HISCOX

Hiscox's approach to climate change

Climate change is one of the biggest challenges the world is currently facing and the (re)insurance industry has a key role to play in helping communities prepare for – and adapt to – the changes taking place in the global risk landscape. Sea levels are rising, the frequency and severity of natural catastrophes is changing, the planet is warming; and these factors have primary and secondary consequences for consumers, corporations and communities.

Over many years, (re)insurers have been building a robust framework for assessing natural catastrophe risk, and Hiscox prides itself on contributing to this development. That's because we understand that we are part of something beyond the bottom line and take our role in the world seriously. Climate change goes beyond natural catastrophes though, and so our work extends to understanding the effects of transitional risks as well as liability and asset risks which have the potential to impact underwriting, claims, reserving and investments.

Interest in environmental, social and governance (ESG) performance – from regulators, investors, media, customers, employees, as well as those who may want to work with us or buy from us in the future – has never been greater, and their interest serves as a reminder to every business, including our own, to do the right thing.

So when it comes to climate change, we have an important part to play in helping our customers prepare for the worst, through our products and services, and recover from it. We also use our research, insight and experience to help shape policy and strategy, both individually and in collaboration with appropriate industry bodies. As a result, every area of our business, from our retail segments through to our big-ticket London Market and reinsurance lines, considers climate-related issues both in how they underwrite and operate.

Climate change challenges for (re)insurers

<u>It affects different perils in different ways</u>
Climate change is impacting different perils in different ways. For some, we can see a clear correlation, while others are less clear-cut. For example, scientific evidence strongly suggests perils such as US wildfire and flood are linked to climate change, while research into the impacts on atmospheric perils like hurricanes and wind storms is more ambiguous, so there is more work to be done to understand climate change impact.

<u>As risks evolve, so does the cost of insuring against them</u>
Climate change is causing traditional risks to evolve and new risks to emerge, which makes investing in catastrophe research and modelling absolutely vital. Having a risk modelling framework that captures climate change risk in a more comprehensive and systematic way is an industry-wide imperative and we are pleased to contribute to this.

<u>There is potential for the climate protection gap to grow</u>
As the world becomes riskier, our industry needs to be at the forefront of developing new products and evolving existing ones, and in aligning new sources of capital with the emerging climate protection gap. This is clearly challenging as some regions or risks become harder to (re)insure, but also creates opportunities for the (re)insurance industry to deliver new, sustainable solutions that address the changing requirements of our customers.

Our approach

Reducing the protection gap created by climate change with products and services
Climate change has an effect on existing risks, and creates new ones, and it is our job to respond to these. We are helping to create more resilient communities and economies by evolving our existing products and services and creating new ones that address emerging risks. We've already done this successfully with flood risk, particularly in the UK and the USA where we've seen the frequency and severity of the risk change and have responded with new insurance and reinsurance products (FloodPlus and FloodXtra), and will do so again in other areas.

Leading the way in the identification, understanding and management of climate risk
We have a market-leading catastrophe research team, and have done for many years. They are responsible for driving our view of risk forward, using both internal and external models to develop what we call 'the Hiscox View of Risk'. The Hiscox View of Risk summarises our analysis of natural catastrophe perils globally and incorporates the latest understanding in climate science to inform our underwriting and portfolio selection. This includes looking at peril and regional links to climate change, and evolving event trends. Our investment in climate change-related research has grown over time and will continue to do so; for example over the last three years, our climate-related research team has more than doubled. This is an important area of research for our business and in 2020 we will expand the team further with a new, dedicated climate change research role.

Working with our underwriting model vendors
We are actively working with underwriting model vendors to ensure they are aware of the industry's requirements in light of a changing and uncertain risk baseline. An example of this is our work relating to US wildfire. Having reviewed an out-of-the-box model vendor solution for US wildfire modelling, we decided to make adjustments to allow for the current trended conditions and risk profile. This was due to the fact that when reviewing the historical data, we saw a clear upwards trend in the association between burn areas and frequency of drought, which wasn't recognised in the model. As a result, we made appropriate adjustments to ensure we accounted for what may be a large climate change signal. We have taken a similar approach to Japanese typhoons, where we have explicitly considered climate change as part of a recent review of our view of risk.

Supporting the transition to a low carbon economy
Climate change can affect financial stability not only through the physical and liability risks, but also through transition risk as the process of adjustment toward a lower carbon economy takes place. The transitioning economy has implications not only for what we underwrite and how insurable certain types of businesses are, but also for how we invest our insurance premiums. Changes in policy, technology and physical risks could prompt a wholesale reassessment of firm's prospects, especially if it were to occur suddenly, destabilise markets, spark financial uncertainty and lead to stranded assets.

As a (re)insurer we have a role in ensuring an orderly transition to a low carbon economy, which will take time. The process of decommissioning coal power plants and oil and gas facilities may already be underway, but an immediate and unruly withdrawal of insurance products to such companies would have detrimental knock on implications; for example, abandoning oil platforms is not responsible, and orderly decommissioning may mean these companies need insurance for some time. This is why we continue to balance the requirements of all sectors by managing the risks of high-carbon businesses as well as sustainable ventures like wind farms and crop insurance.

Stress testing and scenario analysis
We have an embedded internal programme of annual stress testing, which enable us to understand the implications of certain potential events on our underwriting and claims exposure, risk appetite and operational capabilities. This programme of stress testing includes our participation in the Prudential Regulation Authority's annual General Insurance Stress Test (GIST), part of which was carried out in conjunction with the Bermuda Monetary Authority (BMA) – our Group regulator – and which in 2019 included a specific climate change element. This particular exercise, when augmented with research, illustrated that catastrophe risk models can be used to assess the effects of climate change on portfolio results for a multitude of timescales, and will enable a market for climate change products providing coverage on much longer timescales than is currently the norm. We are now leveraging the outputs of the GIST and considering further stress and scenario testing as part of our annual programme.

Engaging with our investment managers
There are a multitude of risks that could affect our investments, and climate change affects a number of these directly or indirectly. Like others, we continue to develop our approach to climate change when it comes to making investment decisions, considering the implications of climate change on a whole range of factors. While certain industries are clearly exposed to climate and long-term investment risks, individual company exposures are not clearly defined and are not static, so we take a considered approach. We are guided by our Responsible Investment Policy, which includes a number of exclusions such as controversial weapons and outlines our approach to impact investing. We expect our asset managers to have sound ESG practices and invest in companies that do too, which is why we conduct an annual ESG integration assessment of our investment managers.

Board and Executive Committee oversight
We have established a cycle of twice-yearly reporting to the Board and the Executive Committee on climate-related issues to ensure appropriate senior level oversight. Board sessions are designed to provide challenge and approval of key ESG matters, including climate-related issues, while the Executive Committee focuses on setting ESG strategy and reviewing plans.

Monitoring, measuring and publicly reporting on our progress
We have appropriate structures and processes in place to monitor and measure our progress on environmental issues, and to publicly report on our progress annually. Our environmental policy sets out the standards we aim to achieve throughout Hiscox Group, and our annual climate report tracks our progress against climate-related issues. We have also developed a climate dashboard with a set of agreed metrics, which allows us to monitor our performance relating to climate change issues, and over time we will expand this into a wider ESG dashboard that covers environmental, social and governance matters beyond climate change.

We support the Taskforce for Climate-related Financial Disclosures (TCFD), which aims to improve the consistency of companies' climate-related financial risk disclosures, and we currently complete public disclosures to showcase our climate-related work via CDP, ClimateWise, Dow Jones Sustainability Index, FTSE4Good and Sustainalytics.

Reducing the impact of our business operations
Being environmentally responsible matters to us, which is why we set key performance indicators for reducing our carbon emissions, and maintain carbon neutrality through carbon offsetting. We also have a network of country-specific Green Teams which are led by our employees who work together to drive local initiatives that promote recycling, reduce waste, and positively impact on our carbon footprint.

Informing public policy-making

We recognise that we cannot change policy alone, but will have more influence partnering with others. That's why we work with policymakers and engage in public debate on climate change issues, both individually and as an active member of relevant industry bodies, such as the Association of British Insurers, and through Lloyd's as a London Market participant. We are also a founding member of the global (re)insurance industry network, ClimateWise, a joint venture between the Cambridge Institute for Sustainability Leadership (CISL) and the (re)insurance industry to help the industry better communicate, disclose and respond to the risks and opportunities of the climate risk protection gap. We are proud of our involvement, both at a working group and at Board level.

Most recently, this has included contributing to consultations on climate change, biodiversity and green finance, and on enhancing banks' and insurers' approaches to managing the financial risks from climate change. We also contribute to the Climate Financial Risk Forum (CFRF), a joint initiative between the Prudential Regulation Authority and the Financial Conduct Authority which seeks to build capacity and share best practice across the financial sector to advance the response to the financial risks from climate change.

Through a supervisory college meeting with the BMA, we set out to them our approach to climate-related issues, and are working to address the European Insurance and Occupational Pensions Authority's (EIOPA) sustainable finance action plan for tackling ESG risks as well as the integration of sustainable risk into Solvency II. Given changing expectations on business preparedness for climate-related issues, we expect regulatory interest in this topic to continue to increase over time.

Building research partnerships

We are a member of the LightHill Research Network, a not-for-profit organisation with the specific aim of enhancing knowledge transfer into business from academic, government and commercial experts at the forefront of risk-related research. Climate change is currently one of the priority research themes being explored by the Network, and as a member of the LightHill steering group we are pleased to play an active part in shaping this agenda.

Our approach in action

FloodPlus – our Hiscox London Market flood product offering

In response to the deregulation of the US flood insurance market, and the changing nature of the flood risk, in 2016 our London Market team launched FloodPlus – a new flood product for US homeowners. The product went some way to meeting a shortfall in flood cover for many homeowners, by offering higher limits and a wider scope of cover than was previously available. It was tested in 2017, when Hurricane Harvey stalled over Houston and caused unusual and extensive flooding, and responded as it should – paying claims and getting people back on their feet. In 2018, we broadened our offering with a new FloodPlus Commercial product.

Both of our FloodPlus products use proprietary technology and advanced analytics to provide more substantial cover at a fairer price than those available through the government-backed scheme, and we will consider building out our offering further in the future as the risk evolves.

Investments – reviewing our managers

We review our investment managers and portfolios each year, including periodic assessment of their ESG policies. During our last review, the Hiscox investment team evaluated the ESG reports of its fund managers in order to assess their performance. This consisted of reviews of ESG policies and other statements or documents produced by the managers regarding climate and impact related matters.

All of the investment managers we work with have a strong focus on good governance in the companies in which they invest. This has been part of their investment processes for many years, meaning the ‘G’ in ESG has been a long-term theme of our investments. In recent years, more managers have been building out their approach to incorporate research of the environmental and social aspects of ESG investing. Most of our managers have now embedded ESG factors into their everyday research and risk processes, seeing ESG factors as risk reducing, and 100% of them are signed up to either the United Nations-supported Principles for Responsible Investment (UN PRI), or an equivalent, or are in the process of signing up. Our asset managers also have the capability to invest in green bonds, should they meet our investment criteria.

Catastrophe research and modelling to improve our wildfire risk understanding
The devastating California wildfires of 2018 highlighted the wildfire risk for (re)insurers worldwide, and we invested in new research and modelling to further increase our understanding of the risk. By licensing a new risk model for wildfire, and applying our own in-house research to it – giving us the ‘Hiscox View of Risk’ – we have significantly increased our understanding of the risk and are now able to set premiums more accurately.

Summary

As the climate change risk evolves, so too does our approach. This is an overview of current climate-related activity across the Group, but there is more to do and we recognise that. Addressing the climate protection gap matters to us, it matters to our business partners and most importantly it matters to our customers and colleagues, so we remain committed to making a positive contribution on this issue.

More information can be found on the responsibility section of our website, www.hiscoxgroup.com/responsibility.

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