



*CAN ESG BE INTEGRATED INTO THE
INSURANCE LINKED SECURITIES
MARKET?*

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ILS OVERVIEW

2021 US WIND SEASON

INVESTMENT RATIONALE

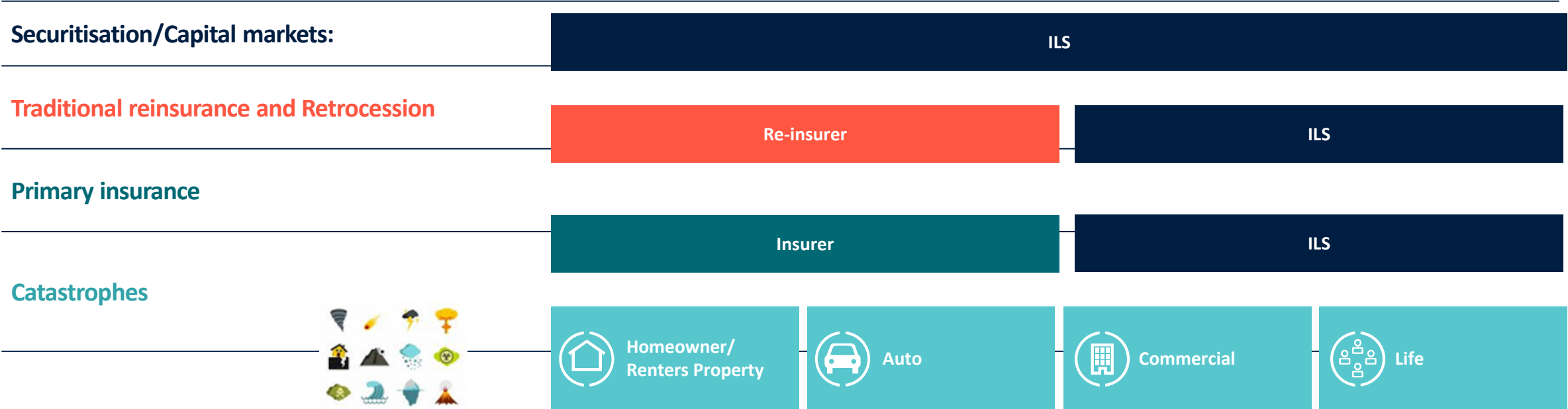
CLIMATE CHANGE OVERVIEW

CONCLUSIONS

Insurance Linked Securities (ILS) market

Structure of insurance and reinsurance market

- Allows insurers and reinsurers to buy additional protection, primarily against losses from large natural catastrophes
- Capital markets participants compensated for assuming some of that risk
- Structured to pass on only pure insurance risks: uncorrelated to traditional asset classes and the market cycle
- \$100 billion in total, across the tradeable (cat bonds) and non-tradeable forms of ILS



Source: Schroders Capital; images: freepic.com and dreamstime.com.

What types of risk are transferred to the ILS market?

Diversification across perils, regions, transaction types and risk levels



Natural catastrophe risks

- Hurricanes, tornadoes, typhoons
- Winter storms
- Earthquakes
- Hail and winter freeze
- Drought
- Flood
- Wildfire

Other non-life-related risks

- Marine and Offshore Energy
- Motor
- Aviation

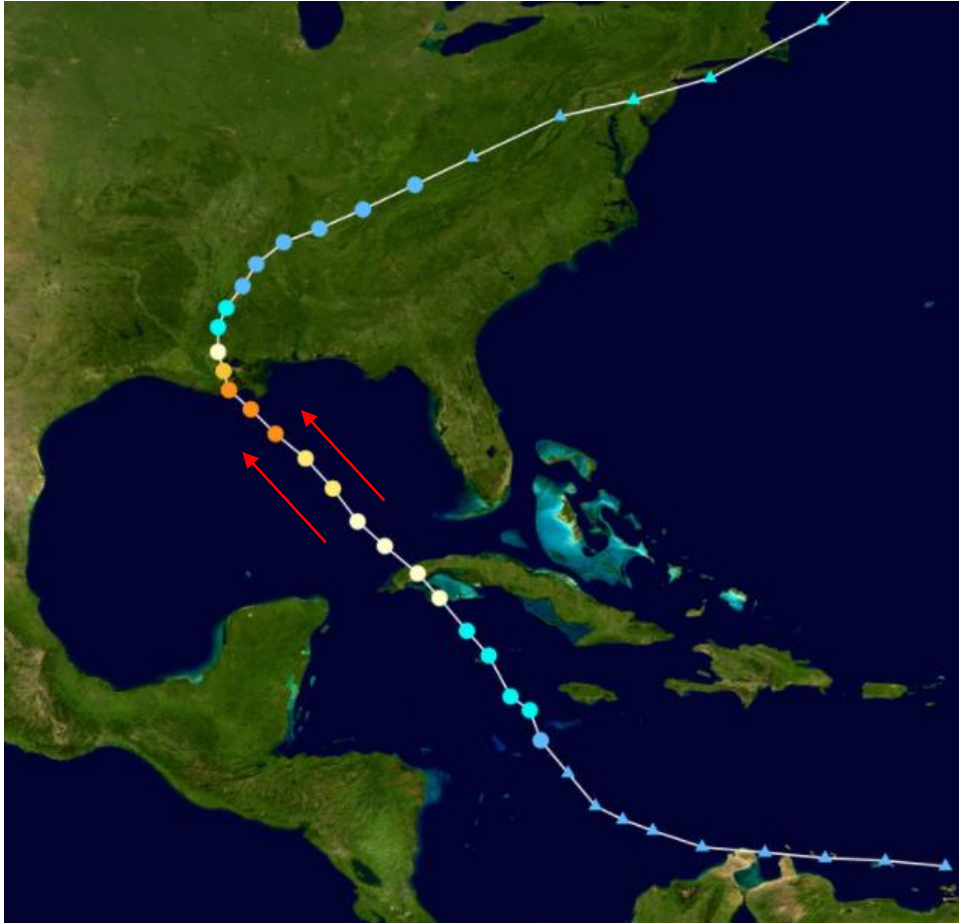
Life related risk

- Mortality/extreme mortality
- Lapse risk
- Embedded value/
Value of in-force
(life insurance policy pools)
- Longevity (not active in this area)

Atlantic hurricane season 2021

Hurricane Ida

Category 4 storm hits Louisiana and creates damage inland



The storm

- Ninth named storm and strongest hurricane of the season to date
- Rapid intensification over the Gulf of Mexico (red arrows) fuelled by warm sea surface temperatures
- Powerful impact at landfall caused widespread damage, power outages and some loss of life

The impact

- Economic losses expected to exceed \$50 billion¹
- Insured losses forecast to reach \$25 billion²
- ILS has some exposure, but after insurers and reinsurers
- Flood protection infrastructure held in New Orleans, after being updated in the wake of the destruction caused by Hurricane Katrina in 2005, mitigating losses

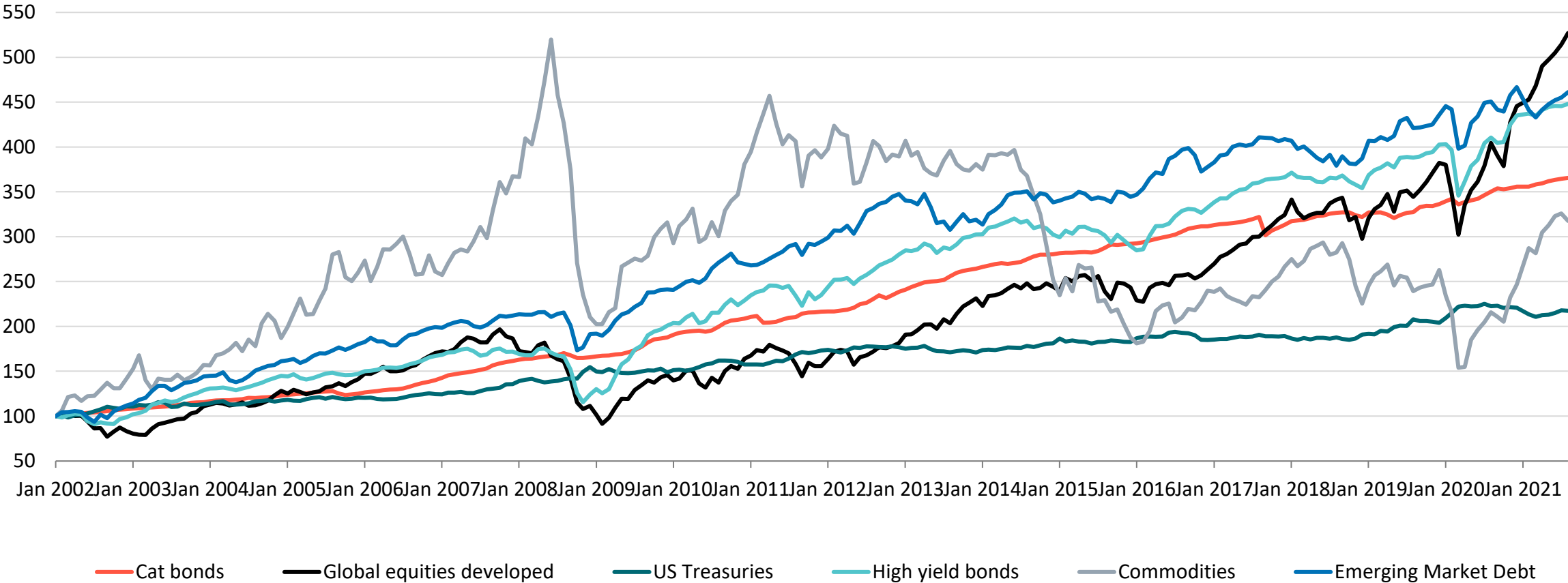
Where it ranks

- Second most damaging storm on record to hit Louisiana (after Katrina)
- Sixth most costly hurricane on record

Source: Schroders, NASA, National Hurricane Center, 6 September 2021. ¹Bloomberg, ²AIR Worldwide

ILS diversification benefits persist through market volatility

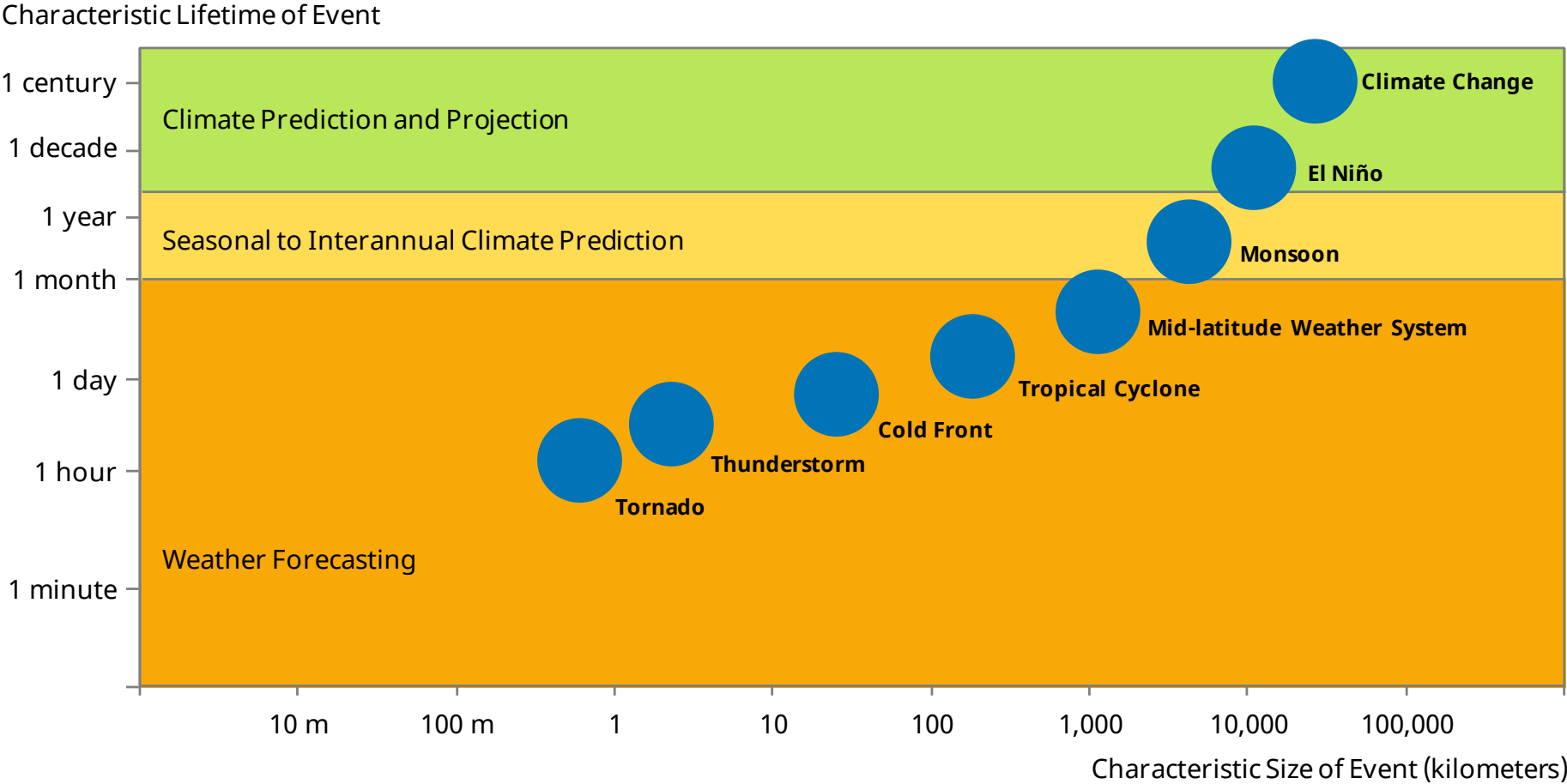
Low correlation of ILS to all major financial assets



Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Source: Schroders Capital. Bloomberg, monthly returns from 31 January 2002 to 31 August 2021 in USD. Cat bonds: Swiss Re Global Cat Bond TR Index, US Treasuries: BofA Merrill Lynch US Treasury, Global Equities Developed: MSCI World, High yield bonds: BofA Merrill Lynch Global High Yield Index, Commodities: S&P GSCI, Emerging Markets Debt: JP Morgan EMBI+.

Climate-related risk

ILS market confronted with near- and long-term phenomena



Source: Schroders Capital. The World Bank, November 2013: Building Resilience – Integrating Climate and Disaster Risk into Development. See also Schroders 'Climate change and insurance-linked securities' September 2020. The views and opinions shared are those of the Schroders ILS team, and are subject to change.

Climate change

Impact on ILS market can be catered for if it can be modelled

Global increase in population	From 4bn (1975) to 7.6bn (2018)
Improved standard of living	Middle class is growing rapidly world-wide
Concentration of people/assets in urban areas	Share of urban population is increasing continually: 37% (1975) – 50% (2010) – 57% (2025)
Settlement and industrialisation of vulnerable areas	Especially coastal areas, areas close to rivers
Increase of complexity and interdependencies	Increasing complexity of value chains (i.e. production cycles) in industrial facilities
Climate change	Intensification and accumulation of extreme weather events in certain areas



Not necessarily problematic
for risk carriers (premiums grow proportionally
with risk)



Problematic for risk
carriers if risk models are not
adjusted accordingly

Conclusions

ILS as an asset class and climate change impacts on severity of perils

ILS as an asset class

- Long-term phenomenon vs short duration investments that are uncorrelated to the economic cycle
- Market reprices regularly to capture climate science findings
- Invest in risks only if fully understood and that are adequately compensated, including climate-related risks
- Continue to embed ESG research into the investment process

Impact of climate change

- A recognised phenomenon in science and finance
- Disasters/losses related to many different factors including population and urbanisation in addition to climate change
- Not all perils are affected by climate change (e.g. Earthquake, Tsunami) but those that are can be more severe
- Growing subset of ILS transactions brought to market by supranational and governmental bodies for aid and disaster relief (World Bank, Red Cross etc.)

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