

ESG more than just a branding exercise in ILS, panellists explain

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Whether an asset class has positive ESG (environmental, social or governance) characteristics is one of the hot topics of the investing world, so naturally a topic of focus in insurance-linked securities (ILS) at this time. But it's more than just a branding exercise in the ILS market, panellists made clear today.

Just how aligned insurance-linked securities (ILS) and collateralised reinsurance investments are with environmental, social and governance (ESG) factors was the focus of a virtual panel discussion as part of the ILS Bermuda Convergence 2020 event today.



The expert speakers made it clear that there's much more to ESG in the ILS market than applying a badge or sticker of approval to their investment strategies. With positive ESG factors already inherent in the products the ILS market offers and steps being taken to provide even greater visibility of ESG positives within ILS investment portfolios.

We first wrote about the potential for catastrophe bonds and other forms of ILS to be considered socially responsible investments back in 2014.

The conversation has moved on a lot and now the broader lens of ESG is a key motivator for institutional investors looking at any asset class and so the ILS market is responding, with ESG becoming a focus, as participants in the asset class recognise the qualities inherent within it and what needs to be done to make it even more ESG appropriate in investors eyes.

Speaking during the Convergence 2020 panel discussion today, Joanna Syroka, Director of New Markets at specialist investment manager Fermat Capital Management, explained that embracing ESG is about more than just framing the asset class as such, highlighting the way Fermat has embedded ESG processes within its underwriting and investment decision-making workflow.

“We rate every asset in our portfolio on an E, on an S and a G basis and give it an overall score,” Syroka said.

Further explaining that, “We do this in a qualitative way, by looking at the transaction itself, how it’s structured, the risk disclosures, as well as looking at the sponsor and then the rationale for the transaction, what is it allowing the sponsor to do.

“We do that for two reasons. First if investors ask, we can have a view of what is in our portfolio, we can be transparent at least from our perspective, from an ESG perspective, what we have in there.

“Secondly it allows us to, in a consistent way, track what we have in our portfolio.”

Jennifer Signori, Principal & Senior Vice President at Neuberger Berman, which operates ILS and reinsurance-linked investment strategies, both dedicated and as components within certain multi-asset funds, explained that ILS aligns with ESG and at her firm they take a systematic approach to it.

“How to think about ILS through an ESG lens? Simply put, you know ILS invests in instruments that help governments and institutions better manage their risk to catastrophic climate events. So, really helping around the resiliency of the global insurance markets and helping to bridge that protection gap,” Signori explained.

She went on to say that at Neuberger Berman, the firm considers ILS to be ESG integrated, which means taking a systematic approach to analysing portfolio assets.

“So they’re looking at the material ESG factors in a systematic way throughout the investment process and incorporated into the investment analysis, to help inform relative value, relative pricing,” Signori said of the ILS portfolio management team at Neuberger Berman.

Ariane West, Director of Structured Finance at Nephila Climate, the climate and weather risk solutions arm of Nephila Capital, commented that ESG has been deeply considered at Nephila and the ILS manager is also keen to help promote awareness of ILS’ positive ESG characteristics.

“We also seek to help drive awareness and build capability across the market, sharing that analytics information with other market participants and counterparties,” West explained.

Highlighting ILS’ inherent ESG qualities by saying, “ILS market products in general provide a source of economic resilience and risk capacity to to our counterparts, as well as helping play a key function of delivering price signals to the market, to help measure the impacts of environmental risks, which I think is a key thing going forward.”

Syroka from Fermat further explained that the effort undertaken to apply an ESG rating framework to investment decisions at the ILS investment manager reaps positive benefits.

“Over the years, we’ve developed some interesting insights by doing that. One thing we realised is, while our rating scheme is done somewhat in parallel to underwriting, we realised there’s a high correlation between how we underwrite and what assets we actually like to have in our portfolio. They tend to be the ones that have the highest ESG rating.

“The concept of ESG attributes and traditional ILS underwriting are inherently intertwined,” Syroka said.

Given the investor focus on ESG and the fact ILS has clear qualities within it that are aligned positively with certain ESG characteristics, there is an opportunity for the market to both improve the social benefits its risk transfer products deliver and to benefit from the interest in institutional circles.

Perhaps also, going forwards, the importance of ILS capital in insurance and reinsurance markets can help expand the reach of the asset classes ESG characteristics, by looking through to cedants motives, strategies and other pieces of the value chain, to see how aligned they are with its ESG objectives.

If a key capital provide to insurance and reinsurance cedants is ESG focused and aligned, it may help to further motivate the traditional market to become more so as well.

Wherever the current focus on ESG and the adoption of ESG criteria and metrics takes the ILS market, Syroka sees it as important for its future and it’s clear this needs to be more than just a branding exercise and has to become embedded within the ILS market’s practices.

“Taking that a step further, adherence to positive ESG standards is going to be critical to the growth and scale and sustainability of this market for both sponsors and investors alike,” she explained.
