CEO Brief

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CEO Brief is a report highlighting key current issues the insurance industry faces.

Next Insurance (Ⅲ): ESG and the Insurance Industry

The "Next Insurance" CEO Brief series diagnose the prospects of the Korean insurance industry and suggest business and policy agendas.

ABSTRACT

ESG factors are gaining attention. People consider the impact of corporates on society more than before, and the investment market and government policies incorporate EGS factors. Unless insurers manage ESG risks, they could face higher claims payout or lower investment value. Therefore, insurers should assess their ESG risks and incorporate ESG factors into their risk management and investment to promote long-term corporate values and sustainable development.

1. How Does ESG Affect Insurers?

ESG (environmental, social, and governance) factors are non-financial factors affecting corporate values and sustainable development. Sustainable development is "a development that meets the needs of the present without compromising the ability of future generations to meet their own needs." It is related to the idea that we should balance environmental, social, and economic aspects in development. The term ESG first showed up in a UN Global Compact Report (2004). Then it has been widely used since the UN Principles for Responsible Investment initiative - which promotes institutional investors to integrate ESG factors into their investment decision - in 2006.

Recently, ESG factors are gaining attention. People consider the impact of corporates on society, and the investment market and government policies

incorporate ESG factors. Rising economic inequality and environmental problems make people rethink myopic profit maximization ignoring negative externalities. Also, many countries have introduced laws and regulations to meet the net-zero carbon target.

Insurers are exposed to ESG risks as risk managers, insurers, and investors. Therefore, unless insurers manage ESG risks, they could face higher claims payout or lower investment value. ESG risks can affect underwriting performance by increasing the probability of insured events: environmental risk to property, liability, or health insurances; social risk to worker compensation, liability, cyber insurances; governance risk to D&O liability insurance, etc. And the ESG performance of insurers' investees will affect insurers' investment performance.

2. What Should Insurers Do?

Insurers should assess their ESG risks and incorporate ESG factors into their risk management and investment to promote long-term corporate values and sustainable development.

First, insurers must provide products and services to mitigate and adapt ESG risks. In some cases, public-private partnerships are imperative. Regarding climate risks, insurers should ❶ induce policyholders to alleviate climate risk in the underwriting and claim payment process, ❷ insure infrastructure projects for sustainable development such as renewable energy projects, and ❸ provide climate risk prevention and recovery services. For vulnerable populations, insurers could ❶ offer business interruption insurance or retirement plans for the self-employed, ❷ develop microinsurance with the governments, and ❸ collaborate with the governments to provide products covering work-related risk or income volatility to platform workers. Also, insurers should integrate governance factors - such as independence and diversity of boards, executive compensation structure, and business ethics - into the underwriting D&O (Directors and Officers) liability

insurance to manage corporate governance risks.

Second, as institutional investors, insurers should ❶ consider ESG factors in their investment decision, ❷ foster markets transacting ESG values, or ❸ practice active ownership to voice opinions on ESG issues. However, for investment integrating ESG factors, it is necessary to improve the comparability and transparency of ESG standards.

〈Table 1〉 How to Integrate ESG Factors into Insurers' Roles

Category		Goals	Insurerse should...	Policy Considerations
Risk Manage-ment	Environmen-tal	induce to mitigate and adapt climate change	• induce climate risk mitigation efforts in the underwriting and claim payment processes • insure infrastructure projects for sustainable development • provide climate risk prevention and recovery services	• collaborate with the governments in establishing disaster prevention measures
	Social	contribute to social safety nets	• offer coverage of business interruption loss or retirement income for the self-employed • provide coverage for work-related risk or income volatility to platform workers	• establish public-private partnerships to develop microinsurance or insurance for platform workers
	Governance	improve corporate governance	• incorporate governance factors into D&O liability insurance underwriting	• improve the comparability and transparency of governance indicators
Investment		make investment decisions to alleviate ESG issues	• consider ESG factors in their investment decision • foster markets transacting ESG values • practice active ownership to voice opinions on ESG issues	• improve the comparability and transparency of ESG standards

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