Why Insurers Care About Your ESG Story

Tuesday, July 21, 2020

Introduction

Today’s Speakers

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Energy Transition Practice

Wood Mackenzie

Evolving Risks Resulting From Climate Change and the Energy Transition

How Wood Mackenzie Assesses The Energy Transition

Our energy capabilities are built on depth that forms an integrated view of various energy transition scenarios all across each segment, commodity, technology and market

Integrated Global Perspectives

Energy Transition Research(Global Energy and Emerging Technologies)

Investible Market Intelligence

Regional Power & Renewables Markets | *Oils & Refining* | *Global LNG & Gas* | *Regional Gas Markets* | *Metals Markets* | *Chemicals Markets*

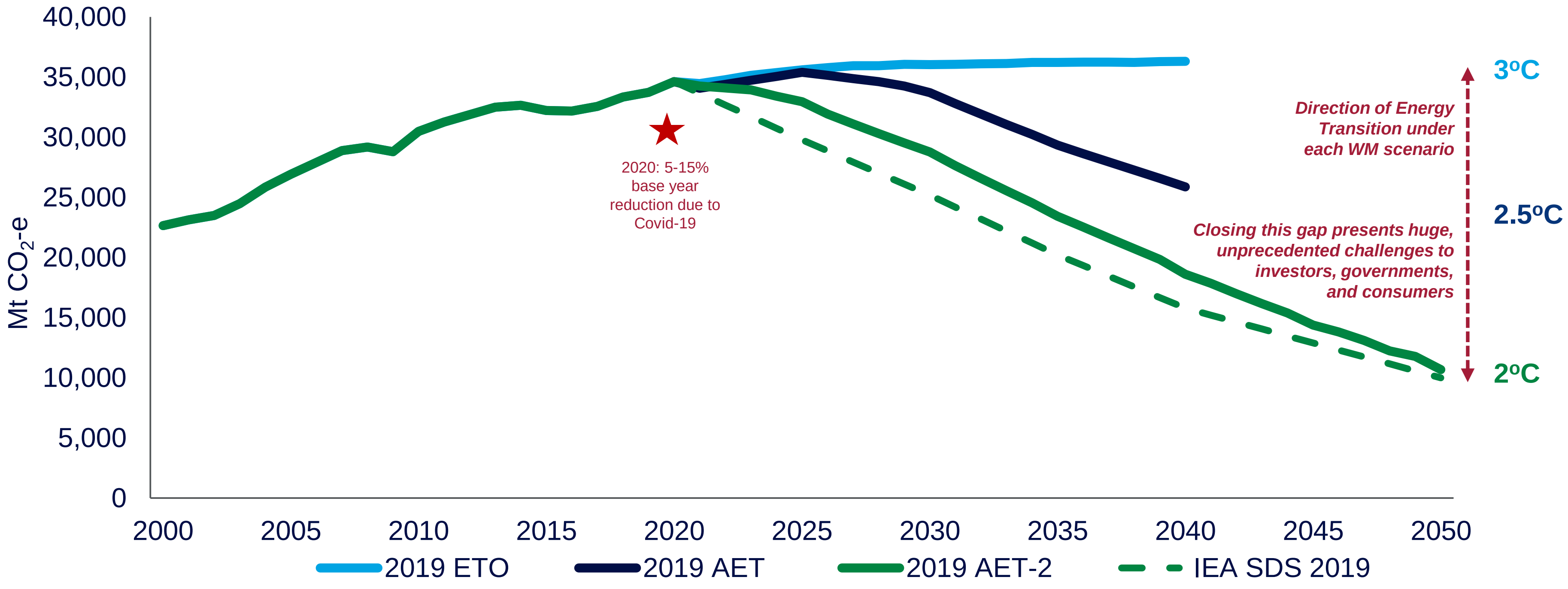
Industry Value Chain Depth: Assets, Technologies, and Costs

Wind | *Solar* | *Grid Edge* | *Energy Storage* | *Electric Vehicles* | *Oil & Gas* | *Metals & Mining* | *Chemicals*

Post COVID-19: Urgency Will Be High To Address Climate Change

Policy, technology and investment need vast 'scaling up' to meet the challenge of climate change. What pathway will we be on in a post-pandemic world?

Global carbon emissions* history and forecast by scenario

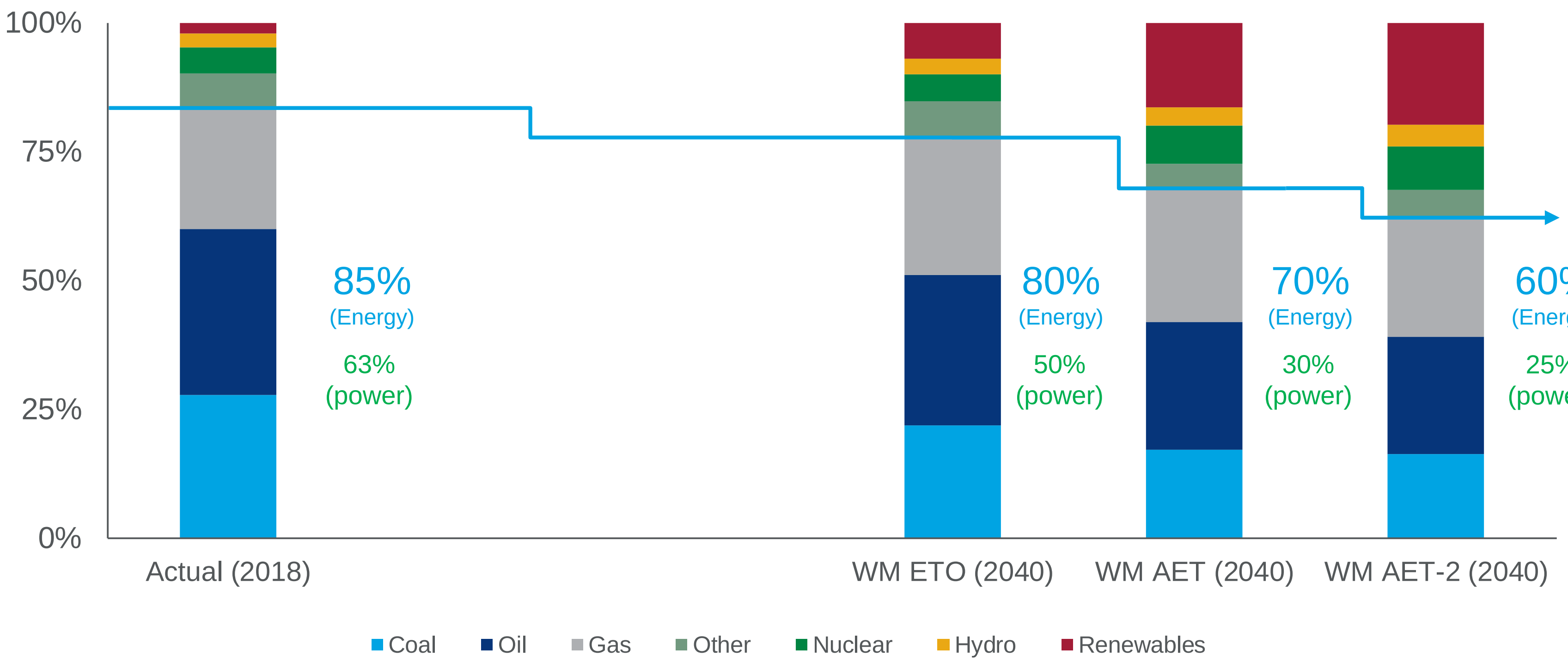


Source: Wood Mackenzie Energy Transition Service *emissions from energy sector

Hydrocarbons Persist As The Largest Part Of The Energy Supply Mix

In rapidly accelerating transition scenarios, there is still a role for hydrocarbons, albeit diminished

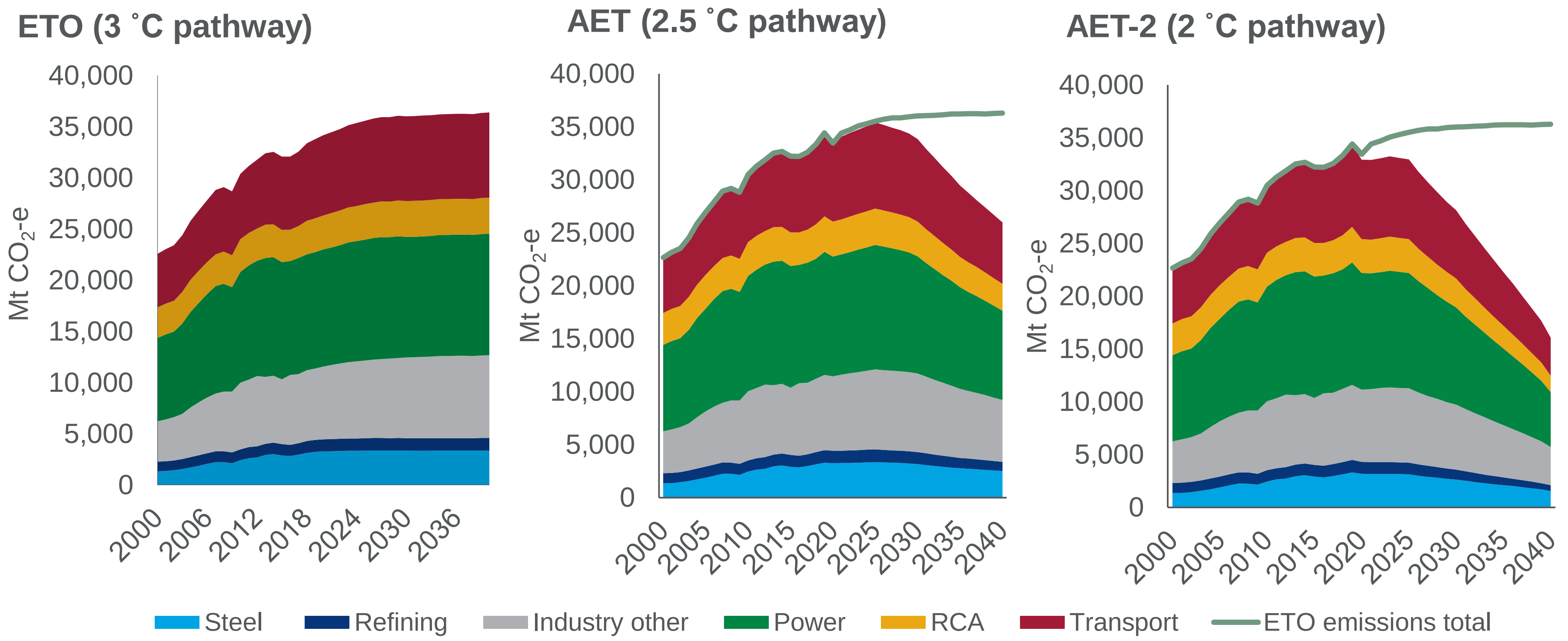
Total primary energy demand by fuel mix



Source: Wood Mackenzie Energy Transition Service

Pre-COVID-19: Emissions Reductions Can Accelerate But Will Require Faster Technology Adoption And Firm Policies

Difficult-to-abate sectors will continue to be challenged after Covid-19



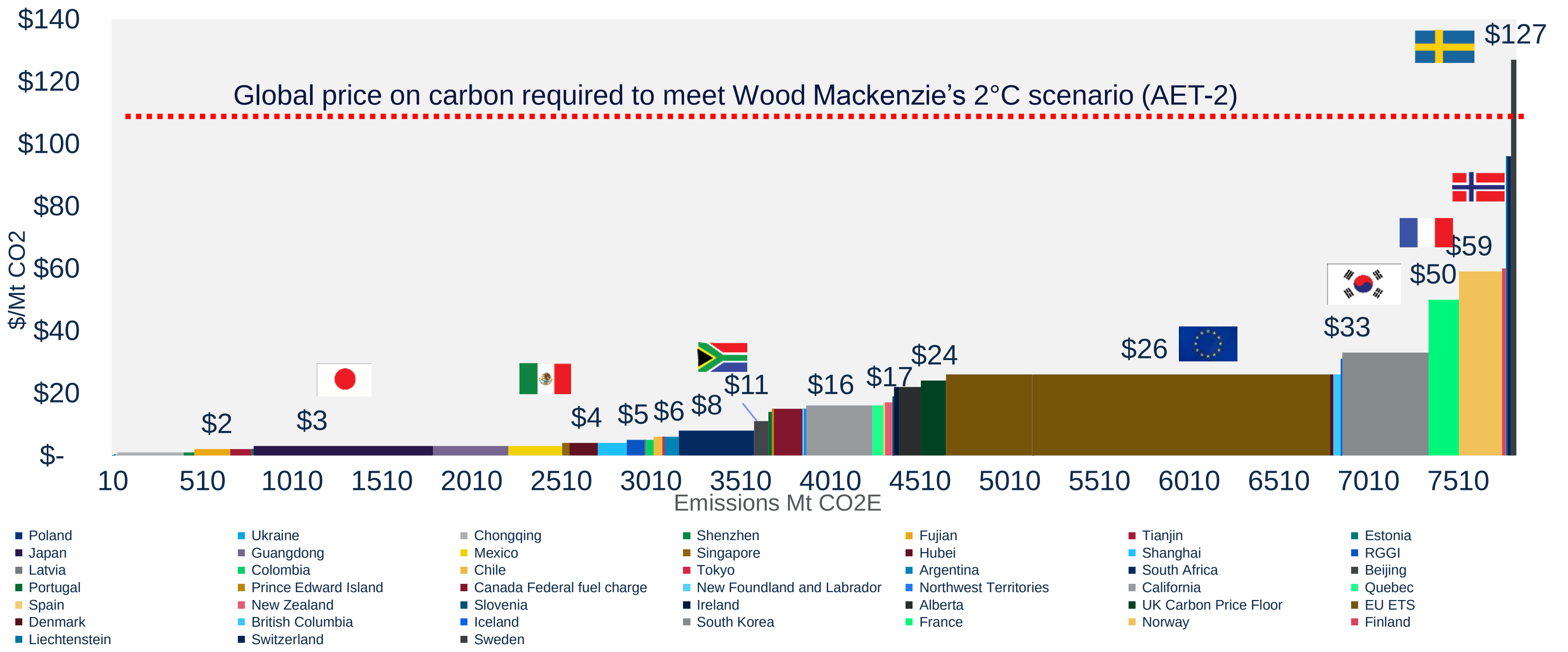
Source: Wood Mackenzie

Industry other includes cement, heat, petchems, smelting, textiles, other manufacturing and processing. RCA: residential, commercial and agriculture

Only 6% Of Global Carbon Emissions Are Covered Under A Regime With Pricing Above $40/Mt CO_2E

The EU ETS accounts for 27% of carbon emissions under a carbon-pricing regime

Current implemented carbon-price regimes by emissions coverage (MtCO2E) and price ($/MtCO2E)



Source: Wood Mackenzie

O&G Strategic Response To Climate Pressures

Dr. Valentina Kretzschmar, Vice President - Corporate Analysis

Investor Pressure Ramps Up, As ESG Scrutiny Increases

Pressure from activist and institutional investors is increasing. EU taxonomy and other sustainable finance legislation provide framework for green investments. US embracing change: SEC to create a firmer standard for reporting ESG metrics.

Investor pressure

2015

Shell, BP, Equinor: Assess portfolio for climate risks **(PASSED)**

2016

Suncor: disclose preparations for a low-carbon future **(PASSED)**

2017

XOM: Publish an assessment of portfolio risks under a 2 degree scenario **(PASSED)**

Occidental: Assess portfolio for 2 degree scenario risks **(PASSED)**

2018

Anadarko: Report on 2 degree analysis & strategy **(PASSED)**

XOM: Report on 2 degree analysis & strategy **(WITHRAWN)**

Shell: Take leadership in Energy Transition **(REJECTED)**

Set targets in step with society's drive to meet the goals of the Paris Agreement **(PASSED)**

2019

XOM, Chevron, Equinor, BP, Shell: Improve disclosure / set targets to reduce Scope 3 emissions in line with Paris Agreement **(REJECTED / WITHRAWN)**

BP: improve disclosure around strategy and investment consistent with the goals of the Paris Agreement **(PASSED)**

2020

Santos and Woodside: shareholders vote against the Board recommendation on adopting Scope 3 targets. **(NOT BINDING)**

Ovinitiv: shareholders vote against the Board recommendation **(PASSED)**

SET SCOPE 3 TARGETS:

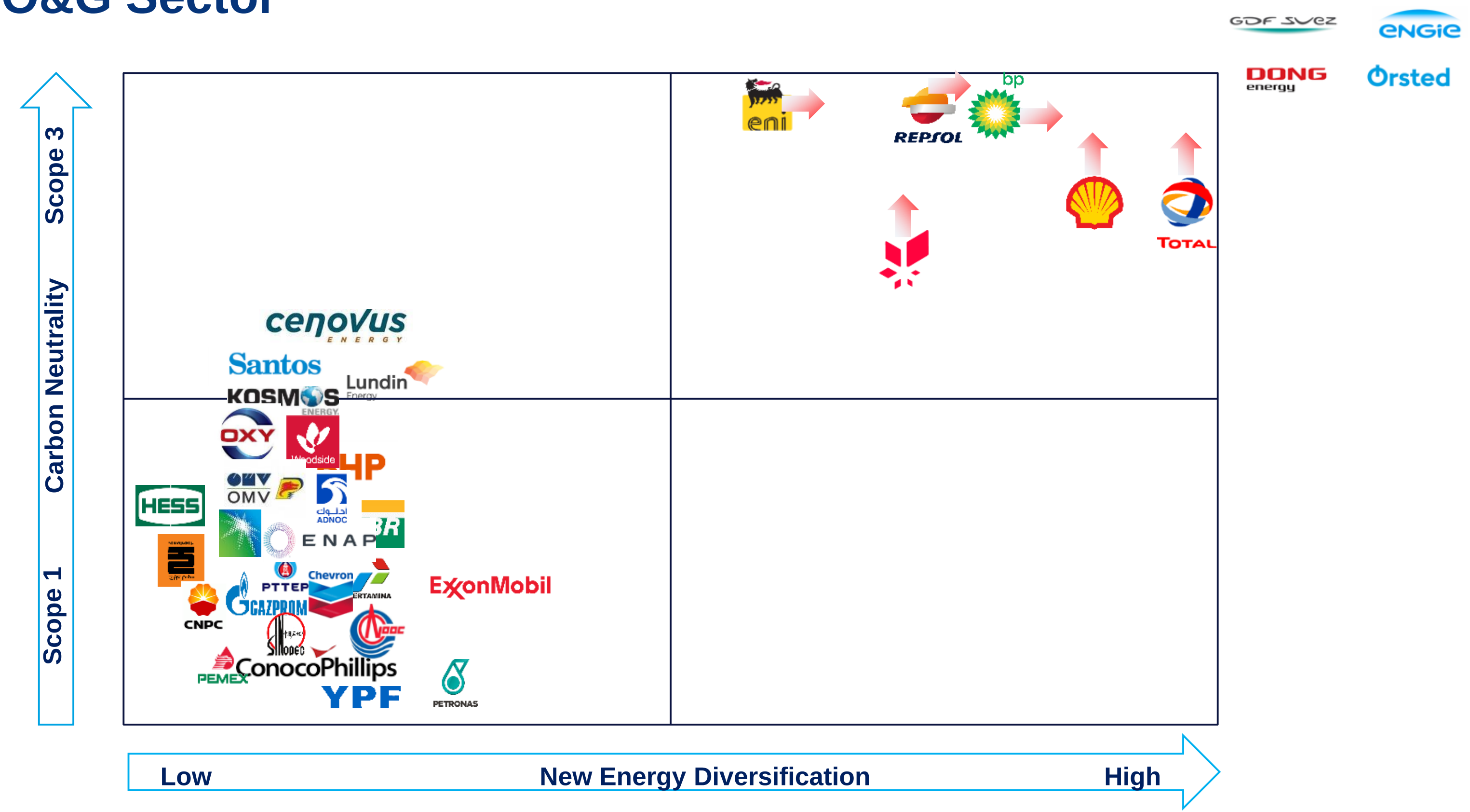
Chevron and XOM: blocked by SEC

Total, Equinor, Shell: at AGM. Shell's Board advised against it. Total to decide if it will be put at AGM.

BP: withdrawn. BP agreed to draft a resolution with follow this to be voted on next year.

Source: Wood Mackenzie

Decarbonisation Is Quickly Becoming A Key Strategic Priority For The O&G Sector

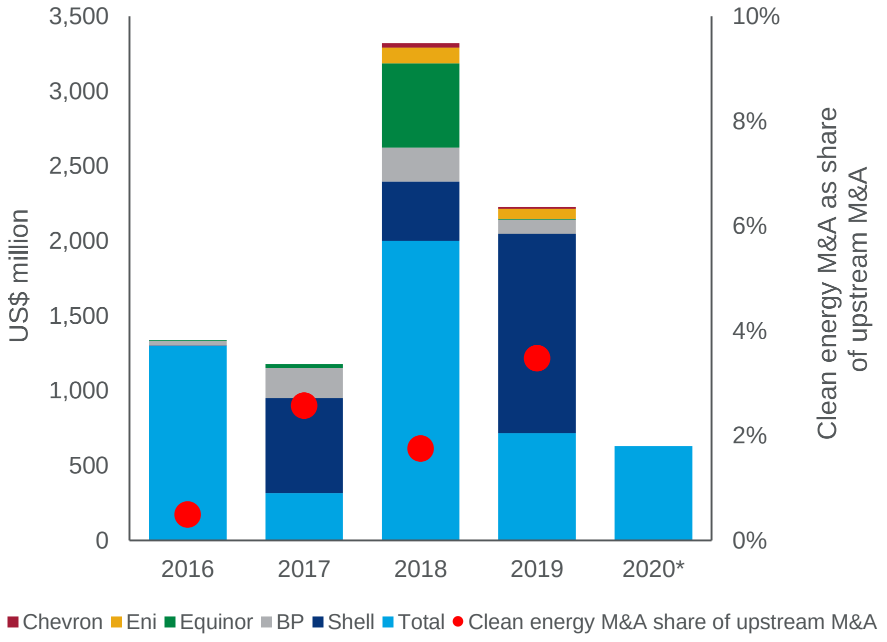


Source: Wood Mackenzie. The Carbon Neutrality axis indicates an extent of carbon commitments. The New Energy Diversification axis indicates how much companies have invested in clean energy diversification to date.

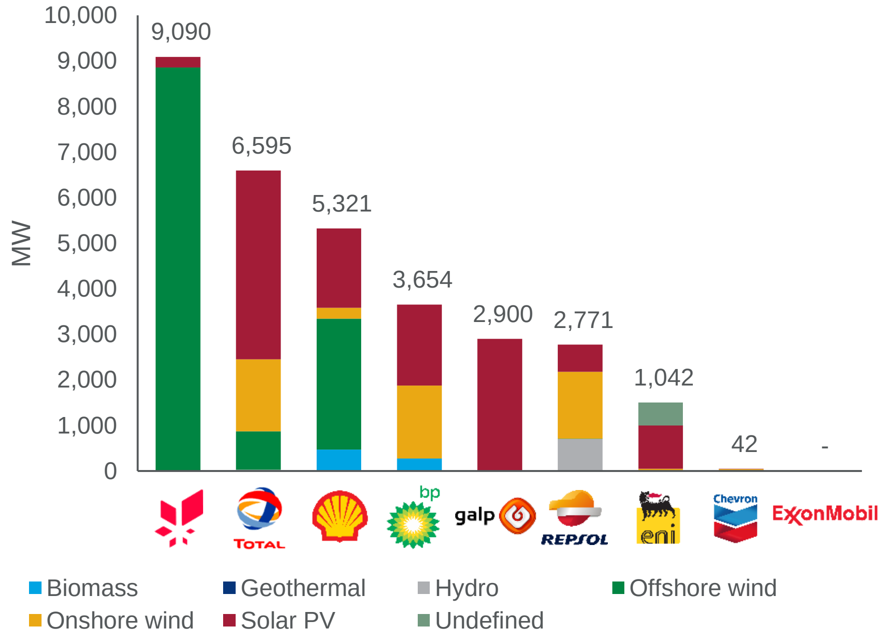
‘New Energies’ Make Up A Small Share Of The Majors’ M&A Spend, So Far

But O&G companies are beginning to build sizeable portfolios of assets

M&A spend on clean energy companies



Renewable power capacity under ownership and in development, oil and gas companies



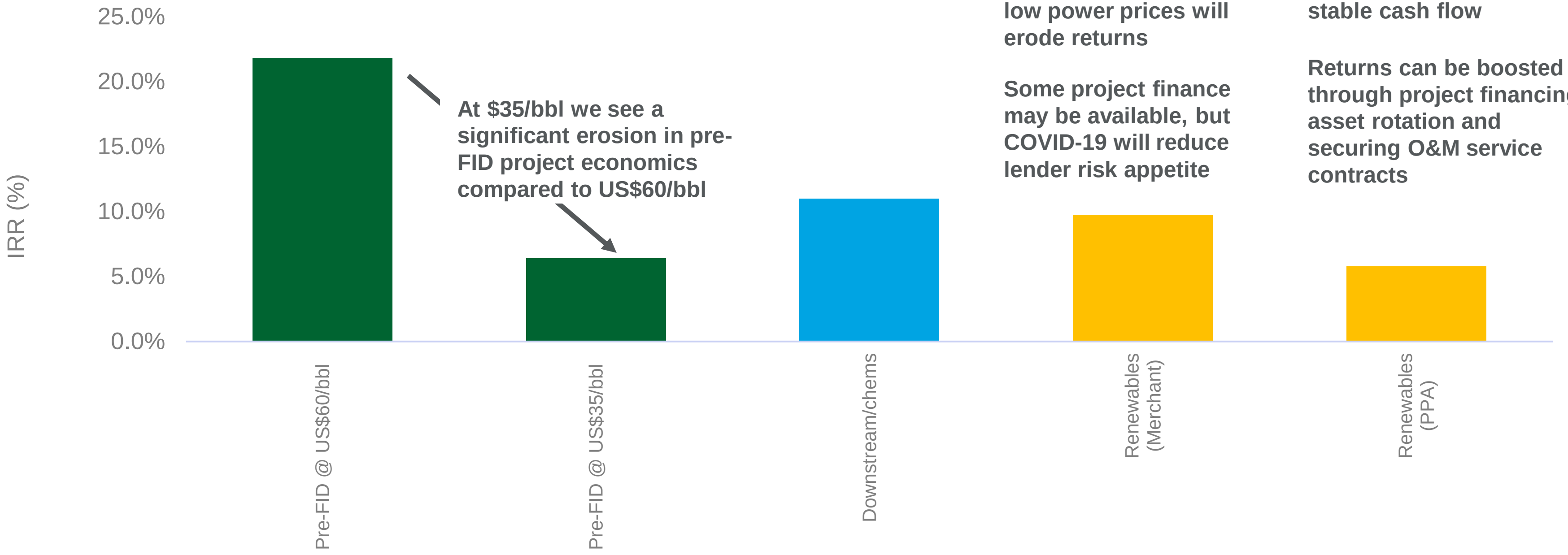
Announced developments only. Does not include Shell’s NorthH2 offshore wind/hydrogen project

Source: Wood Mackenzie, Companies

Renewable Power IRRs Look Relatively More Attractive In The Current Low Oil Price Environment

Merchant renewable projects – though riskier – offer potentially higher IRRs than PPAs

Typical energy project IRRs



Merchant projects are riskier but *potentially* higher return. Sustained low power prices will erode returns

Some project finance may be available, but COVID-19 will reduce lender risk appetite

Power Purchase Agreement (PPA) backed projects offer low risk and stable cash flow

Returns can be boosted through project financing, asset rotation and securing O&M service contracts

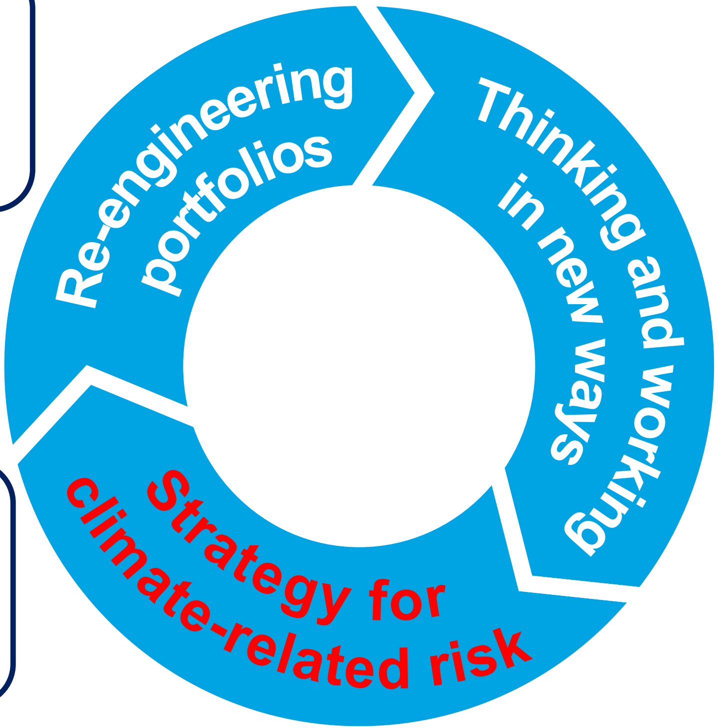
Note: For renewable energy projects we show equity IRRs; for oil and gas projects, we show project IRRs, assuming they are 100% equity financed.

Source: Wood Mackenzie

Strategic Response Of The O&G Sector To The Energy Transition

Most companies do not have competencies and capabilities required to follow the Majors into diversification

- Move portfolio to the lower end of the cost curve
- Investment / cost discipline
- Active portfolio management



- Reorganisation of business units
- Digitalisation
- Business innovation across different business segments

- Net zero carbon strategy
- CCSU, reforestation
- Carbon offsetting
- Strategic diversification into renewables

Source: Wood Mackenzie.

How Banks Are Assessing Carbon Intensity and Climate Risk in Lending Decisions

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Credit Specialties Perspective on Banks

Bank agrees to provide corporate client with financing.

A portion of the resulting credit risk is held by the bank.

This then contributes to the bank's portfolio (sector, geography, etc.).

Any 'surplus' is distributed.

Bank syndication market & other non bank Fis.

Marsh Credit Specialties & the insurance market.

In the boardroom

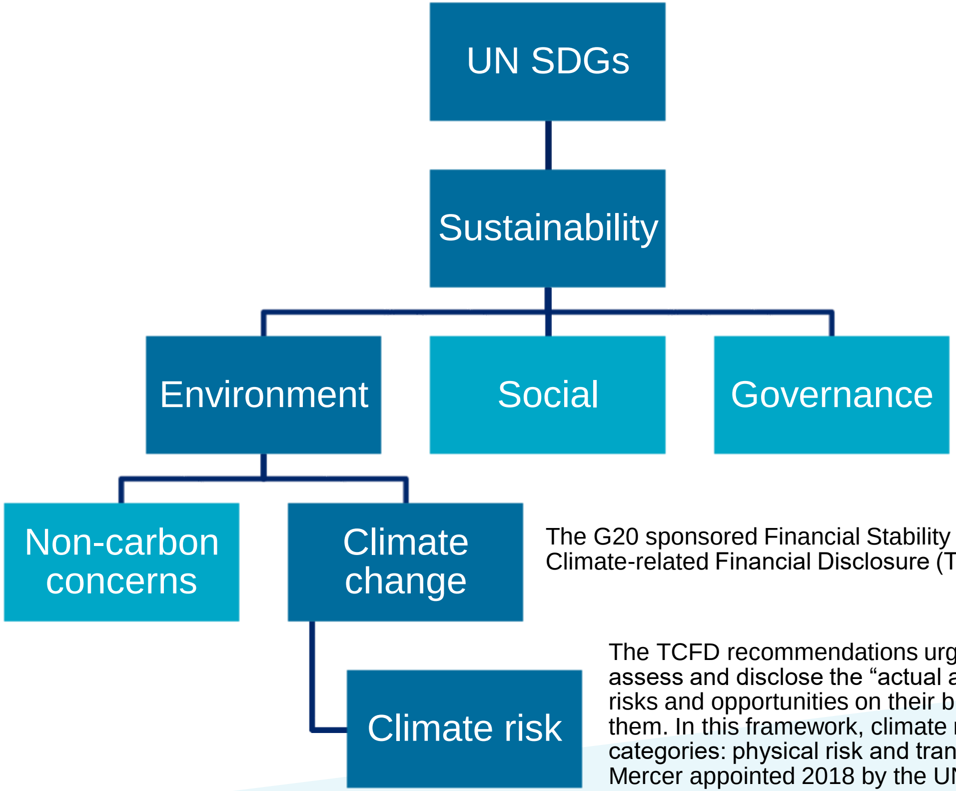
Behind the scenes

How Banks Are Assessing Carbon Intensity & Climate Risk in Lending Decisions
Origins of Bank Behavior

EST. 2015

Aim to end all forms of poverty, fight inequalities and tackle climate change, while ensuring that no one is left behind.

How Banks Are Assessing Carbon Intensity & Climate Risk in Lending Decisions
Overlap Between Environment & Climate Change + The ‘S’ & The ‘G’

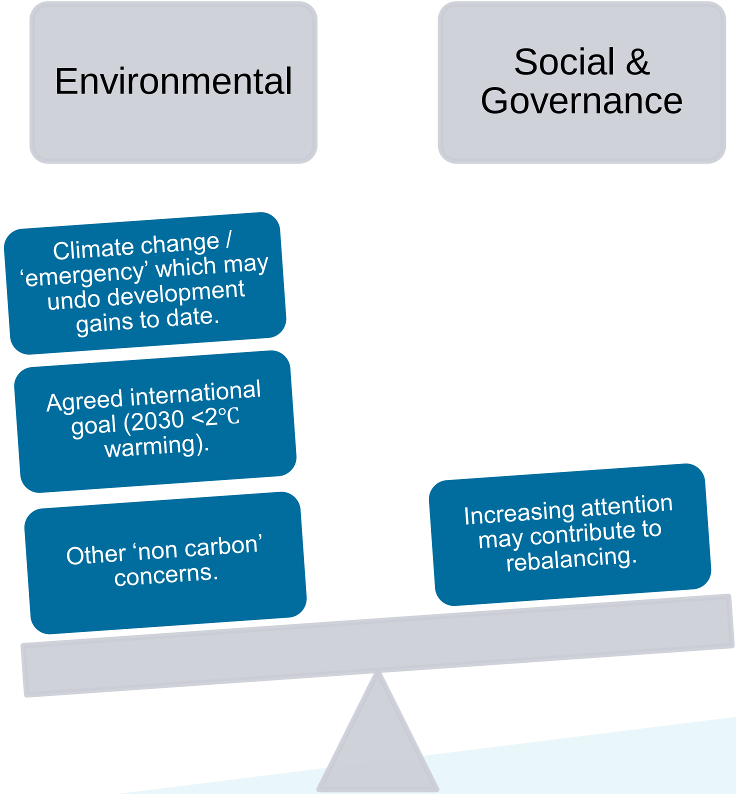


E.g. sustainable use & protection of water, marine resources; transition to a circular economy; pollution prevention & control; protection & restoration of biodiversity & ecosystems.

The G20 sponsored Financial Stability Board established a Taskforce on Climate-related Financial Disclosure (TCFD) in 2015. [MMCs’ Mercer a member].

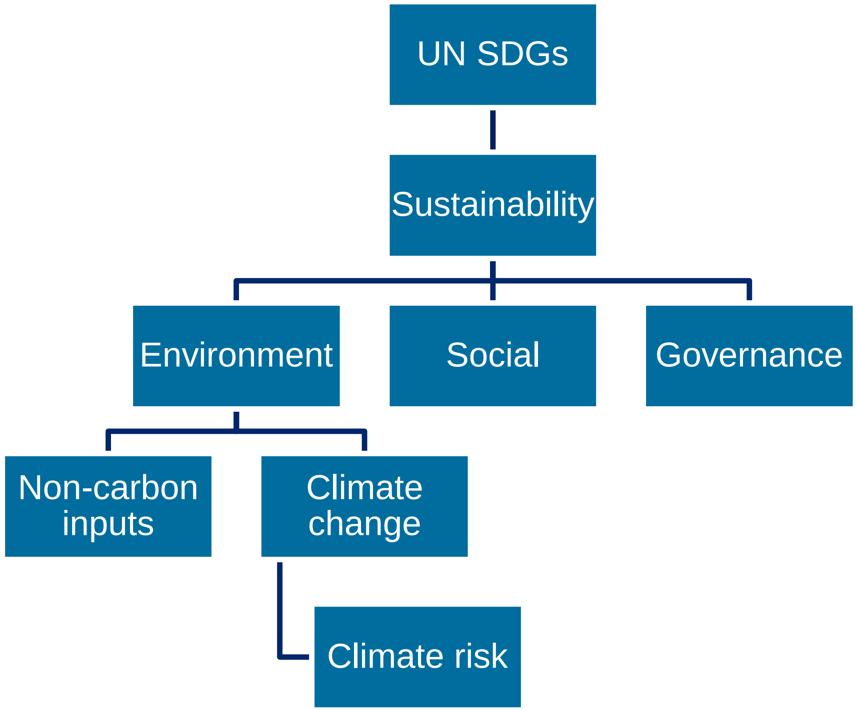
The TCFD recommendations urge banks to use scenario analysis to assess and disclose the “actual and potential impacts” of climate-related risks and opportunities on their business as well as how they manage them. In this framework, climate risk can be divided into two risk categories: physical risk and transition risk. MMC’s Oliver Wyman & Mercer appointed 2018 by the UN to pilot TCFD recommendations with 16 leading international banks (see ‘Extending our Horizons’ paper).

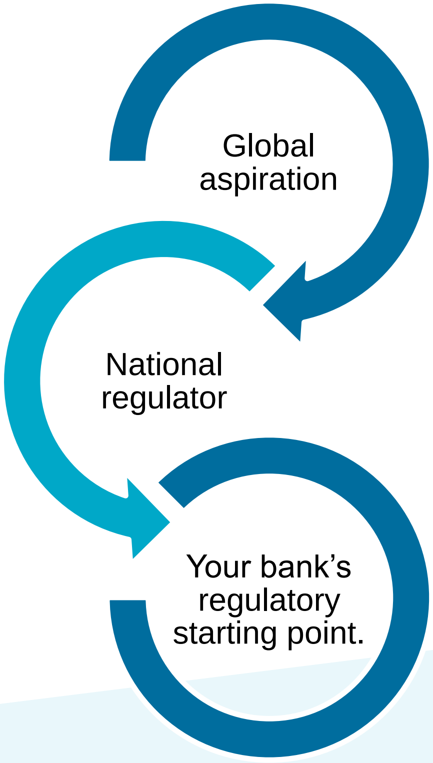
How Banks Are Assessing Carbon Intensity & Climate Risk in Lending Decisions
All About The E?



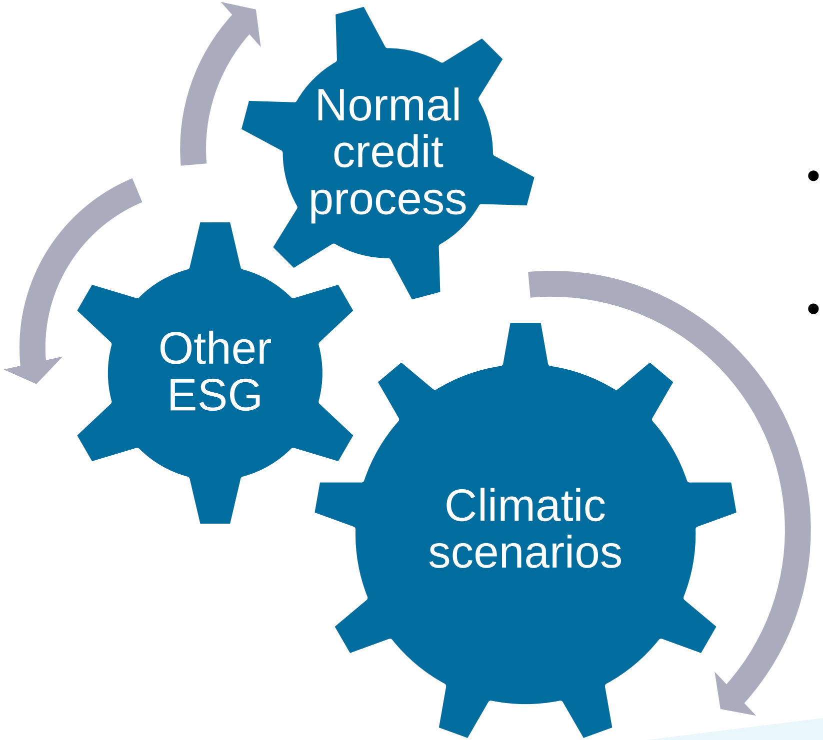
How Banks Are Assessing Carbon Intensity & Climate Risk in Lending Decisions

One More Crucial Ingredient: The Bank’s Regulator





How Banks Are Assessing Carbon Intensity & Climate Risk in Lending Decisions
Climate Risk Scenarios Meet Credit Risk Models



- ‘Other ESG’ considerations are assimilated with a bank’s normal credit process with relative ease.
- Climate is the big & dominant challenge from a methodological point of view.
- However, do not overlook the other ESG considerations.

How Banks Are Assessing Carbon Intensity & Climate Risk in Lending Decisions

Survival Or Something A Little More Comfortable?

CHALLENGE	SOLUTION	ASSOCIATED MODULES
Limited empirical data	▪ Provide transition models outputs that project plausible views of sector-level transition risk ▪ Leverage expert judgment to inform assessments of impact from scenarios to borrower and segment impacts	▪ Transition scenarios ▪ Borrower-level calibration
Risk analysis over extended time horizons	▪ Use scenarios to demonstrate how risk factors could evolve over long time horizons	▪ Transition scenarios ▪ Borrower-level calibration
Varying sector relationships to risk	▪ Take advantage of climate scenario models with geographic and sector granularity ▪ Further differentiate risks across segments through tailored sensitivities	▪ Transition scenarios
Systematic, consistent, and repeatable	▪ Provide a consistent basis for expert judgment, as well as a standardized method for obtaining portfolio impacts	▪ Portfolio impact assessment ▪ Transition scenarios
Bespoke bank requirements	▪ Allow expert judgment and bank-specific risk methodologies to drive assessment of risk magnitude at borrower level	▪ Borrower-level calibration
Improved coordination	▪ Use reference scenarios and a structured analytical methodology to coordinate and integrate judgments across a bank	▪ Portfolio impact assessment ▪ Transition scenarios

How Banks Are Assessing Carbon Intensity & Climate Risk in Lending Decisions

Conclusions

- Banks face significant challenges. Substantive input on sustainability from corporates is a critical component if banks are to be successful in reinventing their offering.
- Corporates have a strong vested interest in being be able to present their position on sustainability. The more granular the better.
- Constant evolution of climate risk & individual bank portfolio characteristics + regulatory differences mean that there is no definitive position ‘today’, nor will there be one in the near term future.
- Engage openly & corporates have a chance to shape their own future.
- MMC is uniquely positioned across its operating companies to enable our clients achieve your goals.

How Are Risk Managers Responding?

How Are Risk Managers Responding?
How to Communicate Your ESG Approach to Insurers

Take a proactive approach to providing relevant ESG information as part of your underwriting submission, market presentations, and engagement with insurers.

Highlight diversification of your business model or planned measures that demonstrate a commitment to transitioning to a low carbon economy.

Demonstrate a commitment to reducing your own greenhouse gas emissions as well as those in your supply chain.

Do not ignore the Social and Governance factors. Highlight positives such as increased indigenous employment, commitment to health and safety, and more.

How Are Risk Managers Responding?
Questions to Consider When Crafting Your Messaging

Environmental	Social	Governance
• What commitment have you made to reducing the carbon footprint of your operations and your products in line with the Paris Agreement[1]? • What commitment have you made toward reducing the carbon footprint of your customers and suppliers? • What assessments of climate transition and physical risk have you conducted on your business?	• Do you ensure there are no human rights violations in your business operations? • How do you monitor health and safety of employees, customers, contractors, suppliers, and the general public? • What is your process for community and other stakeholder engagement?	• How is your governance structure set up to ensure no corruption, bribery, or unethical work practices? • What portion of your board are independent directors or women/minorities? • Are board members trained on climate and other ESG related issues?

Questions?

MARSH

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A Verisk Business

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