ESG reporting makes business sense for insurers

Find the leading factors for an in-depth ESG strategy

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Insurers' opportunities in detailed ESG reports

As far as environmental, social and governance (ESG) efforts go for the insurance industry, the train has well and truly left the station, and for the most part, insurance companies and their executive teams are on board with the concept. Some may be reluctantly on board, given that there is still much confusion about how ESG is defined, measured, and reported.

This acceptance is driven largely by the ever-growing array of ESG-focused insurance stakeholders—customers, regulators, investors, industry analysts, and credit-ratings agencies—becoming more vocal in demanding that insurers take into account ESG factors in their underwriting, investing, and day-to-day operational activities of their businesses.

> *"We find many insurance companies show a high degree of interest in ESG. They've spoken about the importance of disclosing ESG information, but we also see an unequal amount of resources allocated by them to meet this focus area. ESG strategy development including identification, measurement, and reporting, are concepts at varying stages of maturity within the industry."*
>
> **Thomas Kelly**
> **Partner, KPMG LLP**

The demands are such that insurers' chief executive officers and chief financial officers dare not attend an earnings call, investor days, or even tackle their ratings agencies without being prepared to discuss their detailed and actionable ESG strategy.

But, specific evidence about ESG practices is very difficult to unearth in the public domain as it appears very few insurers use, or consistently apply, a specific ESG framework when reporting. A common reason could be that many frameworks exist, which may confuse industry participants.

While reporting on greenhouse gas emissions, for example, can be accomplished using a number of methods, it is when there is an analysis of the ***material*** activities of insurers such as their underwriting and investing activities, significant variations in company practices become evident.

This fact, however, is not surprising given that insurance companies are intertwined with every industry and economy across the globe, and ESG and reporting of it is very much in its infancy in many jurisdictions and industries. This constraint, however, is unlikely to give insurers a free pass for long.

In our view, insurers must be crystal clear when stating ESG goals and providing details about the path they will choose to achieve their goals. Further, it has become critical in this industry to inform stakeholders about how ESG efforts will be measured and how they will be reported.

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Data on current efforts and results

15% of insurers in a KPMG survey say their businesses are "very knowledgeable" on ESG issues and are far along in their ESG maturity journey.

58% reported being at the starting line with a "lack of awareness of key ESG issues" for the industry or understanding what competitors were doing.

In the past several months KPMG has conducted two separate surveys on ESG. The first focused on trying to understand whether any of 131 insurers based in 37 countries submitted ESG reports to a third party for an assurance review. The second survey, which polled 67 insurers from the Americas, Europe and Asia Pacific, sought to understand the percentage of the insurers in the surveys considered their organization ESG market leaders, fast followers, or if they felt their business was still at the starting line.

Findings from the first survey of 131 insurers revealed that a vast majority—107 insurers—in the survey said they "report" on ESG efforts. When we analyzed those reports, however, we learned that only 23 of them—or 18 percent—issued a report where only a portion of it underwent some type of a reasonable assurance process by a third party.

Even then, the criteria and frameworks used among the 18 percent with a portion of their reports "assured" to measure the ESG impact are unknown.

Analysis of the second research study discovered that only 15 percent of insurers in the survey considered their businesses are "very knowledgeable"[1] on ESG issues and are far along in their ESG maturity journey. Fifty-eight percent of insurers in the survey reported being at the starting line with a "lack of awareness of key ESG issues"[2] within the industry or understanding what competitors were doing. The remaining 27 percent consider their businesses as "fast followers,"[3] where they were "aware of particular pain points and looking for help in those

In our experience, all insurers' ESG reports often contain a high-level statement about a commitment to a better environment, social justice, and robust governance standards. While insurers have stated bold ambitions to provide stakeholders with clear, concise, and measurable ESG reports, none at the moment, however, provide reports that have been fully assured by an independent third party.

A reason for this situation may be that "clear and uniform reporting standards are still in their infancy stage as regulations and investor preferences evolve,"[4] and more work needs to be done by regulators (perhaps with input from business) to establish a set of agreed-upon standards to help with issuing assurance to stakeholders. For many, the assortment of frameworks has caused some confusion across industries and within industries. One question that is often asked is whether there is a single framework that insurers should use. Doing so could help insurers create consistency in reporting, which would be beneficial to stakeholders.

Our research indicates that insurers have a significant opportunity to be more relevant to stakeholders by articulating the material ESG topics to the operations of their company that stakeholders increasingly are demanding. Doing so will likely improve investment returns, operational performance, have comparatively lower cost of capital to peers with lesser ESG ratings,

1 KPMG internal research
2 Ibid.
3 Ibid.
4 "A Brief Introduction to the GRI Reporting framework," June 29, 2021, Goby, Inc."

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and improve customer and regulatory relationships. In short, by addressing stakeholder concerns around ESG, management teams can likely improve shareholders' returns. A win-win.

The investment management arm of a large U.S.-based insurance business reported that "detailed and measurable ESG practices resulted in better operational performance in 88 percent of companies, the stock price performance of 80 percent of companies was positively influenced by good sustainability practices and lowered the cost of capital of 90 percent of companies, and companies with strong sustainability scores showed better operational performance and were less of an investment risk.''[5]

Innovation and collaboration between insurers and their stakeholders will have the greatest impact on the transition to decarbonization in the United States. This transition is being driven by the increased focus from regulators such as the U.S. Securities and Exchange Commission (SEC). Chairman Gary Gensler recently noted that ESG disclosure is one of his—and the SEC's—top priorities.[6]

In a July webcast, he used the recently completed Olympic Games as an analogy to make his point: Gensler compared the kind of sports included in competition more than 100 years ago to today's sports: "no soccer, no basketball, no women's sports … That wouldn't exactly reflect where sports are today,'' he said. "Occasionally, fans raise their hands and say, 'I want something a little bit different.' I think that's a good analogy for public company disclosure. Occasionally, investors in our capital markets tell us that they, too, want something a little bit different. When it comes to climate risk disclosures, investors are raising their hands and asking regulators for more."

"Today, investors increasingly want to understand the climate risks of the companies whose stock they own or might buy. Large and small investors, representing literally tens of trillions of dollars, are looking for this information to determine whether to invest, sell, or make a voting decision one way or another … I believe the SEC should step in when there's this level of demand for information relevant to investors' decisions. Thus, I have asked SEC staff to develop a mandatory climate risk disclosure rule proposal for the Commission's consideration by the end of the year. I think we can bring greater clarity to climate risk disclosures.''

Because investors and policy buyers are raising their hands, it is in insurers' best interests to be mindful of ESG implications when considering investment and underwriting policies. Neglecting those considerations, or not fully exploring their impacts, has a high potential to put off buyers and investors, not to mention invite more regulatory scrutiny.

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5 "Why Strong ESG practices Can Offer Companies a Competitive Advantage,'' John Hancock Investment Management, 2016

6 Gensler Says Climate Disclosure Ruled Among 'Top Priorities,' Law 360, May 13, 2021.

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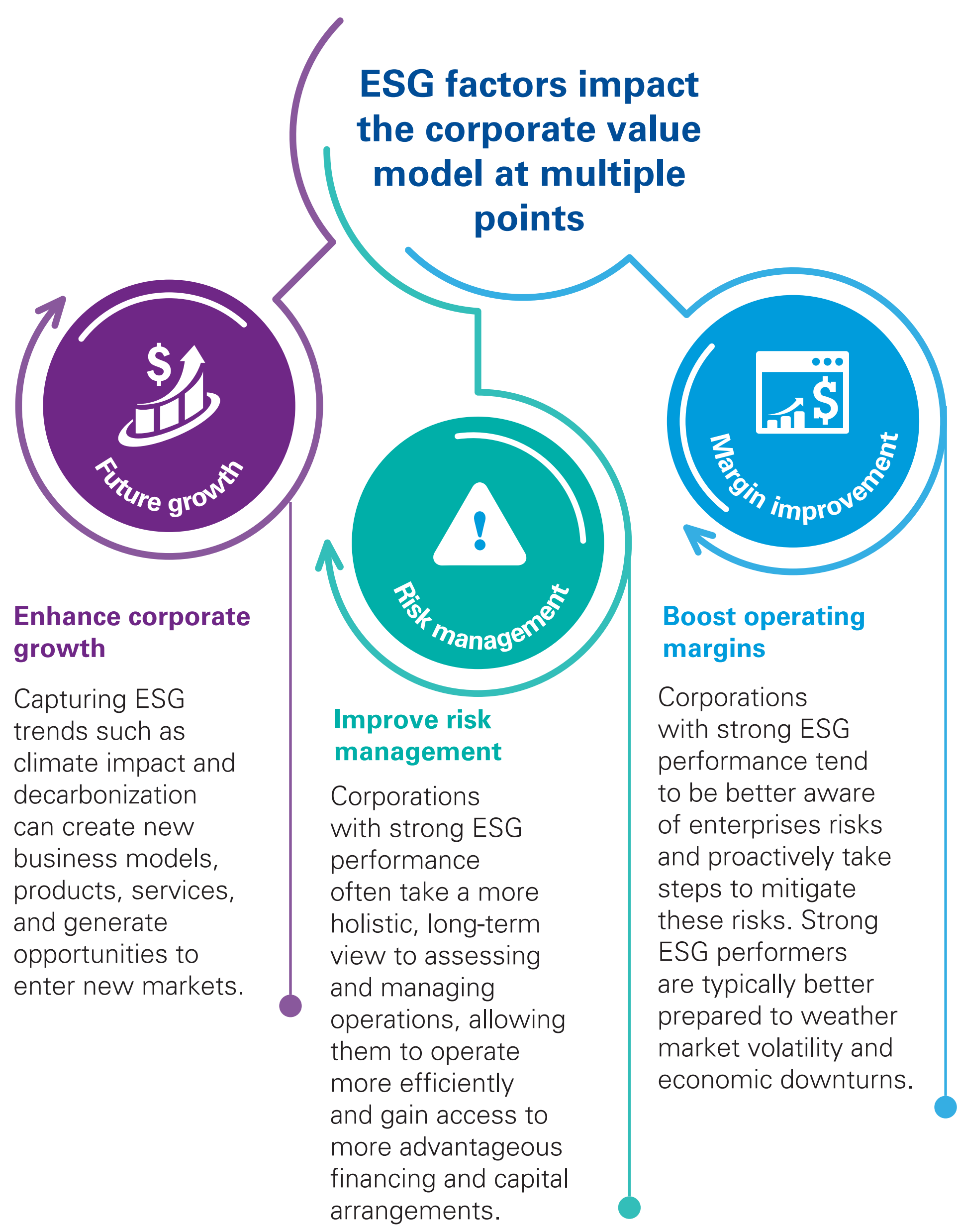
Solving those challenges should be addressed when creating new guidelines for investing and underwriting policies. The creation of those guidelines should not be done in a void.

Given the potentially severe negative consequences of giving ESG considerations short shrift when performing investment and underwriting activities, management teams should embrace the holistic approach that includes ESG specialists in the creation of investing and underwriting guidelines. ESG specialists should be permanently added to investment and underwriting teams.

John Cotes, head of the SEC's Division of Corporate Finance, said "SEC action on ESG is overdue … nobody else is waiting. The rest of the world is moving forward (on stiffer ESG regulation) pretty rapidly.''[7] Current expectations are that the SEC will be introducing proposed rulemaking related to ESG disclosure requirements by the end of 2021.

Convincing some skeptics of ESG will take time and perhaps considerable persuasion. We see the benefits from several dimensions; the business benefits of establishing an ESG program are many:



7 "SEC to Move 'Promptly' on ESG Rulemaking in 2021,'' Bloomberg Law News, April 30, 2021

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The rise of the ESG agenda

As we see in the three levels of ESG maturity among insurers (market leaders, fast followers, and those at the starting line), insurers are at separate maturity levels on the continuum of ESG development. Nevertheless, our insurance ESG specialists have identified eight reasons for the rise of ESG on insurers' business and operational agendas.

C-suite and board buy-in

ESG has evolved from a topic that is primarily owned by sustainability experts and teams, to a C-suite and board concern.

Access to capital

Investors increasingly factor in ESG considerations when making investment decisions, pushing ESG expectations downwards to portfolio companies.

Regulatory developments

ESG-related compliance costs and disclosure requirements continue to evolve, as securities commissions, supervisors, stock exchanges and governments tighten the rules

Reporting standards

Measurement and reporting of ESG-related information is maturing rapidly, as investor-centric disclosure standards are making headway (e.g., TCFD, SASB).

Societal pressure

Stakeholders increasingly scrutinize companies' ESG performance and transparency affecting project approval, brand acceptance, and consumer demand.

Climate change

Companies now accept that climate change equals financial risks. The KPMG Global CEO Report and the World Economic Forum identify climate change as the single greatest risk.

Enhanced risk management and investment returns

ESG integration has become an investment norm. Seventy-five percent of institutional investors now consider ESG factors to be "material" to their investment analysis.

Workforce of the future

ESG has become a key factor in attracting and retaining top talent, as employees are seeking purpose from their work.

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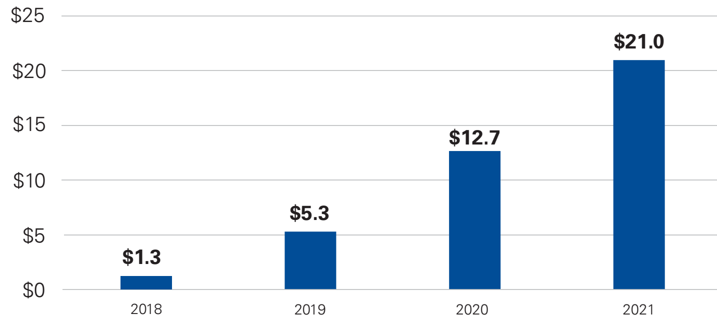
The popularity of ESG investing continues to grow

As the pressure from all quarters of stakeholders is mounting, we also see a more enlightened view on the importance of measurable ESG reporting by insurance executives. Some of the enlightenment is driven by the emergence of a younger segment of the population—millennials, the 73 million people in the 25 to 40 age group. Millennials now outnumber baby boomers (72 million people as of 2020),[8] and they stand to be the beneficiary of the greatest transfer of generational wealth ever recorded. By 2030, some estimate that millennials will inherit $68 trillion from baby boomers, a cohort thought to be the wealthiest generation in history.[9] By 2030 millennials will hold five times as much wealth as they have in 2021.[10]

"Sustainable investing is particularly likely to be popular with younger generations,'' according to a 2019 Morgan Stanley survey, which reported that 95 percent of millennials in the United States expressed an interest in sustainable investing.''[11]

ESG is not, however, only of interest to 25- to 40-year-olds. There is ample evidence that a focus on how a business views its impact on the environment and society is multigenerational. MSCI Inc. disclosed in a recent report that 85 percent of individual investors of all ages are interested in sustainable investing, an increase of 10 percentage points from 2017.[12]



A recent Wall Street Journal article[13] referred in inflows of investments by individual and institutional investors into ESG funds as a "tidal wave.'' (Data for 2018, 2019, and 2020 represents annual inflows; the 2021 data is first quarter inflow.)

8 Millennials Projected to Overtake Baby Boomers as America's Largest Generation,'' Pew Research, 2020

9 "How to Plan for a Wealth Transfer,'' Forbes, March 19, 2021

10 "The Millennial Wealth Report,'' Wealth Engine, 2020

11 "Morgan Stanley Survey Finds Investor Enthusiasm for Sustainable Investing at an All-Time High,'' Morgan Stanley, September 12, 2019

12 "Why is ESG Transparency Important,'' MSCI Research, 2021

13 "Tidal Wave of ESG Funds Brings Profit to Wall Street,'' The Wall Street Journal, March 16, 2021

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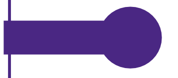
Material topics to assist in identifying, measuring, and reporting on ESG

Insurers seeking to educate stakeholders about the organization's ESG efforts begin by understanding and anticipating stakeholders' expectations, identifying where gaps may be in those expectations, recognizing the risks of not meeting those expectations, and knowing how to define opportunities that accrue from a well-constructed ESG strategy.

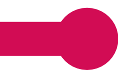
Leading ESG guidance and reporting framework

A set of core first and second generation initiatives, frameworks, and guidance examples are outlined below

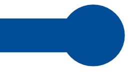


Global reporting initiative standards
- Early, broadly accepted methodology to homogenize sustainability reporting - periodically updated to improve disclosure quality & meet sector specific needs
- Reporters identify their material focus areas and tailor reporting to cover those topics
- GRI provides E, S, and G topic level disclosures for material focus areas, which include both qualitative and quantitative disclosures

Sustainability Accounting Standards Board
- Modeled on the Financial Accounting Standard Board (FASB) - aims to create a focused, standardized reporting framework tailored to corporate needs
- The global economy is divided in 77 sub-sectors - For each sub-sector material topics were identified and topic specific metrics were developed
- Rapidly growing support among investors and corporations alike

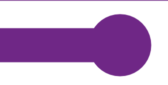


Task Force on Climate related Financial Disclosures
- TCFD requires entities to consider and assess risk & opportunities poised by Climate Change to the business and its operations
- Analysis is forward looking, covering strategic and tactical considerations, as well as the quality of Governance and Management
- Institutional asset managers are beginning to expect (but not yet require) TCFD analysis



Principles for Responsible Investing
- Commitment by Asset Managers to invest all or part of their AUM responsibly
- Set of six voluntary principals to incorporate ESG into investment analysis & decision-making
- Creates reporting expectations (and future requirements) for signatories, including some TCFD metrics

Sustainable Development Goals
- Set of seventeen goals to achieve "a better and more sustainable future"
- Governments and corporations can enable / support progress towards goals through their actions and support
- Wide market support and acceptance, but actions are entirely voluntary and lack tangible metrics / disclosures to evidence support



World Economic Forum
- Set of 21 core and 34 expanded metrics recommended for all companies
- Based on existing standards and frameworks and established to accelerate convergence of these standards

Accomplishing such goals, we believe, requires having a solid understanding of the most-frequently identified material ESG topics and metrics that should be examined, measured, and publicly disclosed. Having the understanding may come from studying existing frameworks, some of which are represented here.

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Having a solid understanding of these framework may go a long way for an insurance company to be able to measure and then report on its ESG strategy—and have that report go through an assurance process.

But understanding the framework may only be part of the challenge of building, publishing, and having an ESG report assured to the satisfaction of the myriad ESG stakeholders in today's industry.

Our lists of potential material topics for the E, S, and G categories are not meant to include only material topics for each type of insurer. In fact, material topics might be slightly different for a life insurance company when they are compared to a property and casualty company or a health insurance company.

The following topics in the graphic below should be viewed as a guide, used for debate among teams crafting an ESG strategy that reflects their own organization's and stakeholder demands. If executives at an insurance company were looking at a list of key topics to be included in an environment section of an ESG report, the list below may help spark discussion. There may be more topics depending on the business or operating strategy of a particular insurer, but these may help create a broad view for stakeholders to evaluate the material ESG topics that an insurance company used when it developed, measured, and reported on its environmental strategy.

Environmental

- Climate change vulnerability
- Sustainable offerings and products
- Carbon emissions
- Decarbonization strategy
- Waste management

Social

- Diversity, equity, and inclusion
- Community engagement
- Employee Health, safety, and well-being
- Social impact and well-being
- Talent attraction and retention

Governance

- Responsible investment
- Privacy and data security
- Independent oversight and governance
- Risk assessment and management
- Transparent information and customer satisfaction

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KPMG can help when developing an ESG plan

Strategy
When developing an insurance company's ESG strategy, we believe it is vital to understand and anticipate stakeholder needs and expectations, incorporate ESG into overall business strategy, balance risks and opportunities when setting ESG goals and objectives, assess gaps, develop mitigation and enhancement plans, and develop ESG policies.

Finding strategy solutions requires program development elements that include gap analyses, benchmarking, and assessments of materiality topics for individual E, S, and G segments. Insurers may also want to conduct portfolio assessments that involve their data-collection strategy and an economic and impact statement.

Social strategy solutions require human capital evaluations that include diversity, equity, and inclusion dimensions. Governance strategy solutions require an evaluation of data and cybersecurity capabilities, and responsible investment policies.

Tax strategy elements would include an evaluation of the insurer's sustainable tax policy and governance, the transparency of its tax reporting process, and carbon-tax analyses.

We'd also recommend a final but critical strategy element that involves a thorough review of the organization's enterprise risk management program, its regulatory-compliance processes, its integrated risk management program, and its overall risk-governance structure and processes.

Embedding ESG into the operating model
In order to achieve an effective ESG strategy, insurers should consider how to embed it in the organization's operation and strategy. That would include understanding the requirements to meet ESG commitments and invest in necessary capabilities, including workforce, supply chain, operations, controls, technology, infrastructure, and governance.

We suggest insurers evaluate any ethical risks in the supply chains and procurement program. The organization's management would want to understand logistical management challenges as they relate to ESG, conduct supplier audits with a focus on ESG elements, and examine the criteria for supplier selection.

From an internal control perspective, an assessment of internal controls over data gathering and reporting would be appropriate. And, on the technology front, one of the key issues management would want to understand is how IT sourcing decisions are being made.

Measuring ESG programs
Developing effective capabilities to measure the benefits and the return on investment of ESG initiatives will be a challenge for insurers, but they are essential as ESG programs increasingly are put under a microscope. Accurate measurement will require an understanding of the many standards, metrics, and ratings frameworks in the marketplace.

ESG measurement will require a keen evaluation of relevant ESG impact metrics, and accurate gap assessments against ESG standards or frameworks. Insurers will face climate-accounting infrastructure demands, a view of internal carbon tax requirements, and they should expect a review of management incentive compensation that is linked to ESG program progress.

Assurance demands will involve which or how many reporting frameworks (e.g., GRI, SASA, TCFD) have been used, an examination of the use of the proceeds of sustainability bonds, and the evaluation of the extent of greenhouse gas emissions.

Final words
In offering this article, KPMG is aiming to engender debate and we encourage readers of this document to reach out to our subject matter professionals so that we can begin a discussion about advancing the insurance industries ESG capabilities.

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KPMG Insurance professionals know how to transform today's uncertainty into opportunity for our clients. We view our insurance clients' current challenges as possible breakthroughs that can transform their operations and create a sustainable advantage.

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