ESG in insurance: Strategy and transformation

KPMG in Belgium

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Foreword

The environmental, social and governance (ESG) agenda has become a key priority for financial services organizations, helping to shape the boardroom agenda and business strategy across many levels. Leading insurers see ESG as an opportunity to lead and drive positive change.

Insurers increasingly recognize their role in advancing the ESG agenda, not only through their products and investment, but also within their own organizations, across their customer base and throughout the broader ecosystem. Yet many are struggling to set their ambition, prioritize their activities and cascade their vision across every division and function. To navigate this, insurers should have a practical, value-driven ESG strategy and transformation plan.

In this report, we discuss how insurers can design and deliver an ESG strategy that not only meets compliance requirements, but also delivers significant competitive advantage. We provide context around evolving regulations, highlight key challenges for insurers, demonstrate examples of where leading insurers are getting it right, and offer key elements to help you compose an ESG strategy that is purpose-driven and tied to your overall business objectives.

KPMG firms work with clients across the spectrum of ESG issues and topics — from strategy development and climate risk modeling through to ESG data, analytics, reporting and controls — giving our professionals deep insights into the challenges and opportunities facing insurers around the world.

We hope this report inspires and enables you to accelerate and enhance your ESG strategy. On behalf of KPMG's global network, we encourage you to contact your local KPMG firm to learn more about the ideas raised in this report or to discuss your own unique ESG objectives.

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Why ESG is strategically important for insurers

In recent years, we have witnessed a shift in investor, customer and employer sentiment. Investors are increasingly looking at organizations that can deliver both profit and purpose, and insurers that can demonstrate both of these attributes are at a competitive advantage. Customers are making more conscious efforts to purchase from organizations that align with their values. And employers are searching for talent that matches their vision and mandate. While some insurers have jumped at the challenge to integrate ESG into their growth strategy, others have struggled to prioritize which ESG factors they should focus on. Three key areas for consideration include:

Employee expectations

- ESG has become a key factor in attracting and retaining top talent as employees seek greater purpose from their work.
- Employees play an increasingly important role in shaping their firm's reputation with clients, stakeholders and new recruits and targets.

Customer engagement

- As policyholders build their own ESG strategies, insurers should have a high level of ESG maturity to interact with clients and meet their value expectations.
- ESG requirements of policyholders are changing, requiring insurers to adapt the level of support they may need to provide.

Investors and ratings agencies

- Investors are factoring ESG considerations, particularly ESG rating agency scoring and risk exposure, into their investment portfolio analysis.
- Rating agencies, governments, non-government organizations (NGOs) and stakeholders are scrutinizing ESG performance and transparency.

Insurance leaders also understand there is a cost to taking a 'wait-and-see' approach to ESG — both from a financial and a reputational perspective. Changes in regulation, technology and customer sentiment can lead to huge transitional risks for insurers. And these could mean an inability to capitalize on new opportunities, attract new talent, expand into new markets or build strong regulatory relationships.

Many insurers are also under increasing pressure to deliver on commitments they've made, particularly on the climate agenda. Customers, investors and regulators want to see what progress is being made against these commitments.

Regulations are evolving

Regulation has been a key driver for many insurers. As regulators increasingly start to focus on climate and ESG risks as prudential risks, a series of new ESG regulations are being developed and issued around the world. The UK and Europe currently seem to be leading the way, with other markets rapidly following suit. The International Sustainability Standards Board (ISSB), the US Securities and Exchange Commission (SEC) and the European Financial Reporting Advisory Group (EFRAG) are all due to release their own reporting requirements in the next few months, and disclosure of non-financial information will likely be key.

The below table shows an illustrative view on some of the ESG regulations that might pertain to insurers in 2023.

Jurisdictions	Selected environmental-related regulations	Selected social-related regulations
UK	• Streamlined Energy & Carbon Reporting since 2019[1] • Prudential Regulation Authority (PRA) expectations on managing financial risk arising from climate change, set out in SS3/19, form part of a supervisory approach from 2022[2] • Task Force on Climate-Related Financial Disclosures (TCFD) disclosures for large companies for reporting periods from 6 April 2022, if not already caught by earlier requirements for listed companies[3] • TCFD product and entity-level reporting for life companies with insurance-based investment products from 30 June 2023[4] • Anti-greenwashing requirements expected to be applicable from 30 June 2023[5] • Green taxonomy: UK government is expected to provide an update on timing and substance during 2023[6] • UK SDR CP 22/20	• Human Rights Statement (2013)[7] • Modern slavery reporting (2016)[8] • Gender pay gap reporting required (2017)[9] • Diversity and inclusion reporting for listed companies for reporting periods after 1 April 2022[10]
EU	• Corporate Sustainability Reporting Directive (CSRD)[11] • Sustainable Finance Disclosures Regulation (SFDR) require product reporting on sustainability objectives[12] • European Union (EU) taxonomy identifies those activities that are considered as significantly contributing to six sustainability objectives — from 2022[13] • European Insurance and Occupational Pensions Authority (EIOPA) requires additional climate information relating to insurance products and investments from 2023 year-end quantitative reporting templates (QRTS)[14] • EIOPA is exploring potential differential treatment in the Solvency Capital Requirement (SCR) calculation for exposures to sustainable investments and economic activities[15]	• CSRD introduces mandatory disclosure in accordance with European Sustainability Reporting Standards (ESRS) across environmental, social and governance topics. Phased implementation starting financial year 2024 for largest firms. Mandatory limited assurance required which also affects non-European groups with significant European business[16] • Gender Balance Directive comes into effect in June 2026[17] • Corporate Sustainability Due Diligence Directive (CSDDD) reporting possible from 2025[18]
ASPAC	• Australian Prudential Regulation Authority (APRA) introduced CPG 229 (effective November 2021) setting out TCFD-aligned guidance[19] • Hong Kong Securities and Futures Commission (HKSFC) will introduce mandatory TCFD reporting requirements by 2025[20] • Japan's Financial Services Agency (FSA) introduces mandatory TCFD requirements, phasing in from 2022[21] • China's green taxonomy, known as the 'Green Bond Endorsed Project Catalogue' was first released by the People's Bank of China (PBoc) in 2015. A revised edition was published in April 2021.[22]	• Monetary Authority of Singapore (MAS) has developed a roadmap for issuers to disclose on ESG matters from 2022[23]
Americas	• SEC will phase in climate reporting requirements from 2023 through to 2025[24]	

* Sources can be found on page 17

A platform for future growth

Some insurers are using ESG to drive ambitious targets, pursue innovation, identify new markets and launch differentiated products and policies.

Leading organizations acknowledge that there is a significant upside to be had. In fact, in a recent survey of CEOs conducted by KPMG International, 44 percent of insurance CEOs said that ESG programs improve their financial performance, up from 40 percent one year ago.

Consider, for example, the new product and policy areas that are emerging. Some insurers are developing innovative policies aimed at protecting diverse natural biomes, such as mangroves, coral reefs and wetlands, from the impacts of storms or floods. Others are looking at covering the risk of possible loss of carbon credits due to natural events such as wildfires. There has also been big progress in the development of policies to cover new technologies, such as hydrogen projects, off-shore wind farms, solar projects and other new innovations.

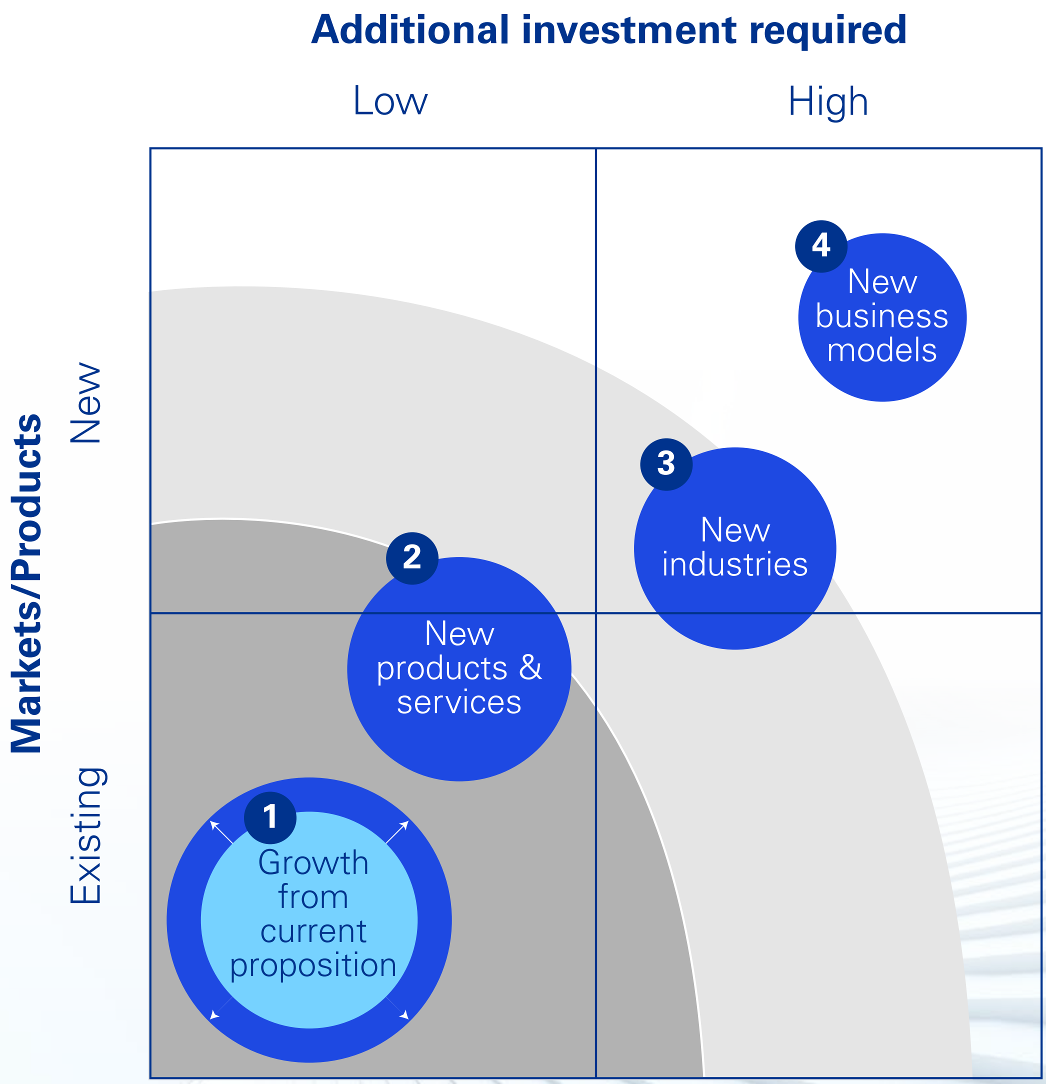
44%

of insurance CEOs agree that ESG programs improve their financial performance.

Source: KPMG 2022 Insurance CEO Outlook, KPMG International, December 2022

Many insurers are currently in the early stages of reviewing and enhancing their current portfolio and investments to be more ESG-friendly or impact-led. However, as maturity increases, ESG data becomes more available, skill sets evolve and ambitions become clearer, leading insurers are expected to move rapidly towards developing new business models and future target operating models. Adopting these new strategies could put them in a stronger position to create new revenue streams and diversify their value.

Prioritizing a number of key ESG themes based on capabilities and aspiration can enable insurers to create tangible value from the emerging ESG opportunities.



> “Insurers have used a lot of resources and effort to develop their ESG stories. We now see more insurance organizations reviewing and repositioning their products and services to better fit their customers’ ESG objectives. As ESG continues to gain importance with customers, discussions between insurers and their distribution partners are focusing on this changing dynamic.”
>
> — **Sean Vicente**
> Insurance ESG Lead and Partner,
> KPMG in the US

How insurers are integrating ESG

ESG can present long-term opportunities for insurers across the value chain — with government initiatives, market-wide commitments, and substantial investment in renewable and green energy. There is a considerable benefit for organizations that integrate ESG into their strategy and navigate some of the complex, enterprise-wide challenges to set a path for success. While insurers are at different stages on their ESG journey, significant activity can be seen across two main focus areas.

01

Insurers are using an ESG lens to enhance how they conduct their own business. They are evaluating their current business and operating models, reducing their carbon footprint, better managing their workforce and building strong governance frameworks. At the same time, organizations are leveraging new ESG data to improve both pricing algorithms and risk ratings.

- **Governance: Insurers are putting mechanisms in place to measure and review progress on ESG objectives and investments.**

  Insurers are creating ESG taskforces that bring together senior executives, business unit leaders and functional experts to ensure ESG is embedded across the organization.

- **Asset management: Insurers are creating methodologies for assessing ESG risks and opportunities for investment purposes.**

  Life insurance leaders are designing their own ESG ratings scorecard as a first step to investment screening, coupled with ESG training and dedicated subject matter experts.

- **Delivering net zero: Insurers are setting ambitious yet measurable goals to manage future risk, reduce costs and enhance efficiency.**

  Insurers are committing to reducing their Scope 1, 2 and 3 emissions to net zero within the next three decades with many setting milestone goals to guide their journey.

- **Workforce of the future: Insurers are using data and modeling to create a fairer and more equitable workplace for employees.**

  Diversity, equity and inclusion remains a challenge for insurers, with 74 percent of CEO outlook respondents indicating that progress on diversity and inclusion has moved much too slowly in the business world. Insurers are leveraging forecasting models underpinned by people analytics to identify hiring needs and challenges, setting targets and monitoring progress.

02

Insurers are using ESG capabilities and experience to help their clients and stakeholders on their own ESG journeys. They are innovating in their product portfolio, they are realigning their claims and underwriting processes to encourage ESG outcomes and they are thinking about their value proposition to the market.

- **Product innovation: Insurers are using technology and gamification to encourage risk reduction for policyholders and members.**

  Life insurers are developing app-based tracking and gamified incentivization programs that reward policyholders for taking part in and recording healthy activities.

- **Better risk awareness: Insurers are embedding ESG elements into existing models to help clients better understand their risk.**

  Insurers are creating Centers of Excellence (COEs) that bring together a range of specialists and enhanced physical and financial risk modeling to support client decision-making.

- **Enabling employees: Insurers are creating innovative programs to help their employees reduce their own carbon footprint.**

  Insurers are offering employees incentives for shifting to electric vehicles by offering a host of benefits such as maintenance, insurance and charging solutions, either subsidized or funded by the company.

- **Incentivizing portfolio companies: Insurers are using their investment power and ESG insights to help encourage portfolio companies to decarbonize.**

  Insurance companies are becoming much more focused on ESG due diligence and reviewing energy transition and decarbonization goals for portfolio companies.

Five steps to an enterprise-wide ESG strategy

Market leaders, both inside and outside of insurance, are taking a more consolidated approach to ESG. They have a clear ESG ambition, and ESG is fundamental to their vision and mission. Their ESG strategy cascades throughout functions, including proposition development, claims, HR and finance. And employees embrace the values and embed them into their daily work.

Our work with leading insurers and ESG programs suggests there are five key steps to creating an enterprise-wide ESG strategy for insurance organizations.

Recommended steps	01 Identification of material ESG factors	02 Ambition setting	03 ESG maturity	04 Strategic options	05 Roadmap
What this can mean	• Determine the **key material ESG factors** which impact the organization • Insurers typically perform a **materiality assessment** which can include stakeholder engagement	• Set an **ambition level**, i.e. where do you want to be compared to good practice and peers. This helps shape the parameters of an ESG strategy	• Understand your **current position** on your ESG journey, i.e. what progress has been made • Review **the gaps** compared with your ambition level	• Identify and **prioritize potential ESG initiatives** for (i) strategic fit with your overall growth strategy, and (ii) value creation potential	• Create a **high-level roadmap** of actions, supported by a **suitable framework** and **measurable key performance indicators (KPIs)** • These KPIs communicate where you are now and where you would like to get to, with a view to building a more **detailed transition plan**

Tips for accelerating and enhancing your ESG strategy

ESG is complex and many insurers are reviewing their approach to develop a strategic and enterprise-wide solution. KPMG professionals are experienced in helping clients to design and deliver successful ESG strategy programs, leveraging knowledge of the industry and broader ESG ecosystem to architect the change needed. This, underpinned by innovative tools and technologies, supports the acceleration and implementation of an ESG agenda for many insurers across the world.

Here are some tips for accelerating your ESG journey and strategy development from KPMG professionals.

Understand the interplay

“While much of the focus of ESG tends to coalesce around the `E', the reality is that many ESG topics are interlinked. Pulling one lever could have a positive or negative effect on another.

Insurers are a critical voice and contributor to the transition of the real economy, through partnering with governments; supporting continuation of economic activity particularly in areas exposed to physical climate risk; and developing new insurance products needed to support the evolution of communities.”

— **Catherine Robertson-Hodder**
Director, KPMG Australia

Bring your stakeholders on the journey

“As with any good business strategy, a good ESG strategy needs to be understood and owned at the board level and that ownership should cascade through the organization across functions. Change management is a key part of any organizational transformation.

This means training, open dialogue and clear opportunities for feedback. It also means ensuring that people across the organization understand why the change is important. For some, making the connection between ESG and their role within the insurance entity might be difficult. Ensuring your talent feels connected to the journey can be a key to success.”

— **Viviane Leflaive**
Partner, KPMG in France

Think laterally about opportunities, and understand how insurers can drive change in the real economy

“Besides the investment portfolio, a primary challenge for an insurance company lies in the underwriting portfolio. Here, insurance companies have an opportunity to support their clients with setting their ESG strategy and help them transform towards a sustainable business model. Insurance companies are typically very knowledgeable around physical risk, which arises from physical impacts across the changing climate. However, insurers typically lack experience in the area of transition risks (business-related risks that follow economic and societal risks towards a low-carbon future, including policy and regulatory risks).”

— **Marc Goessi**
Global Client Lead Partner, Financial Services, KPMG in Switzerland

Get on the front foot with regulation

“Compliance with a fast-evolving set of ESG requirements and standards presents considerable challenges for insurers with operations in multiple jurisdictions. While regulators and standard setters are trying to improve the interoperability of these requirements, there will inevitably be divergence in many areas and firms will need to consider how to implement efficient solutions at both local and group levels.

The consequences of getting things wrong or of being accused of ‘greenwashing’ will likely keep many executives awake. Making sure that data is reliable, processes are well designed and controls are robust will be key.”

— **Matt Francis**
Director, KPMG in the UK

Articulate your ambition

“The ESG strategy is based on the organization’s ESG ambition. Regulatory compliance and reporting should be the baseline. But it is equally important to identify priority areas where you want to make an impact across the ‘E’, ‘S’, and ‘G’ components. The KPMG 2022 CEO Outlook shows that 43 percent of insurance CEOs are struggling to articulate a clear and compelling ESG story to stakeholders.

Don’t let ambition stall you. It does not need to be all-encompassing. And it is perfectly reasonable to have higher levels of ambition in certain areas.”

— **Maria Eugenia Buosi**
Partner, KPMG in Brazil

10 key ESG considerations for your organization

1. Do you want to be an ESG leader, follower, or just meet requirements?
2. Which markets, segments and industries pose the greatest growth opportunities for value creation?
3. What are the challenges and opportunities in the current portfolio?
4. What are the expectations of your clients and distributors?
5. How do the processes in your organization support our ESG ambition in terms of underwriting, handling claims and making investments?
6. Do you have the needed infrastructure and capabilities to achieve your ambition?
7. Do you have access to the right data and analytical tools to generate actionable ESG insights?
8. Is your structure and governance fit for purpose? Do you have robust frameworks, reporting and controls in place?
9. Do you have the right leadership and culture in place? Are your strategy, values, purpose and culture aligned? Are employees supportive?
10. How can you accurately track progress and incentivize outcomes? Do you have the ESG data needed to meet your reporting needs?

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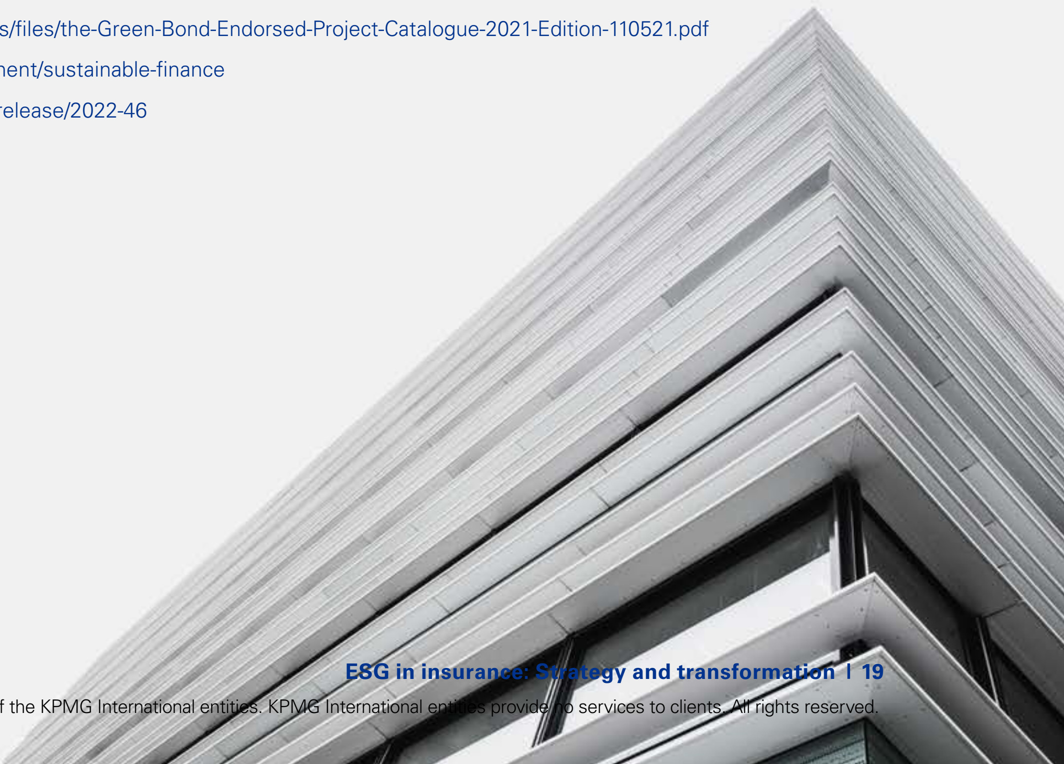

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A special thanks to those who contributed to the development of this report:

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Harriet Kuzemko
Matthew Francis
Nicholas Todd
Krishnamoorthy Subban
Martine Botha
Paul Merrey

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Designed by Evalueserve. | Publication name: ESG in insurance: Strategy and transformation | Publication number: 138650-G | Publication date: May 2023