**ETFs**")
	  • Bond funds
	• Alternative Investment Funds ("**AIFs**"):
	  • Fund of funds
	  • Real estate funds
	  • Private equity or SME loan funds
	  • Venture capital funds
	  • Infrastructure funds
	• Portfolio management	

Insurance	• Insurance-based investment products ("**IBIP**") • Institution for occupational retirement provision ("**IORP**")	• Insurance (selected non-life LOBs)
Corporate & Investment Banking	• Securitisation funds* • Venture capital and private equity funds • Portfolio Management • Indices funds	• Securitisation • Venture capital and private equity • Indices • Project finance and corporate financing
Retail Banking		• Mortgages • Commercial building loans • Car loans, Home equity loans

Challenges

Adequacy of disclosures by Investee Undertakings

- One of the potential challenges identified by industry in relation to the fulfilment of the Action Plan's objectives is the lack of reliable and comparable ESG data from investee companies.

- The Taxonomy Regulation includes provisions regarding the transparency of undertakings that come within the scope of the Non-Financial Reporting Directive ("NFRD"), which would require large companies (public interest entities with more than 500 employees) and parent undertakings of large groups with more than 500 employees subject to the EU Accounting Directive (Directive 2013/34/EU) to include in their non-financial statement, or consolidated non-financial statement, information on how and to what extent the company's activities are associated with environmentally sustainable economic activities.

- The Commission will publish the detailed disclosure requirements by **1 June 2021** and the **requirements will apply from 30 June 2021.**

Low Carbon Benchmarks Regulation

- The Low Carbon Benchmarks Regulation amends the existing EU Benchmark Regulation by introducing two new types of benchmarks:
  - EU Climate Transition benchmarks; and
  - EU Paris-aligned benchmarks.
- In addition to the introduction of these new benchmarks, the amendments require benchmark administrators to update all benchmark statements (excluding those relating to interest rate and currency benchmarks) by 30 April 2020 to include "…how ESG factors are reflected in each benchmark …".
- For benchmarks that do not pursue ESG objectives, it will be sufficient "… to clearly state in the benchmark statement that they do not pursue such objectives". Benchmark administrators that pursue ESG objectives will be required to publish key elements of their methodologies.
- The Commission will adopt delegated acts to provide further detail on the minimum standards for each of the new benchmarks and the requirements applicable to benchmark administrators. Administrators of significant benchmarks ie, benchmarks that are above a certain threshold in terms of usage, will be required to disclose the degree of "Paris alignment" of those benchmarks and must endeavour to provide a Transition benchmark by **1 January 2022.**
- The Low Carbon Benchmarks Regulation entered into force on 10 December 2019.

EU Sustainable Finance Framework

- The Sustainable Action Plan also included a number of legislative proposals, one of which resulted in the adoption of the Disclosure Regulation.

- There are many other legislative proposals in various stages of the EU's legislative process which will start to become effective from 2020 onwards.

Disclosures Regulation	Consistent Disclosure Requirements in Relation to Sustainability
Taxonomy Regulation	A unified classification system for sustainable activities
Benchmarks Regulation	Standardised sustainability benchmarks for green products
MiFID and IDD	Including sustainability considerations in financial advice
UCITS AND AIFMD	Integrating sustainability risks and factors into UCITS and AIFMD
Corporate Non-Financial Disclosure	Strengthening ESG data reporting and accounting rule-making
Green Bonds	A common green bond standard to increase comparability andtransparency
EU Ecolabel	Common EU Ecolabel for sustainable products, including financial products
Corporate Governance	Fostering sustainable corporate governance and collecting evidence of undue short-term pressure from capital markets
CRR / Solvency II	Incorporating sustainability into prudential requirements
Credit Ratings	Integrating sustainability in ratings and market research

Renewed Sustainable Finance Strategy

- ESG specific laws will have a knock-on impact and, in many cases, result in amendments to existing requirements for Investment Managers, e.g. **amendments are proposed to the UCITS, AIFM and MiFID Directives**
- The European Green Deal, in tandem with the recovery from the COVID-19 crisis will significantly increase the investment efforts needed across all sectors – a green recovery?
- A Renewed Sustainable Finance Strategy was **launched** in April 2020 to:
  - Contribute to the objectives of the European Green Deal Investment Plan, in particular to create an enabling framework for private investors and the public sector to facilitate sustainable investments; and
  - Build on previous initiatives and reports, such as the Sustainable Action Plan and the reports of the Technical Expert Group ("**TEG**") on Sustainable Finance
- The EU has launched a consultation which will close on 15 July 2020

Other developments

- European Supervisory Authorities ("ESAs") have issued a public consultation on proposed regulatory technical standards ("RTS") with regard to content, methodology and presentation of sustainability-related disclosures. Six of these RTS must be delivered by 30 December 2020 and one must be delivered by 30 December 2021.
- Draft RTS address areas from "do not significantly harm" principle to guidance on nature and extent of pre-contractual exposures, website disclosures and content required in ESG periodic reports.
- Work on amendments to level 2 rules for UCITS, AIFs have stalled owing to regulatory focus on liquidity management and leverage.

What other reporting regimes should I be aware of?

Non-financial reporting initiatives.

EU

Non-financial reporting initiatives
- Guidelines of reporting www.eurlex.europa.eu/legal-content/en/txt/?uri-celex:52017XC0705(01)
- Transposed to local laws before end 2016.
- Compulsory for PIE's . 500 employees.

EFFAS

EFFAS KPI's
- Founded in 2007
- Partnered with EU commission supported laboratory " Corporate Responsibility and Market Valuation of Financial and Non Financial Performance"

GRI

Global reporting initiatives standards
- Materiality focus
- Aligned with EU Directive and IIRC
- Local impacts

SASB

Sustainability Accounting Standards Board
- ESG indicators to include in the 10K and 20F forums.

IIRC

Integrated Reporting framework
- Different focus of information: future, not past. Strategic, and quality of governance and Management.

TCFD

Task Force on Climate related Financial Disclosures
- Different focus of information: future, not past. Strategic, and quality of governance and Management.

In A Nutshell...

	Taxonomy	Disclosures
WHAT ?	➔ A list of economic activities that are considered environmentally sustainable for investment purposes.	➔ New harmonised disclosure requirements applicable to financial market participants, financial advisors and financial products.
WHY?	➔ Enables informed decision-making ➔ Ensures consistency ➔ Accountability ➔ Not green vs. brown ➔ Transitioning polluting sectors	➔ Strengthening the transparency of companies on their environmental, social and governance (ESG) policies ➔ Introducing measures to clarify asset managers' and institutional investors' duties regarding sustainability
HOW?	➔ Applies to all financial products regardless of whether they are marketed as “green” or not ➔ Contribute substantially to at least one of the six environmental objectives ➔ “Do no significant harm” to any of the other	➔ Managers whose financial products target “sustainable investments” will have to disclose information about these in pre-contractual disclosures, as well as on their websites and in periodical reports. ➔ MiFID II & IDD delegated acts ➔ Investment advisers will have to assess sustainability preferences of clients ➔ Institutions – TCFD, impact reporting

In summary- who is impacted?

Proposed Reform	Application to EU Managers	Application to Non-EU Managers with EU Sub-Manger	Application to Non-EU Managers with no EU Sub-Manager
Amendments to the AIFMD and UCITS Regimes	**Direct Impact** on EU AIFMs and UCITS ManCos	**Indirect impact** on non-EU managers acting as sub-managers to UCITS ManCos **No direct impact** on other non-EU managers	**Indirect impact** on non-EU managers that act as sub-managers to UCITS ManCos **No direct impact** on other non-EU managers
Organisational Requirements for Investment Firms	**Direct impact** on: • EU AIFMs with top-up permissions; • any EU investment firms in the group	**No direct impact** on non-EU manager **Direct impact** on EU sub-manager to non-EU manager	**No direct impact** on non-EU managers
Disclosure Requirements	**Direct impact** on: • EU AIFMs; • UCITS ManCos; • any investment firms in the group with authorisation to provide portfolio management services	**Direct impact** on: • non-EU managers marketing funds to EEA investors • EU sub-managers to non-EU managers **Indirect impact** on non-EU managers that act as sub-managers to UCITS ManCos	**Direct impact** on non-EU managers marketing funds to EEA investors **Indirect impact** on non-EU managers that act as sub-managers to UCITS ManCos
Product Governance	**Indirect impact** where fund shares are distributed to EU investors	**Indirect impact** where fund shares are distributed to EU investors	**Indirect impact** where fund shares are distributed to EU investors
Suitability	**Indirect impact** where fund shares are distributed to EU investors **Direct impact** on: • EU AIFMs with top-up permissions; • any investment firms in the group with investment advice or portfolio management permissions	**Indirect impact** where fund shares are distributed to EU investors	**Indirect impact** where fund shares are distributed to EU investors

Timeline of Key Dates - Summary

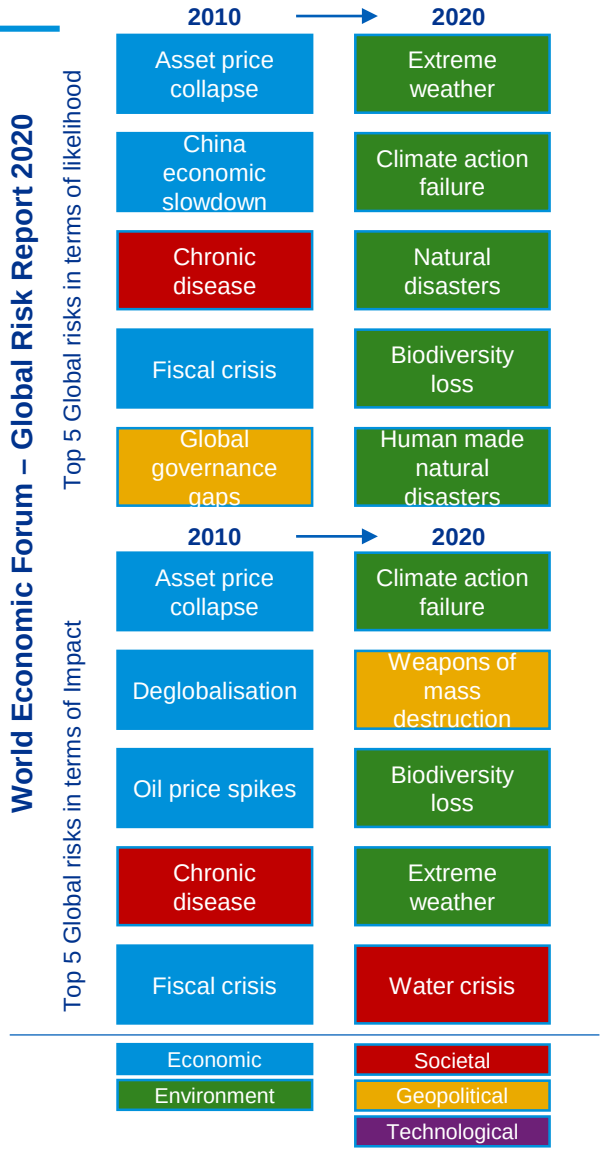
Timing	April – December 2020	March – June 2021	December 2021– January 2022	June – December 2022	January 2023
Key Developments	• **Benchmark Regulation** - Benchmark administrators to update benchmark statements regarding ESG factors (April 30th) • **Disclosures Regulation** ESAs to prepare draft technical standards on disclosures to investors in relation to adverse impacts on the climate and other environment-related adverse impacts (December 30th)	• **Benchmark Regulation** –Application date of most provisions (pre-contractual and website requirements) of the Disclosure Regulation (March 10th) • **Taxonomy Regulation** –Financial market participants with more than 500 employees or which are parent undertakings of large groups with more than 500 employees must publish and maintain on their websites a statement of their due diligence processes with respect to the principal adverse impacts of investments decisions on sustainability factors. (June 30th)	• **Disclosures Regulation** ESAs to prepare draft technical standards on disclosures to investors in relation to adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery. (December 30th) • **Taxonomy Regulation** – Application date in respect of activities that substantially contribute to climate change mitigation and adaptation. (January 1st) • **Disclosures Regulation** – Application date of requirements relating to periodic reports of ESG-focused products. (January 1st)	• **Taxonomy Regulation** -ESAs to prepare draft technical standards on activities that substantially contribute to environmental objectives other than climate change mitigation and adaptation (water, circular economy, pollution, biodiversity). (June 1st) • **Disclosures Regulation** – Where the manager considers principal adverse impacts of investment decisions on sustainability factors, prospectus to disclose whether, and if so how, each financial product considers principal adverse impacts on sustainability factors. (December 30th)	• **Taxonomy Regulation** – Application date in respect of activities that substantially contribute to environmental objectives other than climate change mitigation and adaptation. (January 1st)

Climate risk

Setting the scene

- Climate-related risks are front and centre at policy level as well as consumer level
- Broad range by their nature and they affect all elements of an economy, reaching across all sectors and across all geographies
- High degree of certainty that these risks will materialise over the coming century.
- Impact for **corporates** … mismatch between traditional financial planning and climate change time horizons
- Impact for **insurers** … both from an underwriting and investment perspective

In essence, climate change is a potential source of risk to financial stability



What are climate-related risks

- Risks generally form into two broad categories Physical & Transitional
  - Physical: acute (short term) hurricanes and floods & chronic (longer term) event, rising global temperatures & sea levels
  - Transitional: risks related to the transition to a lower-carbon economy, such as increased regulation, substitute products, newer technologies and reputation.
- Physical risks (where climate change affects property, industry, infrastructure and health) could be very severe, especially if warming exceeds 3℃.
- A transition to a low-carbon economy will require adjustments by all aspects of society … consumers, businesses and policymakers

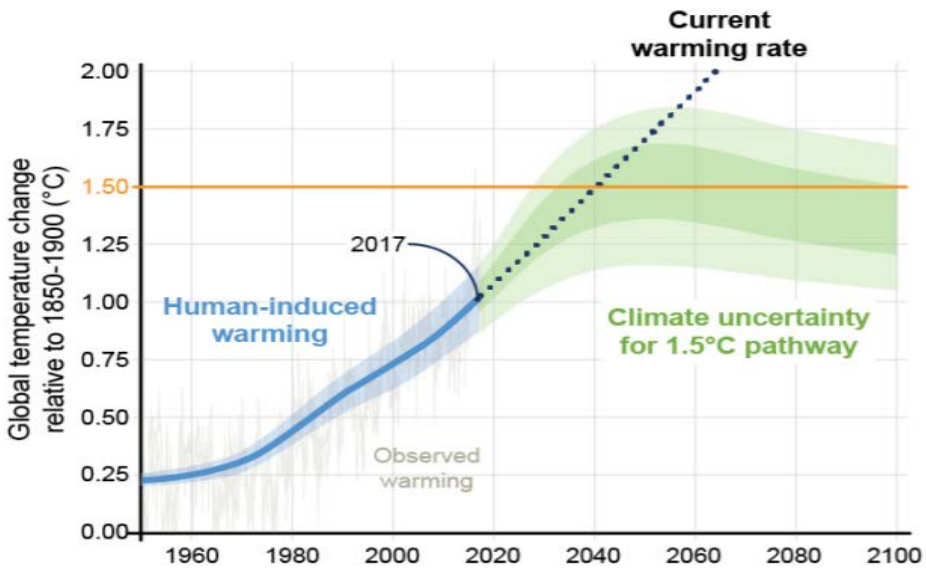
wide range of potential outcomes

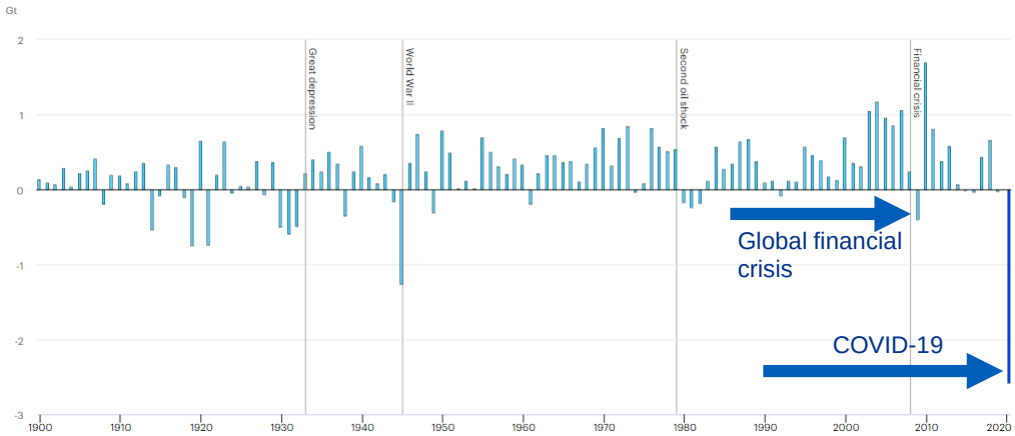
relating to the timing and extent of future warming

Climate-related Risks	
Physical	— Acute: Extreme weather events — Chronic: Changing weather patterns, rising mean temperature and sea levels
Transition	**Policy and Legal** — Carbon pricing and reporting obligations — Regulation of high carbon products and services — Mandates on and regulation of existing products and services — Exposure to litigation **Technology** — Substitution of existing products and services with lower emissions options — Costs to transition to lower emissions technology **Markets** — Changing customer behavior/demands — Increased cost of raw materials **Reputation** — Shift in consumer preferences — Stigmatisation of high carbon sectors — Increased stakeholder concern/negative feedback

Where are we now?

- Research suggests probable warming of 1-6°C above preindustrial levels by the end of the century, depending on the success of mitigating actions.
- Wide range of potential outcomes relating to the timing and extent of future warming
- Potentially huge consequences under scenarios at the upper end of the range.





- Restricting the extent of warming will require a massive and prolonged transition effort, unprecedented in scale and duration, which may be orderly or disorderly.

Chart Sources: IEA and IPPC

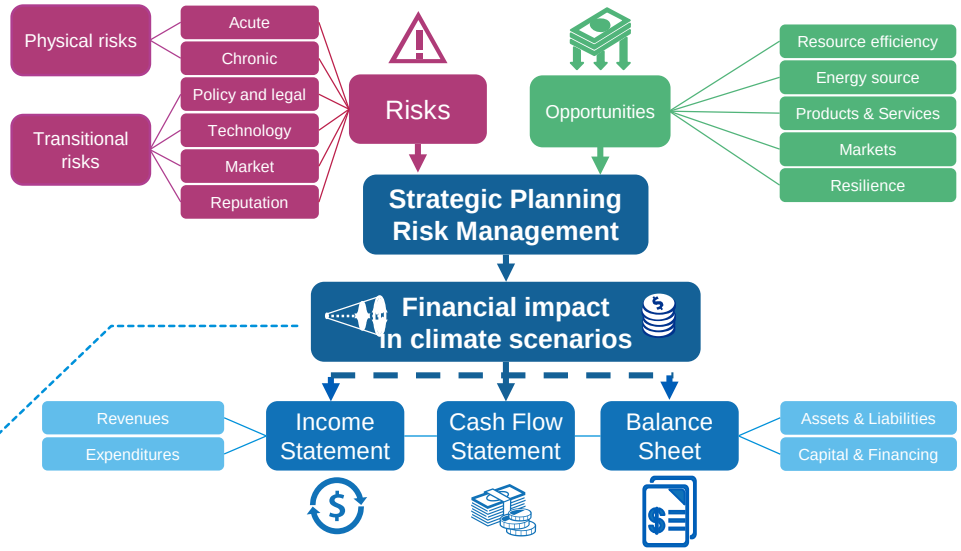
How climate risks and opportunities impact the business model

- The mechanisms through which climate risks and opportunities impact the business model can be diverse
- Identifying the key risks and opportunities and using scenario-analysis to assess the likelihood and severity of the impact of these risks and opportunities builds climate resilience

Potential impacts include …

- production / operation disruptions,
- supply chain disruptions,
- physical damage to assets and **raising insurance costs**
- changes in resource / input prices
- changes in demand for products and price fluctuations
- changes in hedge investment positions

TCFD Risks and Opportunities



Role of insurers - climate risk is not just for corporates

Insurers have a unique role in the global effort to mitigate and adapt to climate change:

✓ Providers of risk protection
✓ Major investors managing c.$30 trillion of assets

Are new approaches to risk protection require?

- History is no longer a reliable guide to pricing risk … 1-in-100 event in the 1960s is now a 1-50 year event … could be even more frequent in the future
- Potential for risk mispricing arises

Consider, a top Physical Risk … the risk of flooding

- Impacts people's homes and businesses, with devastating impacts on communities
- Not just emotional distress associated with damage and loss, there are also financial costs
    - Underinsured to flood risk, flood events can cause losses for homeowners
    - Reduces ability to repay loans … damaging the value of the property
    - Quality of the loan portfolios of banks/insurers

What tools are available?

The Principles of Sustainable Insurance (PSI)

- Principle 1: "*We will embed in our decision-making ESG issues relevant to our insurance business*".
- ESG risks and exposure across differing sectors

Risk mitigation and good practices

- Reporting, standards, industry benchmarking

TCFD

- FSB driven, voluntary but potentially moving into regulatory setting
- Strong focus on governance, risk (& opportunities) and reporting on metrics

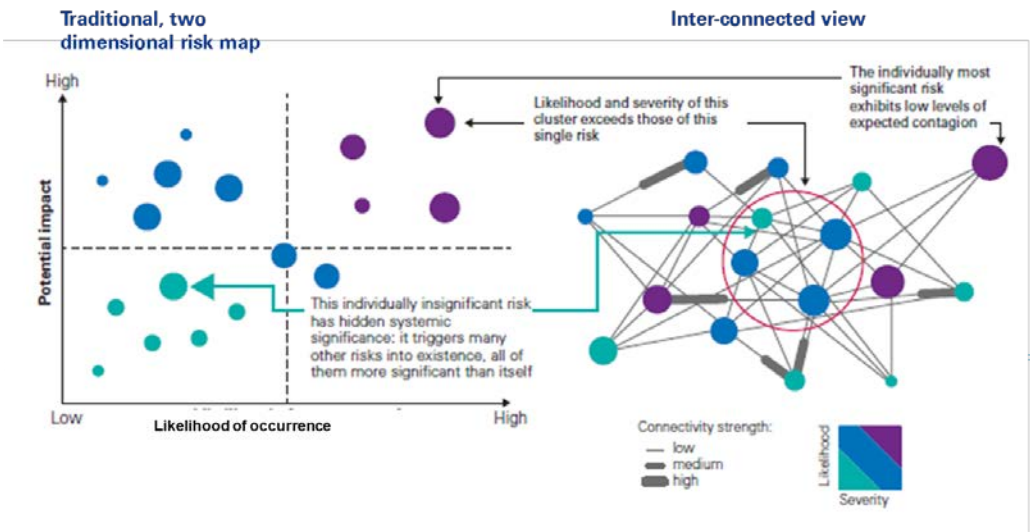
New approaches …

- KPMG - Dynamic Risk Assessment (DRA)

Dynamic Risk Assessment

What is DRA?

- Dynamic Risk Assessment (DRA) is an evolution in risk assessment. It considers the traditional measures of risk severity and likelihood – but also considers risk interconnectedness (risks that link together) and velocity (expected speed with which risks will affect operations).
- The DRA process uses the scientific consensus methodology of *expert elicitation* to collect the data for analysis, and *network theory* to connect the organization's risks in a three-dimensional space



Key features:

- An evolution in risk assessment
- Relies on expert elicitation, and advanced data analytics in order to identify, connect and visualize risk in four dimensions
- Considers the contagion effects of individual risks, and the potential speed with which risks will affect operations
- Identifies the most acute systemic risks for a business
- Identifies the systemically most significant risk
- Provides visibility over how 'structural breaks' (macroeconomic, sociopolitical and other megatrends not necessarily previously observed) impact organization's risk profile
- Helps to inform clients' forward-looking strategic direction
- Can inform control design for the prevention, detection and remediation of the risks
- Informs risk mitigation and response plans in relation to systemic risk
- Can help increase business resilience and turn risk into opportunity

DRA and ESG

Client story - World Business Council for Sustainable Development

"However, ESG-related risks can be difficult to identify, quantify and prioritize. It requires a deep understanding of the business operating environment and leadership that acknowledges and accepts the evolving external landscape. ***On a technical level, the process must move beyond traditional impact versus likelihood analysis to consider the interconnectivity and speed of onset of these risks***."

"Because of these challenges, the World Business Council for Sustainable Development (WBCSD) engaged KPMG, through its process known as Dynamic Risk Assessment."

"It presents analyses from ***the application of an enhanced risk assessment technique - KPMG's Dynamic Risk Assessment methodology*** - to the risk landscape represented by the perspectives of nine leading companies operating in the food and agricultural sector. ***This report dives into how a dynamic risk assessment can improve companies' risk practices and identify crucial aspects to continue creating long-term value***."

An enhanced assessment of risks impacting the Food & Agriculture sector

Published: 22 Jan 2020
Type: Publication

The current risk landscape for business has changed as all of the top five risks identified for likelihood were environmental according to the World Economic Forum Global Risk Report in 2020. In addition, the complexities and connectivity of environmental, social and governance (ESG)-related risks mean companies must assess risks not just individually, but as an interconnected and aggregated group.

This report on the food and agriculture sector is intended to help companies more effectively assess their exposure to food system challenges and to integrate this knowledge into target setting and solution building.

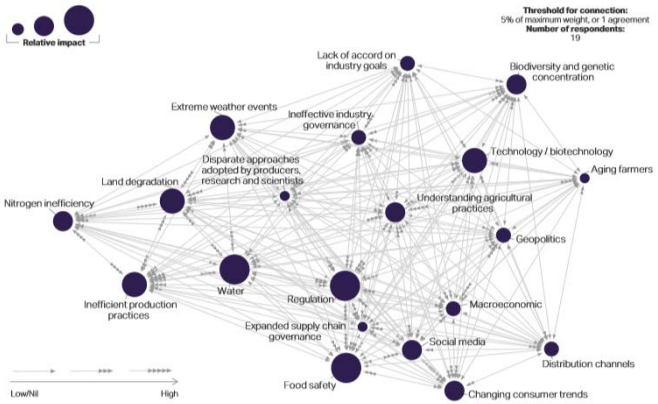
It presents analyses from the application of an enhanced risk assessment technique - KPMG's Dynamic Risk Assessment methodology - to the risk landscape represented by the perspectives of nine leading companies operating in the food and agricultural sector. This report dives into how a dynamic risk assessment can improve companies' risk practices and identify crucial aspects to continue creating long-term value.

This report is a continuation of WBCSD's risk work and the guidance built in collaboration with COSO on Applying Enterprise Risk Management to Environmental, Social and Governance-related Risks.

Share

Download the report

Figure 6: A network view of the risks identified including relative impact and connectivity



https://www.wbcsd.org/Programs/Redefining-Value/Business-Decision-Making/Enterprise-Risk-Management/Resources/An-enhanced-assessment-of-risks-impacting-the-Food-Agriculture-sector

DRA and climate change strategy

Client story – City of Sydney

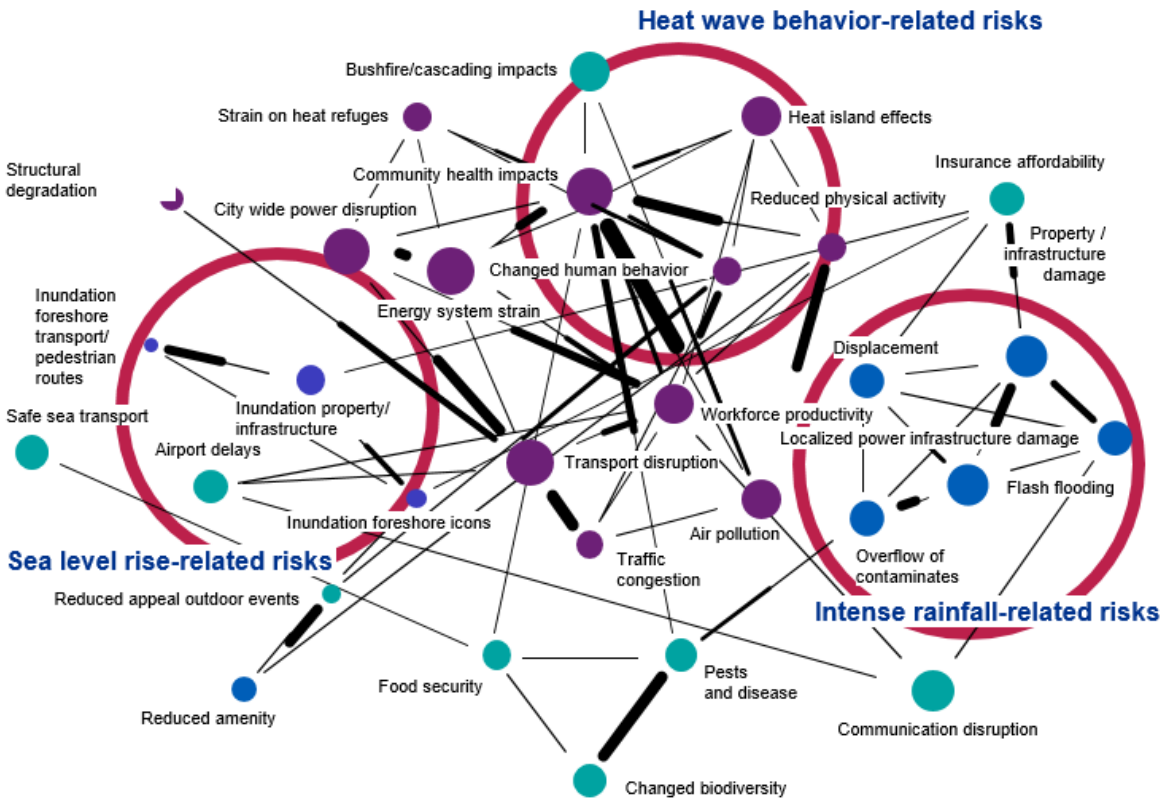
KPMG Dynamic Risk Assessment helps the **City of Sydney** develop its climate change strategy.

The City of Sydney in New South Wales, Australia needed to understand how climate change is likely to affect the city in 2030 in order to develop an effective Climate Adaptation Plan.

KPMG in Australia performed a DRA to understand the interdependencies between 32 different climate change risks faced by the city. KPMG analysts used expert elicitation to develop a graphic representation of the relationships between the risks and perceptions of severity. Their analysis also identified trigger risks which were central to causing other risks, and those that are most centrally affected by other risks. Clusters of risks that were likely to occur together were also identified, so that these could be managed together.

As a result of the DRA, the Sydney City Council benefited from greatly improved insight into the risks that climate change posed to the city and was in a better position to develop actions to address these.

The thickness of the connecting lines in the diagram illustrates the strength of the connections between the individual risks.



Graphic adapted from: RPS (2015) City of Sydney Climate Risk and Adaptation: Project Report. Available from:

https://meetings.cityofsydney.nsw.gov.au/Data/Environment%20Committee/201512071401/Agenda/151207_EC_ITEM03_ATTACHMENTD.pdf

Resources

- Relevant ESG materials are available to download from **www.kpmg.ie/esg**
- Follow **Conor Holland & Shane O' Reilly on LinkedIN** to keep up with latest KPMG publications and insight on sustainable finance and asset management trends. Niall Naughton, Brian Morrisey for KPMG Insurance updates.
- Our latest (May 2020) '*Frontiers in Finance – purpose or profit?'* publication explores the rapidly growing ESG agenda in the financial services sector by looking at the opportunities and growth areas, the global efforts in transitioning to an ESG-aware financial system; the growing demand for standardised measurement and disclosure; and the evolving political and regulatory landscape related to ESG. Visit: https://home.kpmg/xx/en/home/industries/financial-services/frontiers-in-finance.html

- For KPMG Ireland's overview of the current regulatorylandscape in EU Sustainable Finance, visit: https://home.kpmg/xx/en/home/industries/financial-services/frontiers-in-finance.html

Thank you

Q&A