Sustainability will be key for insurers in 2023 as global concerns mount

Sustainability, inflation and the war in Ukraine continue to weigh on both insurers' minds and balance sheets. But sustainability is the watchword for 2023. Here's a taste of what insurers are up against in the coming year

An artistic installation of 'The Human Safety Net' in Venice; a fitting metaphor for Europe's insurance industry

Growing supply is leading to investments in “greener” insurance companies

The threat of economic recession in the EU, rising interest rates, increased inflation, growing costs of losses, natural disasters, cyber risk and fierce competition from tech are among the challenges European insurers are facing in 2023. But above all, climate change, a sustainable economy and the UN’s Sustainable Development Goals (SDG) are the hot topics on insurers’ agendas for the coming year.

> *Insurance companies have a unique position in climate change mitigation*

Insurance companies have a unique position in climate change mitigation. They play a very important role given their standing as both risk underwriters and large institutional investors. “The greener the better” is the motto of a growing number of insurers. We believe that insurers who engage in activities which help mitigate climate change and promote SDGs in 2023 have a competitive advantage with investors who are increasingly willing themselves to be active players in combatting climate change.

Those investors are willing to dig deeper and look beyond the headlines of annual sustainability reports; they try to evaluate the actual impact that insurers’ green activities will have. And that poses a lot of challenges for insurers as it's no longer viable for them just to state they support certain SDGs - they have to 'walk the walk'.

Sustainable Development Goals are not limited to climate change; they're also about diversity and inclusion, combatting poverty and access to education, ending hunger, and gender equality. This is also an opportunity for insurers to differentiate themselves on many levels. For instance, investors want to know how diversified the workforce is, especially the top management of any given insurance company. As such, having a larger number of women among top executives can signal to investors that the insurer is committed to promoting gender equality.

The role of social and sustainability bonds

A growing number of European insurers are opting to finance their green projects by issuing green, social and sustainability bonds. This allows for substantial investments in sustainable projects. It also allows investors to examine how the money raised is allocated. Since September 2019, more than €11bn has been raised in a green and sustainable format, of which 80% is in subordinated and 20% in senior. Each insurer picks its own categories of projects in line with the UN’s SDGs which will be financed or refinanced with the bond issuance.

Around a year after the pricing of the green offering, insurers publish allocation reports. This provides investors with transparency over how the net proceeds were allocated. While many green and sustainability frameworks were published before the European Commission’s Climate Delegated Act of July 2021, future updates to them and the newly established frameworks aim to align with the EU Taxonomy and proposals for an EU Green Bond Standard. Compared to 2021, 2022 was a relatively quiet year for green and sustainable bond issuance. We expect the activity to pick up in 2023. Several names, such as a.s.r. and Achmea, are in the pipeline, as they have established Green Frameworks but are yet to raise funding through them.

> *The amount of green investments in insurers’ portfolios is set to grow*

Some insurers still have work to do on the allocation front. While most of them have already fully allocated the net proceeds of the bond offerings, some, like AXA and Unipol Gruppo, still have some work to do next year. With challenges come new opportunities. Economic, social and governance (ESG) efforts can also boost product innovation. Old policies can be modified, and new policies can be created to support the transition to a carbon-neutral economy. For example, discounts can be offered on the insurance of electric cars, and new insurance products can be created to cover building renovations with sustainable materials.

As a large underwriter and investor, the insurance sector often comes in close contact with carbon-intensive companies. Insurers have the power to divest from companies which do not support ESG goals, as well as no longer providing them with coverage. It's clear: the amount of green investments in insurers' portfolios is set to grow.

€11bn Outstanding green/sustainable bonds

Inflation and cost-of-living crisis pose a challenge to non-life profitability

Rapidly rising inflation is pushing the costs of losses higher, a d that poses a threat to non-life insurers' profitability, with motor, accident and general liability taking the most significant hit. While the Covid-19 pandemic caused premiums to increase, the costs of the insurers have recently been rapidly rising on the back of increased inflation. We estimate that non-life premiums are likely to increase by mid-single-digit percentages in 2023, just enough to outpace inflation.

However, rising interest rates could also be a positive development for insurance companies, as they promise greater returns on their investment portfolios. For the last decade, low interest rates have been weighing heavily on non-life profitability, as well as posing challenges for life insurers.

The cost-of-living crisis and anticipation of inflationary recession across Europe can have another negative impact on the insurance business: it can also result in decreased demand for insurance products, as customers have less money to spend on new policies and some are likely to let their existing policies lapse.

Impact of the war in Ukraine is smaller than expected

Devastating events in Ukraine have had a limited impact on European insurers. The lines that are concerned are trade credit, political risk, aviation and marine insurance. Aviation is taking a hit as hundreds of leased aeroplanes remain stranded on Russian soil, and leasing companies are making billions of losses. According to Fitch, the total residual value of aircraft left stranded in Russia is $13bn. However, it might not have a substantial impact on insurance companies after all. In the event of war, the insurer is allowed to suspend the coverage within a certain amount of days, which we believe most likely happened.

> *The demand for political risk and trade credit insurance is set to grow*

Trade credit insurance also excludes acts of war. However, there is a certain degree of uncertainty as to whether that would apply to only Ukrainian or also Russian companies. A less obvious business line to be affected is cyber risk. Since the escalation of the conflict between the two countries, numerous cyber attacks have been launched. Cyber warfare is no longer a new phenomenon, but the extent of its impact on insurance companies is still not easy to assess. It is unlikely that many Ukrainian companies or firms operating in Ukraine have contracts with European insurers to protect them from cyber malware. It is also arguable whether such contracts would be binding as, generally, there is a clause that excludes war coverage.

Most of the insurers' losses are from political risk and trade credit risk insurance. These explicitly provide coverage to companies in the event of war, civil war or any political upheaval. No new political risk policies for Russia, Ukraine and Belarus are being created, and the losses on the existing ones grew significantly in the second half of 2022. The pace is expected to slow down next year. However, some losses may well still arise in the first quarter.

Supply chains and world economies are so intertwined that the events of the war can trigger political risk and trade credit insurance in various parts of the world. The demand for political risk and trade credit insurance is set to grow, as are their related premiums. So this is really a double-sided situation: while insurers incurred losses, they also have a chance to make some of it back by charging new and higher premiums.

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