ESG in insurance: Insured emissions

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Foreword

Insurers have a part to play in net-zero transition

The world is rapidly changing. Climate disasters are more prevalent, and insured losses from natural catastrophes are increasing. For the insurance industry, the loss and damage to property and life is significant and has resulted in huge payouts, in turn threatening the solvency of many businesses.

The financial implications of these climate disasters mean that insurers are re-evaluating their approaches to underwriting. Many organizations are updating their policies to exclude high-risk activities. For example, major outdoor cultural festivals in some countries have become uninsurable due to the high risks posed by bush fires. But creating such exceptions to insurance policies, or stopping underwriting all together, is only treating the symptoms of global warming. Addressing the cause — the increased carbon in the atmosphere — can help prevent climate disasters, reduce the subsequent damage to property and safeguard insurance organizations.

Rather than shifting the blame to high-emitting sectors, insurers recognize that they also have a part to play. By underwriting carbon-intensive businesses, insurers are supporting unsustainable business practices. With global aggregate premiums across life and non-life insurance close to US$8 trillion (or 6.8 percent of global economic output)[1], and with over US$36 trillion in global assets under management[2], the insurance industry and its supply chain needs to achieve net-zero targets by tracking their own emissions progress and investing in less carbon-intensive sectors and technologies.

Fortunately, the insurance industry has already committed to making the changes and the creation of international alliances has been an important start. But there are numerous challenges that insurers face identifying, measuring and benchmarking the emissions associated with their underwriting and investment activities. Many are struggling with how to baseline their carbon emissions, for example, creating reference points against which their greenhouse gas (GHG) emissions are measured going forward.

While the task may seem overwhelming and is complicated by few standardized methodologies, inconsistent data and a lack of skills, there are frameworks in place to help. The launch of the Global GHG Accounting and Reporting Standard for Insurance-Associated Emissions by the Partnership for Carbon Accounting Financials (PCAF) in 2022 was a key milestone. There are also several technology platforms scaling up to support GHG reporting in the insurance industry.

Combined with initiatives by regulators such as the International Sustainability Standards Board (ISSB), the U.S. Securities and Exchange Commission (SEC), the Financial Reporting Advisory Group and the Bank of England's Prudential Regulatory Authority (PRA), which are all holding senior management to account to address climate risk, the insurance industry journey to reducing carbon emissions is now underway.

KPMG firms have experience in helping businesses calculate the impact of their Scope 1, 2 and 3 emissions, and can help them to develop decarbonization strategies and execute transition plans.

This report puts the spotlight on insurance industry emissions baselining in addition to suggesting new analytical frameworks to help businesses with their transition plans. 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.

Jacques Cornic
Head of Insurance
EMA Region and Partner
KPMG in France

Roger Jackson
Global Insurance ESG Lead,
KPMG International and Partner
KPMG in the UK

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Insurers and emissions baselining

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There is a common saying: What gets measured gets managed. If insurers are serious about their net-zero commitments and addressing the risks associated with climate change, they need to understand how much the organization emits and agree on future reductions. Once equipped with the numbers, insurance leaders will have better visibility on their progress towards net zero.

External pressures have made net zero a business imperative. And while some insurers have committed to achieving net zero, very few can accurately baseline the full suite of their Scope 1, 2 and 3 emissions, although many insurers are developing processes to navigate this challenge.

Emissions baselining — External drivers

- **Increasing regulation:** Following the creation of the 2015 Paris Agreement, the past few years have seen an increase in environmental, social and governance (ESG) regulations across all financial sectors with the UK, the European Union (EU) and the US leading the way.
  - The EU Sustainable Finance Disclosure Regulation[3] (SFDR) now requires financial service providers to assess and report ESG impacts on investment decisions, while in the US, the SEC has proposed rules requiring the disclosure and assurance of carbon emissions for public companies.[4]
  - In April 2022, the UK became the first G20 economy making it mandatory for large businesses to report on their climate-related risk in line with the recommendations of the global Task Force on Climate-related Financial Disclosures (TCFD).[5] It means that banks and insurance companies operating in the UK are now being measured on how well they are managing climate-related financial risks and reducing their carbon footprint.
- In April 2019, the Bank of England's PRA became the first financial regulator to publish a set of supervisory expectations for this sector on their management of climate-related financial risks.[6] Today, it is collaborating with other financial regulators in the UK and switching its role from more of a supervisory approach of assessing to actively supervising how companies are measuring up against targets.[7] This active supervisory approach involves more frequent interaction, guidance, monitoring and progress.
- **Rising litigation:** The growing number of rules combined with existing legislation have intensified ESG-related litigation risks for reporting entities. More than ever, companies are being scrutinized for their climate-related disclosures, which also increases the risk of litigation. For example, there are a growing number of lawsuits pertaining to ESG statements in securities filings and bond offering documents. Impacts on insurers from ESG-related litigation are often more strategic, operational and reputational than financial. Many lawsuits seek structural changes to a company's business and operating models. These lawsuits may also pressure governments to take greater levels of climate action.
- **Independent verification:** Increasing numbers of entities are offering independent verification of emissions and targets, such as the CDP carbon disclosure project and the Science-Based Targets Initiative (SBTi). These organizations are also tracking the progress of emissions reductions in key sectors, with companies voluntarily submitting their emissions data to them. For example, in 2021 CDP reported a record number of emissions disclosures. It collected and tracked environmental data from more than 13,000 companies (making up over 64 percent of global market capitalization). For insurers, as more and more sector data are benchmarked and reported, peer pressure to address carbon emissions is likely to increase.
- **Methodologies and alliances:** The investment sector is forming its own collaborations and networks to achieve its emission tracking and reduction goals. The Net Zero Asset Owners Alliance (NZAOA)[8] is a good example of an association that has highlighted goals to transition their investment portfolios to net-zero emissions by 2050, with intermediate targets of 22 to 32 percent CO2 reduction by 2025 and 40 to 60 percent by 2030, with methodologies and toolkits available. In 2021, eight insurance companies announced a new commitment to a net-zero economy and launched NZIA. The alliance aims to achieve net-zero GHG emissions by 2050, but the commitments are contingent on governments taking action to implement new policies that support the transition, which has been slow to materialize.[9]

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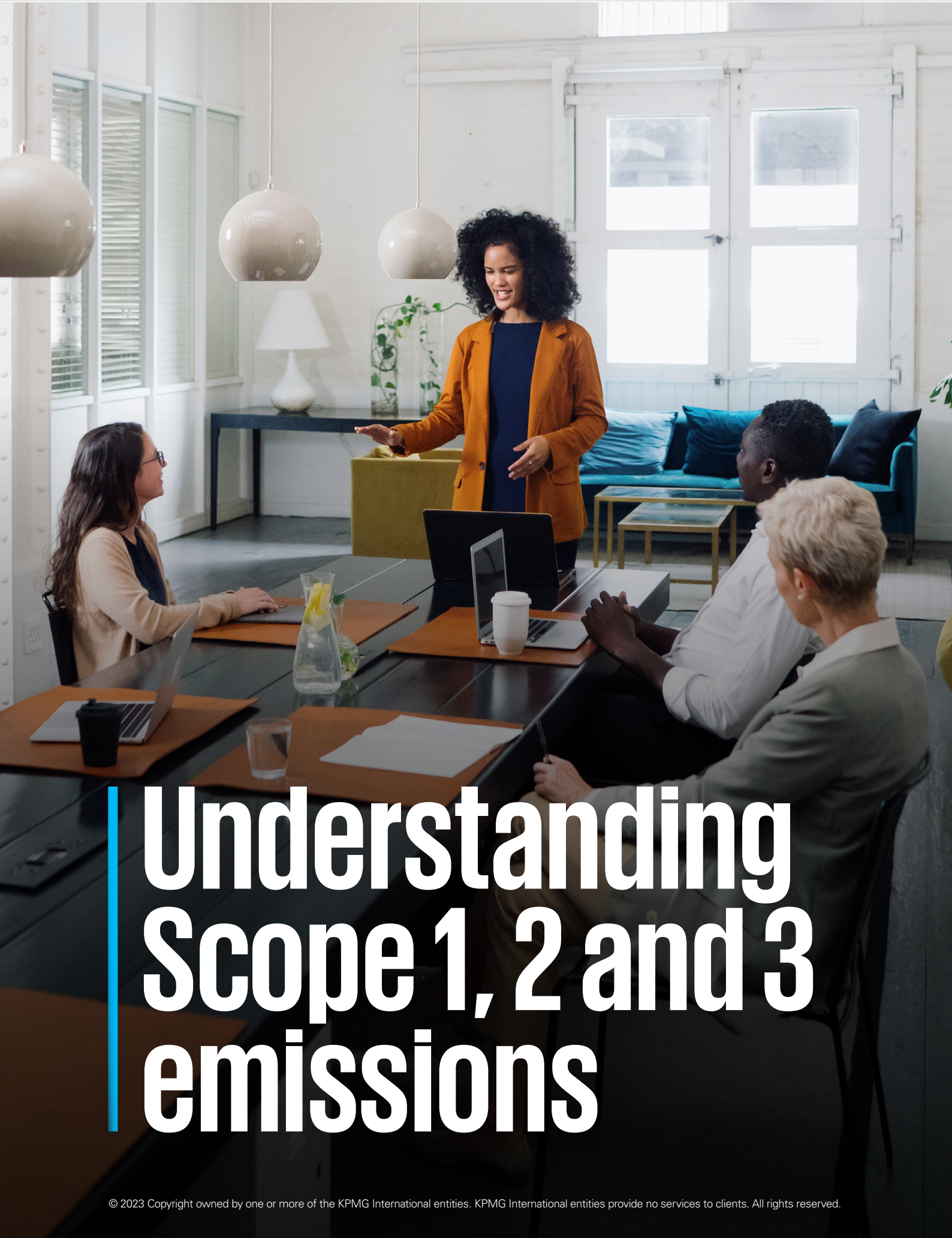

Understanding Scope 1, 2 and 3 emissions

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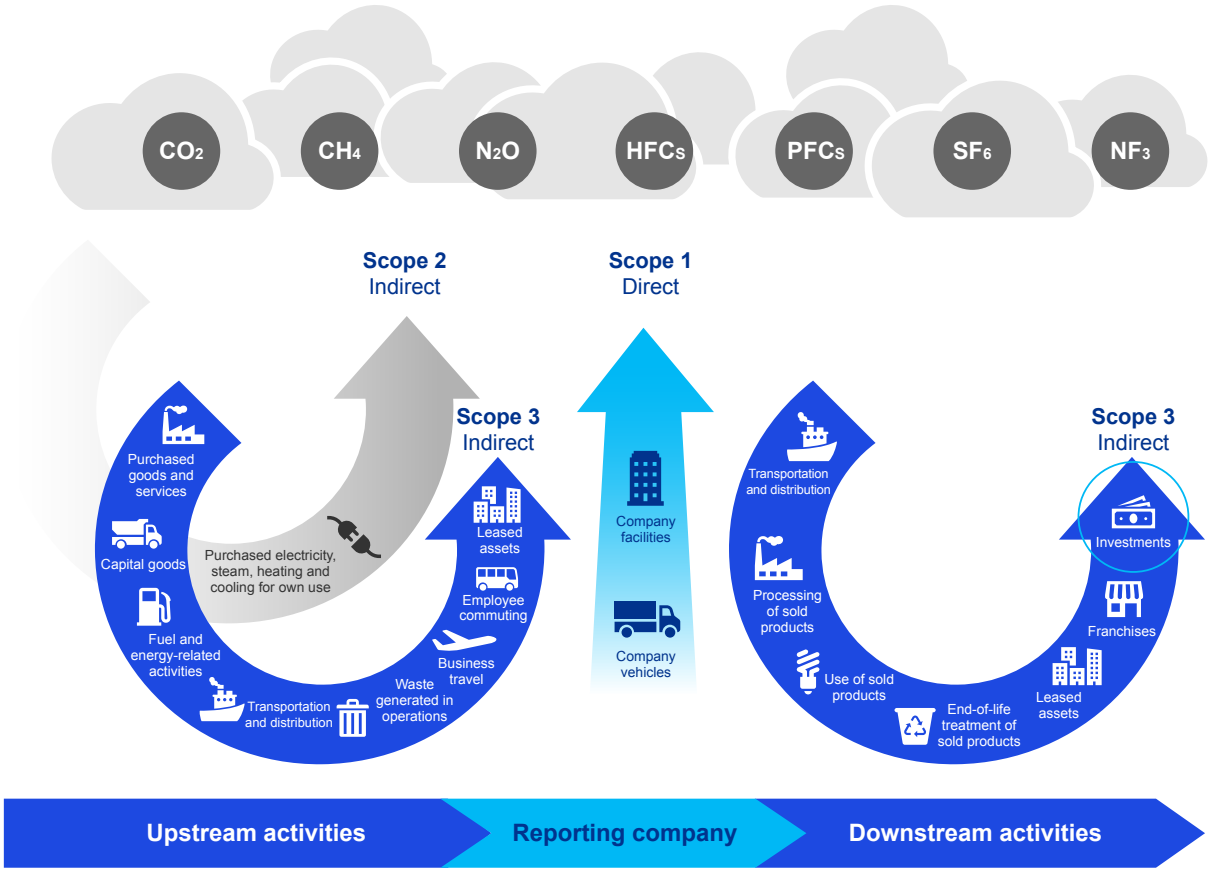
To baseline their footprint, insurers should first understand how their emissions align with GHG Protocol categories. The protocol identifies emissions as either direct or indirect:

- **Direct emissions** are from sources owned or controlled by the reporting entity.
- **Indirect emissions** are a consequence of the activities of the reporting entity but occur at sources owned or controlled by another entity.

The GHG Protocol then further categorizes direct and indirect emissions into three broad scopes, providing further definition for indirect emissions through Scopes 2 and 3.

Figure 2-1. Overview of GHG Protocol scopes and emissions across the value chain



Source: (WRI and WBCSD, 2011)

For many insurers, Scope 1 and 2 emissions are largely generated by day-to-day business operations, driven by their real-estate footprint (including heating and cooling), data centers or the use of their fleets. Due to relative ease of data capture, many organizations find these emissions easier to measure and monitor. However, Scope 3 emissions can be more of a challenge.

For insurers, Scope 3 emissions mainly cover upstream areas like business travel and waste disposal; further downstream, emissions include those arising from their underwriting and investment portfolios. Across the insurance industry, more than 95 percent of emissions fall into Scope 3, and although reducing them will therefore be highly impactful, they are also the hardest emissions to categorize, track and abate.

But as pressures grow, insurers will become more accountable, not only for the emissions produced and along their supply chain, but those released by entities they finance, invest in and underwrite (indirect).

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Financed emissions versus insurance-associated emissions

The emissions associated with investment and insurance activity are defined as Scope 3 (downstream) and are known as **financed** or **insurance-associated emissions**. Insurers are unique in the need to consider both types of emissions. This is because insurers help organizations operate through investment and underwriting activity. Many businesses could not exist without some form of insurance. Therefore, it is important insurers are recognized as part of the value chain — through their underwriting, they can enable businesses to continue to pollute or, conversely, encourage business to operate in more sustainable ways.

Responding to industry demand for a global, standardized GHG accounting and reporting approach, PCAF developed the Global GHG Accounting and Reporting Standard for the financial industry, focusing on measuring and reporting financed emissions. Published in November 2020, the standard provides detailed methodological guidance to measure and disclose GHG emissions associated with six asset classes: listed equity and corporate bonds, business loans and unlisted equity, project finance, commercial real estate, mortgages, and motor vehicle loans. PCAF has subsequently issued a report detailing an emissions-reporting standard for calculating insured emissions related to commercial and motor vehicle insurance.

The report identifies the core difference between financed emissions and insurance-associated emissions, which is the nature of the relationship between a financial institution and its client. As a result, where financed emissions adopt a follow-the-money principle, insured emissions should instead adopt a follow-the-risk principle.

- **Financed emissions:** Investors should account for emissions proportionally to their share of financing in the company.
- **Insurance-associated emissions:** Insurers should account for emissions they enable and influence through the insurance contract.

The approach recommended in the standard is to apply an attribution factor to the emissions profile of the client or insurance contract, with the aim of creating a reference point from which to understand and baseline existing exposures and measure future changes in emissions.

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Commercial lines

$$\text{Attribution factor}_i = \frac{\text{Re/insurance premium}_i}{\text{Customer revenue}_i}$$

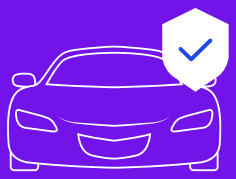
Glossary:

(Industry) Attribution factor$_p$: Attribution factor of portfolio P, which will be calculated and provided by PCAF using publicly available information and open-source research from markets globally.

(Individual) Attribution factor$_p$: Individual insurer's attribution factor of portfolio P. [10]

Re/Insurance premium$_i$ (numerator): For the purpose of this standard, re/insurance premium is defined as gross written premium (the total amount to be paid by the insured to the re/insurer for the policy written in the period) minus external acquisition costs (e.g., external brokerage fees). For multi-year contracts, an annualized premium value shall be used. Gross premium shall be also used for Fronting Policies.

Customer revenue$_i$ (denominator): Total amount of income generated by the customer through the sale of goods or services. [11]



Personal motor lines

$$\text{(Industry) Attribution factor}_p = \frac{\text{Insurance industry's total premium from the motor line of business}}{\text{Total costs associated with vehicle ownership of all vehicle}}$$

or (for cases where risk carriers are unable to use the industry attribution factor above)

$$\text{(Individual) Attribution factor}_p = \frac{\text{Insurer specific premium from the motor line of business}}{\text{Total costs associated with vehicle ownership of the portfolio P vehicles}}$$

Source: The global GHG Accounting & Reporting Standard Part C — Insurance-Associated Emissions (carbonaccountingfinancials.com)

For commercial portfolios, the reinsurer accounts for a portion of the annual emissions of the customer. This portion is determined by the ratio between the re-insurance premium for that customer and revenues generated by the customer. For personal motor portfolios, attribution can be calculated by considering factors that relate to the vehicle's use throughout its operational life while being insured, including vehicle depreciation costs, fuel costs, maintenance, registrations/taxation and parking charges and tolls. The insurance-associated emissions are determined by the ratio of the insurer's revenue received from the insured (i.e. the insurance premium) to the revenues of all other factors that are part of a vehicle's ownership. For simplification of calculation, this value is approximated by the cost of insurance related to the annual running costs of a passenger vehicle.

Insurers — through their financing decisions and insurance cover — enable economic activity, many of which are inherently risky and would not occur without the benefit of insurance. As a result, the decisions made by insurance companies to extend or restrict access to insurance based on climate impacts ultimately influences decarbonization efforts in the economy as well as people and their livelihoods.

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Challenges with capturing emissions

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One challenge that insurers face is the difficulty in obtaining accurate data from suppliers, clients and other stakeholders. Once insurers have decided what scope of emissions to include, whether from their own operations or those associated with the products and services provided, insurers will still need to standardize the data against key targets and track progress. Inconsistent data capture and a lack of skills are among other factors hindering progress.

Data availability and quality

Following the GHG Protocol principles and PCAF's Global GHG Accounting and Reporting Standard, insurers will need to adopt a systematic approach for calculating Scope 1, 2 and 3 emissions. An insurer's clients (i.e. supply chain partners) can range from large corporations that have comprehensive disclosure requirements and well-established reporting standards to small businesses and individuals with no formal data collection processes. Obtaining data and calculating insurance-associated emissions from such a diverse base becomes a considerable challenge. With specific lines of business, collecting emissions data for personal lines outside motor insurance can be challenging as there is little standardization in place. Privacy concerns and data protection rules further complicate gathering data. Collecting insurance-associated insights can also present difficulties due to potential data misalignment between insured legal entities and their emissions and revenue-reporting data.

Double counting

While double counting is not unique to the insurance industry, the structure of the sector adds complexity. Insurers are in the business of risk management; some risks are still too large to be borne by a single insurer alone, so they are restructured and spread across different players (e.g. other insurance players, re-insurance players and retrocession). This creates the problem of double counting — either of an insurance-associated emission within a reinsurer across different lines of business, between insurance and risk management service, or between different reinsurers of the same client. PCAF recognizes that double counting is a frequent and inherent part of GHG accounting and should not be problematic, as long as it does not interfere with the stated decarbonization goals. The aim of which is to get a clear view on where portfolios are connected to their customers' and investees' emissions and that all methodologies and limitations are made transparent as part of the disclosure.[12]

Absolute versus emissions intensity

Another important challenge is the choice between setting an emissions target based on an absolute metric or on the intensity of the emissions. An **absolute target** refers to the total emissions being emitted, and it aims to reduce GHG emissions by a set amount. An **intensity target** is a normalized metric that measures a company's emissions targets relative to some economic target or output such as revenue, number of employees or manufacturing production. The latter can be more flexible because it allows a business to set emissions reduction targets while accounting for economic growth. While both targets have specific advantages and disadvantages, it can be hard for insurance organizations to choose while starting their baselining particularly if they have not yet set clear decarbonization priorities and goals.

Technical expertise

Calculating emissions often requires staff with technical knowledge and subject-matter understanding across carbon measurement and abatement. Insurers are finding that hiring manpower for this task presents a barrier to action, with competing demands and business priorities. In KPMG's 2022 Insurance CEO Outlook[13], nearly 60 percent of global insurance CEOs believed that their organization was seeing increased demand from stakeholders for greater reporting and transparency on ESG issues. How insurers can achieve net zero was cited as a particular challenge, with over a quarter of CEOs reporting the lack of skills as one of the greatest barriers to meeting these targets. Compounding ESG technical talent challenges were workforce challenges generally — 24 percent of CEOs stated that attracting and retaining talent was at the top of their operational priorities for achieving their three-year growth goals in 2022.

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Questions for insurance leaders — baselining emissions

01

Emissions considerations

1. Are you able to baseline your Scope 1, 2 and 3 emissions currently?
2. How accurate is your Scope 3 emissions capture across your operational emissions, financed emissions and insurance emissions?
3. Can your current data vendors provide GHG emission collection and reporting?
4. Who is accountable for the reporting and controls around the data? CRO? CFO? Chief Sustainability Officer?
5. Can your sustainability or emissions data be assured?

02

Wider considerations

1. What are your current targets or commitments for your emissions?
2. Are these targets science based, substantiated and achievable?
3. Do you have near and mid-term milestones for your path to net-zero emissions that are transparent and accountable, which makes your long-term net-zero goal credible?
4. Has your sustainability strategy been developed with the input of the broader business?
5. Is your sustainability strategy embedded into the core of your business, and can your employees (including leadership) understand and act on your sustainability goals?

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Baselining emissions

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It's important for the insurance industry to have a standardized approach to baselining emissions. KPMG firms have developed a structured approach for insurers to start the baselining process for their both their financed and insured emissions. This captures industry best practice, including approaches to reduce emissions, and is outlined below.

KPMG's approach to baselining carbon emissions for insurers

Initial steps		Scope 3		Implementation	
Establish your current climate activity	**Set organizational and operational boundaries**	**Align asset classes**	**Collect and evaluate data**	**Calculate Scope 3 emissions**	**Set a strategy**
Discuss the work you have already done, including emissions accounting and reporting. Determine the type of target you want to set, if any. It is important to note that carbon baseline and setting emission-reduction targets are important parts of the process.	Establish control boundaries that determine which emissions are accounted (e.g. operational or financial control, equity share). Ensure the relevant entities are included within the reporting boundary.	Map assets to asset categories in methodology being used. Confirm the asset classes for which emissions will be calculated, and on which targets will be set, if applicable.	Collect data from any required or optional assets. If data is unavailable, work to identify appropriate proxies and/or emissions factors. Engage relevant stakeholders to collect activity data.	Calculate Scope 3 emissions using actual data when available and using proxy data when necessary, using an agreed methodology and appropriate attribution. Proxy data is catalogued and replaced with real data as it becomes available.	Once emissions are calculated, you can use the data in a number of ways, including to bolster business strategy and set decarbonization targets.
Ongoing stakeholder management, engagement updates and governance					

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Once insurers have a clearer idea of what their carbon emission baseline is, they are better able to make strategic, financial and operational decisions and mitigate against the increasingly uncertain regulatory, policy and climate-related impacts on their businesses.

To understand their current level of progress made regarding climate reporting, insurance companies should consider the following:

1. Collect a wide range of data on their carbon footprint and use proxies where actual data is not available. This information may come from a variety of sources, such as energy bills, vehicle and fleet tracking, and supply chain insights. Data may also include the quantities and intensities of carbon-equivalent emissions.
2. Analyze data to identify usage, using variables like carbon pricing, damage cost equivalents and impact ratios.
3. Trends and patterns in energy consumption and emissions are identified, and scenarios are built. Insurers should collaborate to learn best practices from high-emitting sectors.
4. Data should be transformed into emissions baselines. Insurance organizations will then need to apply emissions baselining to set pragmatic targets and create emission-reduction trajectories. Businesses also need to prepare and submit the relevant documents required for target validation.
5. Data and reporting are then used to support supply-chain partners to identify opportunities for emissions education in the value chain.

By showing a commitment to managing and disclosing its exposure to climate-related risks and opportunities, and tracking emissions to mitigate the risks, insurers can enhance their reputation and build trust with their stakeholders, suppliers and customers.

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Net-zero transition plans

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A robust approach and platform for emissions baselining will provide a foundation for insurers to start their transition towards net zero. An insurer's net-zero transition plan is integral to an insurer's overarching business and climate strategy. The plan can inform a comprehensive strategic roadmap that articulates how the company will achieve net zero. While the efforts to create and execute a transition plan will not be insignificant, it is necessary to maintain a social license and thrive in the low-carbon economy.

But it can be a challenge knowing where to start to make any net-zero plan a reality. For many companies, it means balancing their net-zero ambition with what is achievable given their own client base and existing exposure. Insurers often need to strike a balance between decarbonizing and generating economic gains as part of their fiduciary duties as asset owners and managing long-term physical risk exposure, which they are inherently exposed to. In doing this, they should be realistic, be transparent and make sure the transition involves the whole company. This is important given the NGO scrutiny on greenwashing and alignment to the Paris Agreement and internally, as without the whole company on board, understanding and acting on the goals of the transition, it will fail.

Many companies continue to struggle with bridging the gap between high-level strategy and execution of the strategy due to the disconnect between the central sustainability functions, which is tasked with operationalizing net zero, and the rest of the business, which needs to act on it. Organizations also face the additional challenge of integrating climate and sustainability factors into commercial considerations.

A robust net-zero transition plan should cover these broad elements:

1. Set the emissions baseline to create the net-zero pathway, which includes interim targets.
2. Create a short to medium-term prioritized action plan to achieve interim targets, focusing on emissions hotspots across business operations and product lines. The plan should be costed to understand size of opportunities and identify financing options.
3. Focus on how organizational change, systems, data and business processes should pivot to leverage opportunities in the transition.
4. Include a data plan that builds on emissions baselining and can collate and update data to feed into management information and support decision-making.
5. Develop governance mechanisms that support execution of the plan, underpinned by robust periodic reporting and accountability is included in remuneration plans.
6. Put in measures to address risks for the workforce, supply chain, communities or customers that could arise in the transition.
7. Develop an engagement strategy to work with customers, peers and government to collaborate and identify opportunities to reduce emissions across the value chain.
8. Develop measures to demonstrate resilience to the changing climate and how that resilience is being built and embedded into the organization.
9. Understand how the business may need to evolve to deliver on the transition. Ensure the workforce has the right expertise and businesses processes to adapt to the changing operating model.
10. Design a communication plan, including key message materials, with a strategy in place to manage all stakeholders from shareholders, regulators, employees and NGOs.

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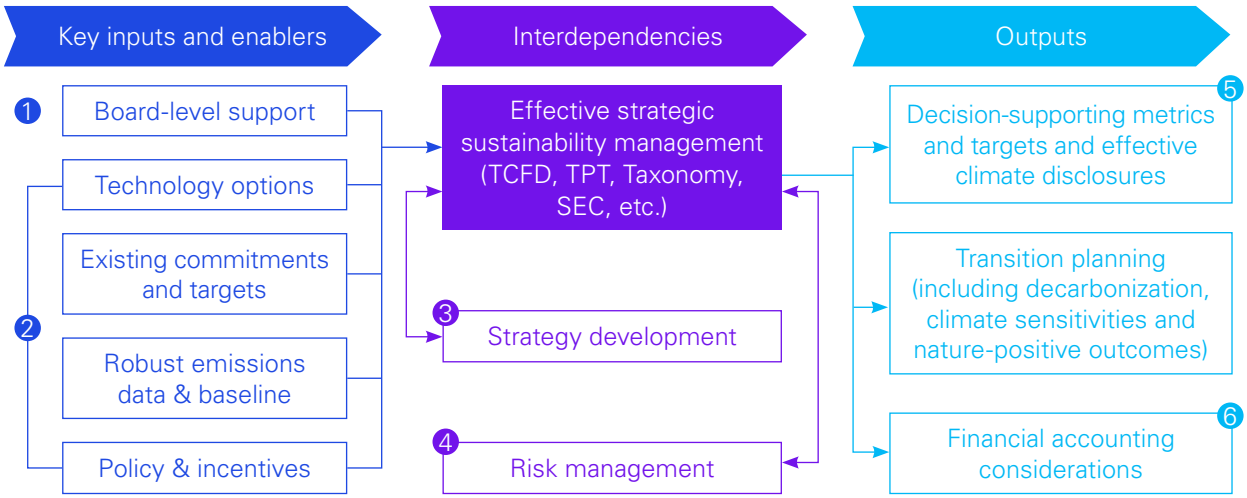
Successful integration of climate strategy can help improve organizational resilience

Global disclosure frameworks provide opportunities to embed strategic risk management of climate into key facets of a company's operations, building it into core business practice.



1. Transitioning your business involves significant strategic decisions and will require board-level engagement to support successful delivery.
2. Understand your critical levers to decarbonization. Costing these and improving underlying emissions information will give you greater confidence in ability to manage change.
3. Your climate strategy should embed in broader corporate strategy and be integrated with any existing climate scenario analysis.
4. Embedding climate top-down into risk-management processes can ensure that you deliver on your climate commitments at a business-unit level.
5. Setting the right metrics and targets to measure your performance ensures you stay on track to meet climate ambitions.
6. Where plan delivery has financial implications, these should be reflected in the financial accounts to ensure consistency.

Source: KPMG International.

The road to net zero means insurance organizations should examine their whole value chain to identify and address the biggest vulnerabilities while also supporting their suppliers to decarbonize.

Beyond engagement, the insurance industry can play to its strengths by using physical risk modelling, where insurers can leverage their advanced-prediction and risk-management capabilities to inform and track their own carbon footprint under different transition scenarios.

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ESG considerations

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While we have focused on Scope 3 emissions, they cannot be isolated from the wider ESG considerations that insurers should be considering.

Environmental

- **Biodiversity loss:** Climate risk and biodiversity loss go hand in hand. Biodiversity loss is an increasing concern for financial services organizations and undermines nature's ability to support a healthy environment. For insurers, this could mean an increase in claims due to natural disasters or higher mortality rates due to toxic environments. The Taskforce on Nature-related Financial Disclosures is due to bring out a framework allowing for organizations to report and act on evolving nature-related risks. While it seems obvious, remember that nature is key to help mitigate carbon emissions and build resilience to climate change. Biodiversity loss includes the loss of nature and natural ecosystems such as water and soil quality, ocean acidification and loss of endemic species.

Social

- **Health and safety:** Insurance companies are becoming increasingly active at influencing the health and safety policies of the companies to which they provide insurance. This includes aspects like labor practices, culture behavior and employee voice as well as talent management. Creating a safe workspace can also help to nurture and attract talent.
- **Product labeling:** Ensure the marketing, advertising and labeling of insurance products is transparent and fair. From an ESG perspective, this means transparency and disclosure around ESG, green and social-labeled funds and products. There is a need to ensure that commitments made are verifiable and fully operational in order to avoid greenwashing. Having a robust and defensible understanding of your ESG impacts, responsibilities and requirements will help guide appropriate decision-making and reduce risk. Independent assurance on this data may also help to instill trust and promote more customers to invest in green/socially linked products.
- **Human rights:** Insurance companies should be aware of human rights issues before underwriting any insurance policy to avoid litigation. Social issues risk significant reputational fallout if not managed properly. Litigation risks are arising from the emergence of social inflation affecting claims volumes and expenses, as well as political/regulatory influences on greenwashing and fiduciary duty conflicts.
- **Sustainable transition:** Insurance firms can play a significant role in a just transition to a more sustainable low-carbon economy. Businesses can contribute through sustainable insurance products, engagement and advocacy, risk mitigation and loss prevention, ESG-linked investment strategies, and collaboration and partnerships with stakeholders.

Governance

Governance is a critical element of a transition plan. According to KPMG's 2022 Global CEO Outlook, 23 percent of the CEOs indicate that one of the greatest barriers to delivering on a transition plan is lack of adequate internal controls to operationalize the plan. Consider instituting a formal governance mechanism that includes these four pillars:

Oversight by the board and C-suite	Well-defined responsibility and accountability	Robust risk management framework	Communication
• Ensure the transition plan is signed off by the board. • Regular updates are provided to steering group/board to ensure the process goes according to plan.	• Ensure there is one dedicated lead for all sustainability activities and a company-wide level, directly overseen by the CEO/group CFO. • Create dedicated teams for data management, reporting, transformation and communication.	• Configure a comprehensive risk-mitigation framework that helps identify, assess and manage climate-related risks and opportunities.	• Develop a robust communication plan aimed at internal and external stakeholders, highlighting progress of the transition plan.

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Wider ESG approaches

Insurers may also need to examine their emissions strategies as part of wider ESG approaches. Consider the following examples related to the value chain, the regulatory landscape and technology:

Value chain

As discussed earlier, there are a variety of ways insurers contribute to reduce Scope 1, 2 and 3 emissions. From a decarbonization standpoint, insurers should consider:

- Developing a sustainable risk assessment framework that can assess climate change risks and consider net-zero goals while underwriting any kind of insurance
- Accounting for financed and insured emissions
- Developing sustainable/green risk transfer products, which will permit capital market investors to play a more direct role aimed at decarbonization.

Regulatory landscape

The regulatory landscape is evolving at a rapid pace. While the SFDR, the Carbon Border Adjustment Mechanism and the Corporate Sustainability Reporting Directive are being implemented across the EU, further climate disclosures are anticipated, mandated by the SEC in the US and ESG disclosure in other jurisdictions from the ISSB. Under these regulations, insurers will need to disclose their Scope 1, 2 and 3 emissions to avoid penalties. It is worthwhile for insurers to consider:

- Having processes to anticipate upcoming regulations and adapting operations and business accordingly (gap assessments can help ensure organizations have the data that is required to disclose)
- Conducting scenario analyses of current and upcoming regulations to assess their impact
- Ensuring regulatory compliance and investing in decarbonization to bring potential tax benefits and help generate additional revenues
- Implementing internal practices, such as the three lines of defense model, to ensure data are reported correctly and errors are kept to a minimum
- Ensuring data can be audited with as much granularity as possible.

Technology

Investing in key technologies like machine learning, artificial intelligence and robotic process automation could help decarbonize key elements of the value chain, such as underwriting, claims management and policy servicing. These technologies can be used to:

- Assess emissions hotspots across the underwritten portfolio, which can be used to develop decarbonization strategies
- Allow real-time monitoring of emissions across the insurance value chain and configure appropriate reduction strategies
- Help develop algorithms to drive sustainable underwriting and drive decarbonization initiatives.

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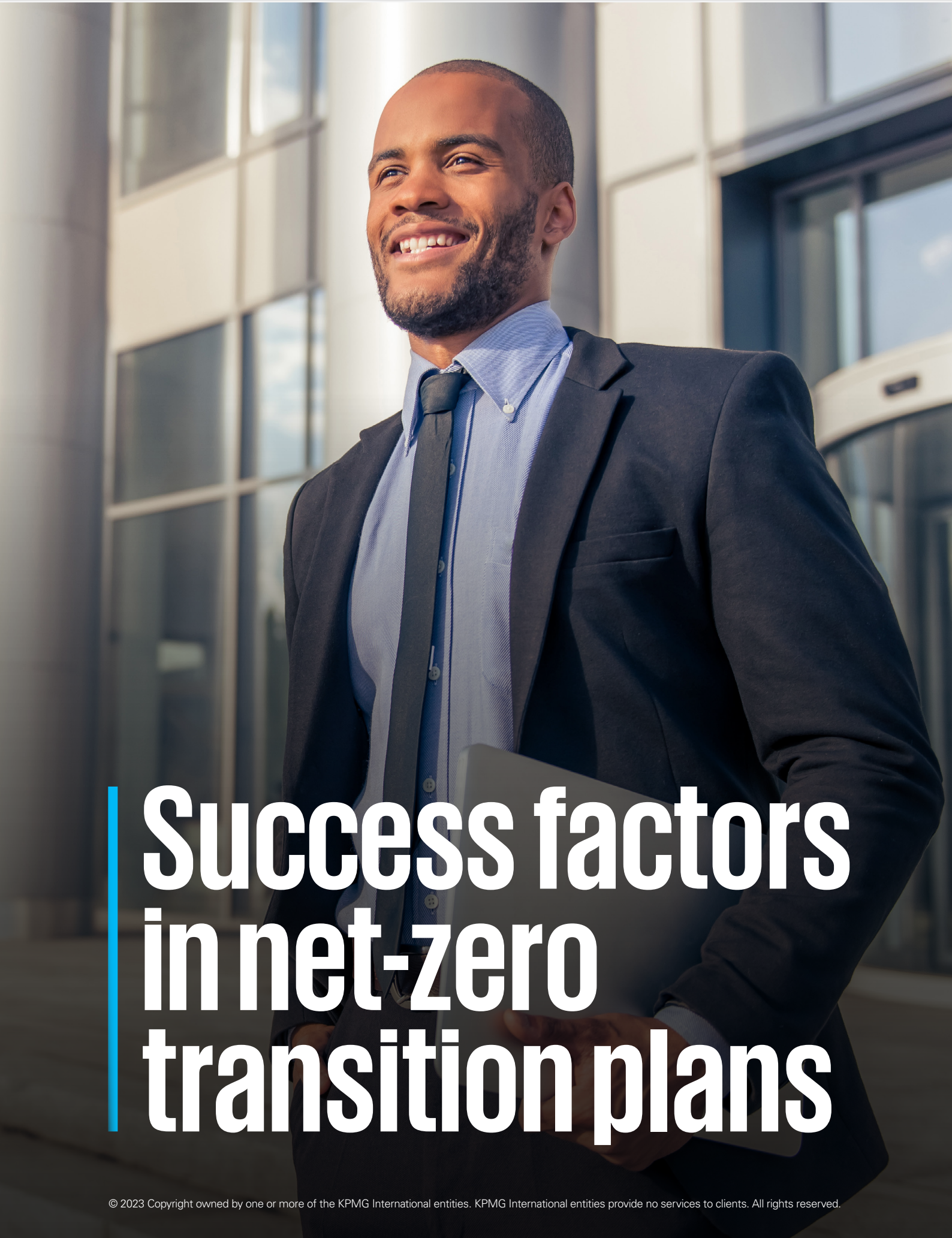

Success factors in net-zero transition plans

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A successful transition plan should underpin the business case and strategic direction for enterprise-wide transformation, and it should be driven by the board and company leaders. It should not only complement the broader corporate strategy but also be closely integrated with the company's value chain and day-to-day operations. Leaders should ensure that net-zero transition plans are embedded in decision-making. In a study published by KPMG in France focusing on European insurers[14], one of the key success factors of net-zero plans was if ESG-related measures were understood and actionable across the wider business (i.e. if they were fully integrated into the standard business and decision-making processes).

Transition plans require significant financial commitments, so consider and address how it could impact an insurer's finances, including detailed cost pathways that indicate the extent and type of business developments required. This is particularly important, as the transition should be wide in scope and include wider climate risks and opportunities, nature and biodiversity, and additional social and governance considerations.

Collaboration with stakeholders and suppliers

The insurance industry has an important role when it comes to transitioning other stakeholder and suppliers to more sustainable business and operating models. One way to influence behavior is through the products and services they engage when dealing with insurance claims.

Some of the larger insurance companies and industry bodies already have initiatives underway. Steps include taking account of emissions-reduction strategies and targets in supplier onboarding, making sustainability a factor in decision-making on suppliers, tracking emissions and approaching product and services with a circular-economy mindset.[15]

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Example insurance carbon reduction initiatives

Motor insurers are looking to work with suppliers to insure new activities related to product disassembly, refurbishment and recycling, as well as to imagine new kinds of insurance to promote a more circular economy.

Stewardship and actively managing investments is another method that insurers can use to influence organizations to lower their GHG emissions. For example, Zurich Insurance Group has integrated ESG data into its internal systems to drive investment decisions and track the of its portfolios against key ESG parameters.[16]

Measuring investments against ESG parameters is also facilitating a better understanding of where Zurich's asset managers are in terms of their ESG capabilities and ability to assess assets against ESG criteria.

Allianz Insurance has launched a sustainable procurement charter to encourage its suppliers to adopt and develop sound ESG practices.

UK insurer Aviva has prepared its transition plan and articulated interim climate goals and targets. It sets out how it pledges to be net zero by 2040:

- In 2021, Aviva stopped underwriting insurance for companies making more than five percent of their revenue from coal or unconventional fossil fuels, unless they have signed up to science-based targets.
- The insurer is expected to invest a further £10 billion in assets from auto-enrolment default fund and other policyholder funds into low-carbon strategies.

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Act now or pay later

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The industry insurance should become more involved in the emissions-reduction conversation. And with the growing impact of climate change on the weather — in 2022, weather-related insurance losses totaled more than US$120 billion according to some estimates[17] — the uncertainty and scale of the problem grows every year.

In 2021, the Bank of England carried out its first assessment of the impact of climate change on the banking and insurance sector in the UK. Its model showed that if no additional action was taken, that the UK insurance sector could expect to see a rise in average losses of around 50 to 70 percent each year due to weather-related climate change.[18]

The industry must address the carbon footprint of insurance business, their supply chains and the investments and assets the sector supports.

Every journey starts with a first step, and emissions baselining can be that first initiative. Once established and integrated into the wider financial and operational functions, this provides a starting block to measure where insurers are on their decarbonization journey, and how far they still need to go to meet their organization's commitments.

But the journey will have its share of challenges. Capturing and tracking baseline emissions requires extensive data management, new tools and skills. Also, insurers will need to engage with their suppliers and customers to encourage them to reduce their impact on the environment too. They need to be supported by their leaders and by strong governance.

With a little time and effort, new processes like emissions baselining can become part of day-to-day operations. Fortunately, one of the insurance sector's major strengths is its ability to deal with and adapt to change.

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Contacts

Frank Pfaffenzeller
Global Head of Insurance
KPMG International
E: fpfaffenzeller@kpmg.com

Jacques Cornic
Head of Insurance
EMA Region and Partner
KPMG in France
E: jcornic@kpmg.fr

Roger Jackson
Global Insurance ESG Lead
KPMG International and Partner
KPMG in the UK
E: roger.jackson@kpmg.co.uk

Simon Weaver
ESG Strategy, Transformation and Implementation Lead and Partner
KPMG in the UK
E: simon.weaver@kpmg.co.uk

Jonathon Ko
Insurance Lead for ESG and Partner
KPMG China
E: jonathon.ko@kpmg.com

Mark Spicer
Partner, ESG Advisory and Assurance
KPMG Australia
E: markspicer@kpmg.com.au

Sean Vicente
Insurance Lead for ESG and Partner
KPMG in the US
E: msvicente@kpmg.com

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

Kaisie Rayner
Martine Botha
Riona Bowhay
Nadia Montoto
Krishnamoorthy Subban
Stuart Bruce
Jheryl Cabey

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