
# Polling question # 1

ESG risks are material financial risks?

A. Agree

B. Disagree

C. What are ESG risks?



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## Polling question # 2

I should be considering ESG risks within my work?

A. Agree

B. Disagree

C. What are ESG risks?



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## Polling question # 3

Do you think that climate change will significantly affect how the life industry operates a) before 2025?; b) before 2035?

A. Yes

B. No



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# Addressing climate change – the route forward

| Climate change agenda | How can actuaries help |
|---|---|
| There has been an increased in interest in climate change related issues in recent times as seen by the Paris Agreement signed during the 21st Annual Conference of the Parties (COP21) in October 2016. | ? |
| Climate change is on the global agenda and is likely to impact businesses across the globe. Inevitably, some regions will have better understanding relative to the rest. | |
| Being a relatively new topic, it is unlikely that businesses have the required insights and expertise to address these issues. | |
| One of the key ways of understanding climate change related issues may lie in the advancement of technology. | |
| There is a need for actuaries to pay greater attention to climate change related issues as part of their daily work, including those in the investment space. | |





# Selected firms' sustainability statements

1) *"In 2016 engage with over 500 companies on environmental, social and governance issues."*

2) *"It is important that our fund managers understand these risks before they make their investment decisions, and monitor companies' ESG risk-exposure on an ongoing basis. There is growing acceptance that taking proper account of ESG risks in investment helps safeguard long-term investment returns.*

3) *"…committed to responsible investment, using our influence to support more sustainable businesses and ultimately a more sustainable economy and society. Our investments support the transition to a low carbon economy."*

4) *"Managing a sustainable business means managing a wide range of ESG issues. Every one of these areas is integral to our performance and sustainability."*

5) *"We routinely meet with management…to question them on…governance and sustainability matters. We advocate for reform in the markets and regulation consistent with our clients' interests in a sustainable economy."*

## What we will cover

1. **What is ESGI?**
2. Responsible investment – “why not” rather than “why”?
3. The role of actuaries - takeaways and action points

# What is ESGI?

**ESGI is also known as Responsible investment**

It is defined as “*an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long-term returns*.” (Principles for Responsible Investment).

# Environmental factors

We have set out below our perception of the types of climate change risks with examples of each of them. These risks are only a starting point and it is expected that many physical impacts of climate change are self-reinforcing.

**Physical**

Damage to land, buildings, stock or infrastructure owing to physical effects of climate-related factors, such as:

- Heat waves
- Drought
- Rising sea levels
- Ocean acidification
- Storms or flooding.

**Secondary**

Knock-on effects of physical risks, such as:

- Falling crop yields
- Resource shortages
- Supply chain disruption
- Migration
- Political instability and conflict.

**Policy**

Financial impairment arising from local, national or international policy responses to climate change, such as:

- Carbon pricing or levies
- Emission caps
- Subsidy withdrawal.

**Liability**

Financial liabilities, such as insurance liabilities and legal claims, arising under the law of contract, tort or negligence due to other climate-related risks.

**Transition**

Financial losses arising from disorderly or volatile adjustments to the value of listed and unlisted securities, assets and liabilities in response to other climate-related risks.

**Reputational**

Risks affecting businesses engaging in, or connected with, activities that some stakeholders consider to be inconsistent with addressing climate change.

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# Social factors

Social Factors

**Diversity**

- Gender
- Culture

**Human Rights**

- Local communities
- Health and welfare of employees
- Supply chain

**Consumer protection**

- Mis-selling

**Animal Welfare**

- Pharmaceutical companies

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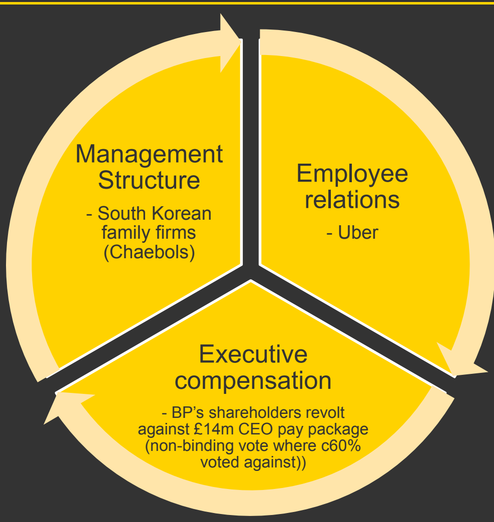
# Governance factors

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# What is ESGI?

**Responsible investment** activities are often categorised into three elements:

**Invest – ESG in investment analysis**
Integrating ESG factors in investment decision making and analysis; identify thematic ESG opportunities.

**Avoid – Negative screening**
Avoiding undesired investments altogether, through screening or reallocation for financial risk.

**Engage –** Active ownership
Exercising shareholder rights, and engaging with companies on ESG topics to encourage them to adapt certain behaviour.

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# Waiting for climate change



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# The pace of change quickens

ESG related discussions kicked off long ago, dating back to 1987.

| Year | Event |
|---|---|
| 1987 | - World Commission on Environment and Development Issues report "Our Common Future" |
| 1991 | - UN Framework Convention on Climate Change (UNFCCC) opens for signatures at Rio Earth Summit |
| 1997 | - Kyoto Protocol is adopted in December 1997, establishing for the 1st time a global commitment to reducing carbon emissions and to fight climate change. |
| 2005 | - UN-backed Principles for Responsible Investment (PRI) are launched.<br>- EU Emissions Trading launches. |
| 2010 | The Cancun Agreements stablishes the Green Climate Fund in December 2010. |
| 2016 | Paris Agreement, which required 55 countries representing 55% of global emissions of greenhouse gases, is ratified after 10 more countries finally endorse the deal. |

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# What are we hearing?


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# What are the drivers for financial services firms?

- ESG and performance – how do they compare?



**INDEX RISK AND RETURN CHARACTERISTICS** ( NOV 30, 2009 – MAY 31, 2017 )

| | | | | ANNUALIZED STD DEV (%) [2] | | | SHARPE RATIO [2,3] | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Beta | Tracking Error (%) | Turnover (%) [1] | 3 Yr | 5 Yr | 10 Yr | 3 Yr | 5 Yr | 10 Yr | Since Nov 30, 2009 | (%) |
| MSCI ACWI ESG Universal | 0.99 | 1.01 | 13.72 | 10.91 | 10.20 | na | 0.51 | 1.13 | na | 0.67 | 18.40 |
| MSCI ACWI | 1.00 | 0.00 | 2.74 | 10.81 | 10.13 | na | 0.50 | 1.10 | na | 0.65 | 19.20 |

[1] Last 12 months [2] Based on monthly net returns data [3] Based on ICE LIBOR 1M





# What are the drivers for financial services firms? (cont'd)


Pension scheme trustee's guidance

Diversification of return / green investment


Corporate governance…


Risk of inaction - stranded assets


Marketing / brand strengthening



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3. **The role of actuaries - takeaways and action points**

## IFoA initiatives

- IFoA Risk Bulletin
- ESG Investment Working Party
- Practical guide for ESG
- PRI Network supporter
- ESGI as part of exam curriculum

## ESG – what is the actuarial angle?

1. Understanding the implications for specific asset classes
2. Translating qualitative views on ESG into quantitative framework
3. Implementing ESG considerations into investment strategy and decisions
4. Modelling impacts of ESG factors
5. Understanding the different implications of E vs S vs G



## What should actuaries be aware of?

**Understanding of responsible investment**

- Related concepts and terminology, including sustainability, SRI, ethical investment and impact investment; differing emphases on financial and environmental/social/ethical objectives
- Importance of long-term perspective, but relevant over short-term too
- Relevant at all stages of the investment process: asset allocation, manager selection and monitoring, stock selection and monitoring, exercise of ownership rights, reporting
- Example approaches: integration, negative screening, positive screening, ESG-related indices (including tilting), themed investments. Note: all asset classes, not just equities
- Climate change as an environmental and social factor, including distinction between physical, transition and liability risks, and concept of stranded assets
- Corporate governance codes, complemented by stewardship codes

# What should actuaries be aware of?

**Legislative requirements and regulatory expectations**

- Fiduciary duty of pension scheme trustees (eg Law Commission guidance in the UK)
- UK Pensions Regulator's guidance for DB and DC schemes
- Amended EU directives: IORP and shareholder rights
- Task Force on Climate-Related Financial Disclosures





# What questions do you have?

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# Key takeaways

- Actuaries are uniquely placed to understand and manage risks
- Work to harmonise the information available in the marketplace
- Consider ESG risks in your investment decisions
- This cannot be ignored and should be incorporated into our standard practice





# Thank you

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