30 September 2019

**Response of the Association of German Public Insurers[1]
to the Principles for Sustainable Insurance Initiative's working paper**

"Underwriting environmental, social and governance risks in non-life insurance business"

The Association of German Public Insurers (VöV hereafter, Verband öffentlicher Versicherer) welcomes the consultation of the Principles for Sustainable Insurance Initiative[2] on Underwriting environmental, social and governance risks in non-life insurance business. As Germany's second largest primary insurance provider with a strong regional presence, the group is committed to constructive dialogue in the interests of all market participants and of a stable European and global insurance sector.

General remarks

The VöV generally supports the approach to **develop voluntary and market driven approaches to strengthen ESG criteria** in the business models of insurers. Best practices and flexible guidelines for a holistic treatment of ESG risks are therefore very welcome, whereas mandatory and inflexible rules would be harmful for insured parties, insurers and the economy.

The **VöV rejects any approach** that **excludes entire industries from insurance coverage** or **increases premiums** due to non-risked based ESG considerations. Such an unjustified and unproportional intervention into the business models of insurers would have detrimental consequences for insured companies, their employees, value chains, regional economies and tax earnings. Any ESG assessment must take consequences for companies, jobs and growth into account.

In particular, the VöV supports an open approach that allows for **sufficient flexibility in strengthening ESG considerations** in the underwriting process on a voluntary basis. This openness is essential to help insurers of all sizes to succeed in this endeavour. Rigid rules would be a significant burden for smaller companies and **proportionality will be a key factor** for the progress of the initiative.

[1] The Association of German Public Insurers (VöV) is the umbrella organisation of the German public insurance companies and a corporation established under public law. Founded in 1911, it represents 11 primary insurers across Germany that are deeply embedded in their regions. The group is the second-largest primary insurance provider in the German market, with more than EUR 140 billion of investments under management, thereby making a significant contribution to the European economy. The group is committed by law to support the public good. It has 50 million insurance contracts and pays out EUR 18 billion each year to its clients.
The public insurers employ 30,000 people. Through 17,500 own branches and offices of their partners, they offer advice and protection across most insurance sectors (health, life, pension, motor, indemnity, fire, etc.) for retail clients of all income groups and for professional clients, with a specific focus on small and medium-sized companies.
The Association of German Public Insurers represents the interests of its members at the national and the European level through its head offices in Düsseldorf and Berlin and its liaison office in Brussels.

[2] https://www.unepfi.org/psi/

Methodological and technical remarks on the consultation paper

Do not mix risk-based calculation of premiums and ESG assessment

VöV advocates an approach that considers all risk appropriately in two separate steps. The risk-based calculation of premiums and the ESG assessment underlie different reasons and methodologies and should be strictly separated. The process of underwriting comprises the economic calculation of premiums on a market and risk basis. It is essential for a financially viable business model of insurers and should not be overburdened. Sustainability risks and in particular reputation risks for the insurer play the central role in an ESG assessment. To ensure a proper treatment of these different risks, we suggest not merging the two different processes.

The actuarial calculation of premiums is there a genuine, isolated step. In a different step, ESG criteria should be analysed to see if a project complies with the ESG standards of the insurer and whether it should be insured also from this prospective. We refrain from mixing economic pricing mechanisms and political ESG considerations. An ESG-mark-up would not be a serious option either. On the one hand, this implies a higher premium that is not based on risk considerations. On the other hand, it does not lower the potential reputational damage of the insurer in case an ESG-risk materializes.

Consider regional and economic consequences in the ESG assessment

Insurers need to take decisions not to insure companies due to ESG-reasons with great care. Failing to be insured (fire insurance, liability insurance, etc.) has serious consequences on companies, their financing, employees and their regions. Insurers need to fulfil their core functions and should not become political instruments for policy objectives that are best reached or already addressed in different ways. Property insurance is the wrong instrument to meet ecological targets. All business activities must have access to insurance coverage. Otherwise citizens and taxpayers would bear these risks on their own, for instance in case of environmental damages due to a power plant.

Ensure proportionality to enable a widespread implementation

The paper could even further emphasize the necessity of proportionality. For instance, it might be neither necessary nor possible that the CEO or a board member is directly responsible for ESG issues, as suggested on page 12 of the discussion paper The principles should be more open to bottom-up approaches, where experts working on the topic on a daily basis develop strategies informally and gradually. Not all insurers have comprehensive ESG strategies in place yet and it might require time to develop them for their specific business model. The bottom-up approach could be more suitable for small and medium insurers than the proposed hierarchical top-down process.

Change the impractical and inconsistent methodology of heat maps

Furthermore, we point out several weaknesses of the methodology of economic sector and business lines heat maps, starting on page 18 of the document.

> First, the definition of economic sectors is too broad to be applicable. For instance, the sector energy operation comprises renewable as well as fossil energy sources. If further differentiations within a predefined sector are required in most cases, than the

classification is of no purpose. Property insurance for industry and business always have to consider the individual case. Sectorial classifications are misleading and would stigmatize entire branches.

Second, the heat maps are static and do not incorporate dynamic factors. Some sectors might exhibit larger ESG risks at a first glance, but they might be indispensable in the transition to a regime with lower risks. As industrial value chains are very complex, the sectoral classification could often be misleading. This aspect is discussed intensively in the technical expert group on Sustainable Finance of the European commission as well. A best of class approach might help to manage the transition from companies with less sustainable characteristics to better ones. This requires in turn that individual companies, if not even individual projects, need to be considered in a potential classification. For instance, a steel producer switching from an energy-intensive technology to the best technology available clearly serves the purpose of improving the ESG performance. When considering branches as a whole as suggested, this producer could not be incentivized to innovate.

Third, the treatment of the financial sector is not consistent with other sectors. In most cases, banks and other financial market participants will have insignificant direct environmental effects. On that basis, this sector should be considered compliant with the E of the ESG criteria. However, the heat maps suggest taking indirect effects into account as well, and judge the sector based on its investments. This is clearly inconsistent with the approach for other sectors, which is limited to direct effects. Otherwise, the whole value chain of these other companies would need to be analysed as well. For instance, an equipment and machinery manufacturer can produce parts for renewable energy, or for coal power plants. Therefore, heat maps either concentrate on direct effects in all sectors, or have a comprehensive value chain analysis in all industries (which would raise significant methodological challenges and create an enormous effort).

Fourth, the heat maps might be inconsistent with other classifications. The EU legislators are currently working on their classification ("Taxonomy") and inconsistencies or conflicts between these frameworks would weaken the applicability of the heat maps even further.

Given these serious weaknesses, we therefore suggest to restrain from including the heat maps in the paper at all. In any case, the optional character of the heat maps as one tool of oy many needs to be emphasized more clearly.

Strengthen Proportionality in the four Principles for Sustainable Insurance

We fully support the four Principles for Sustainable Insurance on page 26 of the discussion paper and suggest strengthening the proportionality aspects. In principle 1, it should be clear that an ESG strategy could also be a part of a more holistic company strategy. Smaller insurers might find it appropriate to incorporate their ESG strategy in existing strategies, for instance CSR or risk strategy. The same argument holds for the implementation or corresponding processes. In principle 2, we propose to mention the important role business associations play in the work with stakeholders. Smaller insurers often cooperate within associations on developments that affect the industry as a whole and do not get in touch with governments or regulators themselves.

We are looking forward to continuing the fruitful exchange on ESG risks in underwriting and we remain at your disposal for further questions.

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