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Cooperativa de Seguros Múltiples de Puerto Rico
CLIMATE-RELATED RISKS AND OPPORTUNITIES (RY 2022)

A. GOVERNANCE

For Cooperativa de Seguros Múltiples (CSM) climate-related risks and opportunities are a key issue affecting our core business, since CSM have a crucial role in assessing and managing climate-related risks and opportunities. This climate report provide us with a new perspective on the undeniable need to develop this topic in our future, particularly those initiatives related to opportunities.

The impact of CSM as an insurance provider in the financial services sector is quite small compared to other industries. Regardless of the impact, CSM sustains its responsibility for the environment in a serious way and is committed to reducing the adverse environmental impacts of its own operations in addition to complying with all applicable legal and social responsibilities. For this reason, over the past few years, we have held regular meetings with executives and directors to discuss physical climate risks and climate-related opportunities, such as the development of new products, investments in companies that employ ESG (environmental, social, governance) principles and the inclusion of procedures that help increase our operational efficiency, which we believe contribute to minimizing CO2 emissions.

Herewith a brief of CSM’s governance around climate related risks and opportunities:

All our climate issues are channeled through CSM's Enterprise Risk Management (ERM) Committee, which is represented by its senior executives and risk manager. Our ERM committee is supported by the operational structure, information systems and external advisors who provide business analysis and recommendations.

This ERM Committee was formally introduced at CSM in 2018, as part of our Strategic Plans, which establish the guidance to comply with the best Enterprise Risk Management practices.

Most of the risks included in the Risk Management strategy are climate related, in particular physical risks. These risks are analyzed and discussed in different instances with our board members throughout the year in the strategic planning process, in budgeting, and in executive and finance committee meetings.

B. STRATEGY

CSM has traditionally followed a conservative business strategy, through a sound underwriting, reinsurance, and investment policy. However, we know that the possibility of highly improbable, unpredictable events with potentially adverse massive financial impact always exists. To manage that possibility, after identifying risks exposures; we actively run standard procedures intended to anticipate, transfer, avoid, or mitigate adverse unexpected results.

As expected, one of our main risks is the potential loss from catastrophic events, particularly hurricanes. To manage this risk, which is directly related to climate change, CSM has established as a strategy to continue strengthening its policyholder surplus, promote insurance products diversification, maintain a robust reinsurance program with highest credit quality reinsurers and develop our Business Continuity Management Program (BCMP) to mitigate the negative impact of natural and manmade events while maintaining operations and restoring operations as quickly and effectively as possible. For BCMP purposes, CSM has its own insurance policies that provide coverage for property damage including electronic equipment and business interruption.

Based on CSM's insured values in 2022, the RMS v 21 model for long term perspective estimated that the potential loss from a hurricane with a 1/200-year probability of occurrence could be around $297.4 million, net of facultative.

This RMS v21 model contemplates the ability to capture the current and expected impact from climate change. The hurricane wind climate change direction was modelled with medium confidence for higher likelihood of cat 3 – 5 storms; increase in frequency of rapidly intensifying events; decrease in forward motion and poleward migration. For storm surge the climate change direction was partially modelled with very high confidence of increased coastal flooding in low lying areas and shorelines.

As an alternative view of this risk, RMS modelled our portfolio to share their perspective about 5-year forward view of hurricane activity in the region, derived using recent forecasting techniques that account for a comprehensive range of drivers of short-term fluctuations in hurricane activity; this rate uses a baseline season range of 1900 to 2020. The RMS v 21 model for short term perspective estimated that the potential loss from a hurricane with a 1/200-year probability of occurrence could be around $352.3 million, net of facultative. These figures allow us to identify the possible financial impact that climate change could have on CSM's insurance portfolio in the short term, which is estimated at $54.9 million[1].

For 2023, CSM's catastrophic reinsurance program has a coverage limit of $402.5 million. This catastrophe reinsurance coverage exceeds the loss estimates calculated by RMS for the short and long term.

[1] Difference between CSM short-term and long-term potential loss from a hurricane with a 1/200-year probability of occurrence, according to the RMS Model.

On the other hand, our investment strategy incorporates climate change in the return and risk decision making assumptions.

CSM also takes into consideration in its investment decisions the innovation aspects of companies to identify whether such innovations should contribute positively to climate change and whether they could differentiate themselves from other companies in terms of anticipating legislative or consumption patterns changes. Most of CSM's corporate bond and equity investments have an MSCI ESG rating in the range of AAA to BBB and set targets on CO2 emission levels.

In addition to addressing the impact of underwriting and investment risks associated with climate change through different actions and programs established in our business strategy, we are recognizing the importance to manage all other aspects of our business activities to positive contribute society through a cooperative climate effort as an economic system.

C. Risk Management

To adequately manage hurricane risk, which has been identified as the risk with the greatest potential for loss in the portfolio underwritten by CSM and which is directly related to climate change, the board of directors has established the loss tolerance for this type of event and the strategies that allow CSM to maintain and transfer these exposures.

To comply with these guidelines, CSM must have a catastrophic reinsurance program that allows it to cede losses that could be caused by a hurricane like Hurricane Maria adjusted to the exposures and inflationary indexes applicable at that date. It was established as a tolerance that the total retained losses including the reinstatement costs of catastrophic contracts should not exceed the sum of 10% of the policyholder surplus plus the net income budgeted for the year.

Other initiatives that allow us to adequately manage this risk are to ensure that new business underwriting has a lowest or neutral impact on the probable maximum loss (PML) estimate under the RMS model and to inform our policyholders of the importance of reviewing their property policy coverage limits.

In addition, CSM has the advantage of being an insurance cooperative majority-owned by the country's credit unions, which has the financial backing of a system with just over $11.5 billion in assets to support its risk management program in 2023.

D. Metrics

CSM uses the models developed by risk modeling companies, RMS, and Verisk, to know the annual potential loss that could be caused by an earthquake and hurricane according to the total insured values (TIV), the type of construction and the geographic distribution of such risks, among other characteristics.

Likewise, in addition to the results obtained from external models, CSM conducts internal evaluations for specific events. For example, we estimate the potential loss that could be caused by an event such as Hurricane Maria brought to 2023, which is estimated at $367.2 million for personal and commercial property risks.

This loss estimate is compared with those developed by RMS to guide our risk management decision making system. The following table illustrates a comparative analysis of the maximum probable loss ratio as percent of TIV produced by the long-term RMS v21 model at 1/200-year for 2022 and the CSM's adjusted damage ratio for a hurricane like Hurricane Maria for 2023 (CSM's risk tolerance) for personal and commercial property lines.

Line of business	PML: RMSv21 1/200-year LT	Adjusted Damage Ratio: Hurricane Like Maria
Personal Property	1.05%	1.80%
Commercial Property	6.11%	6.34%

The metrics illustrated in this table demonstrates the risk standard CSM has adopted in managing its climate-related principal risk.