The COVID-19 pandemic has led to an unprecedented disruption to lives and businesses. It has also presented an equally unparalleled opportunity to change and accelerate action in areas that were not the forefront of attention before, one of these being Environmental, Social and Governance (ESG) matters. The concept of ESG is not new by any means, however developments in this space have accelerated in the past two years. What was once only part of the “sustainability arm” of operations or dealt with in various sub-committees, has now risen to the top of boardroom agendas in an encompassing manner.

ESG has applicability across the globe to every organisation, industry, and sector, whether public or private. These matters should not be seen in isolation as they penetrate every aspect of business including strategy, policies, risk, and day-to-day operational considerations.

Insights

Businesses are finding that stakeholder ESG awareness has become heightened and more answers are demanded in terms of demonstrating the role they play in addressing the environmental, social, and economic challenges presented. Performance is no longer measured just by the financial bottom line, but rather through understanding the organisation’s economic, social, and environmental impacts and how the related risks and opportunities are managed. There is a need for enhanced ESG disclosure that goes beyond reporting on lagging indicators and talks to impact measurement and reporting.

The KPMG 2020 CEO Outlook survey identified a change in priorities of corporate leaders, as noted below. In this evolving environment there is a clear need for businesses to understand their purpose and impact on society. It is critical to be able to adapt to maintain success and enhance resilience.

A year later, the KPMG 2021 CEO Outlook Survey2 (which included the views of a number of CEOs of insurance companies) identified the following: 10% of South African companies rate environment and climate risk change as one of the top three risks that pose the greatest threat to an organisation’s growth, with the global average not far off at 12%.

Key changes in CEO’s thinking found in the survey

- Integrating ESG reporting into measurement and reporting processes was identified by 6% (global: 15%) of South African companies as a top operational priority in order to achieve growth objectives over the next three years. However, 58% (global: 52%) of South African companies are seeing an increasing level of demand from stakeholders (investors, regulators and customers) for increased reporting and transparency on ESG matters. 51% (global: 52%) of the demand and pressure is coming from institutional investors, 34% (global: 29%) from regulators, 11% (global: 5%) from employees and new hires and 3% (global: 14%) from customers.


The South African Insurance Industry Survey 2021 - proudly published for more than twenty years
Key challenges identified by South African respondents in communicating ESG performance to stakeholders include:

- Respondents were also asked to indicate the impact of the company’s ESG programme on financial performance. 48% (global: 27%) of respondents indicated a reduction in financial performance, 20% (global: 25%) an improvement in financial performance. 16% (global: 45%) indicated negligible or no impact on financial performance with 16% (global: 11%) indicating a significant improvement on financial performance.

- Lastly, respondents were asked to indicate what percentage of revenue will be invested in programs that will enable the organization to become more sustainable:

  - 5% or less
  - 1-5%
  - 6-10%
  - 11-15%
  - 16-25%
  - 26-35%
  - Greater than 36%

Why should ESG matters be considered in the insurance industry?

Through their roles as risk managers, risk carriers, and investors, insurers are well positioned to lead and address emerging ESG challenges. In the past, ESG issues may not have been variedly integrated into investment analysis and decision-making by investors; this is changing. There is an increased appetite to understand how ESG factors and an organization’s improved performance are intertwined.

It is known that the insurance industry is highly affected by environmental changes. It is critical that material climate risks and exposures are identified and measured and responded to through governance, strategy, risk management, product offerings, and overall reporting. The role that this industry plays is vital in the transition to a low carbon economy.

The South African Insurance Industry Survey 2021 - proudly published for more than twenty years

KPMG’s Survey of Sustainable Reporting1 2020 sampled 200 of the largest companies by revenue in 52 countries and noted the following trends in ESG reporting:

- 80% of companies worldwide now report on ESG or Sustainability – with 96% of the top 100 companies in South Africa reporting on ESG or Sustainability publicly.

- One in five companies globally report climate risk with recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD).

- Globally, more than 70% of companies are now disclosing carbon reduction targets in their reporting and a growing number are linking these targets with financial performance. Of these external linkages, the most popular climate goals was to link targets to the Paris Agreement goal to limit global warming to 2°C above pre-industrial levels.

- The United Nations (UN) Sustainable Development Goals (SDGs) have also begun to resonate strongly with businesses. Close to 75% of companies globally connect their business activity to the SDGs in their corporate reporting in some way, although, there is a significant room for improvement in the quality of reporting.

- The transition of companies to reduce carbon emissions is somewhat slower. Through their roles as risk managers, risk carriers, and investors, insurers are well positioned to lead and address emerging ESG challenges. In the past, ESG issues may not have been variedly integrated into investment analysis and decision-making by investors; this is changing. There is an increased appetite to understand how ESG factors and an organization’s improved performance are intertwined.

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Social risks also have a significant impact on the industry, and these should equally be considered and addressed. KPMG’s 2021 CEO Outlook Pulse Survey3 noted such heightened focus on environmental and climate risk.

Continued focus on environment and climate risk

- The following ESG issues are material to the insurance industry and developing mechanisms to manage and report on these could lead to improved performance:

  - Climate change
  - Carbon emissions
  - Air and water pollution
  - Deforestation
  - Water management
  - Gender and diversity


Environmental issues:

- Climate change
- Carbon emissions
- Air and water pollution
- Deforestation
- Water management
- Social inclusion
- Data protection and privacy
- Gender and diversity

Social issues:

- Executive remuneration
- Lobbying
- Boards and committee composition
- Whistle-blower policy

Goverance related issues:

- Board diversity
- Executive remuneration
- Lobbying
Environmental risks similarly may lead to a wider spectrum of potential knock-on impacts that insurers should be considering when modelling such scenarios and considering in their management actions. Rising temperatures and climate-induced extreme weather events are resulting in both more frequent and more intense events and subsequently property and health risks. However, rising temperatures and climate change also lead to more frequent extreme weather events, which result in both higher frequency and higher severity of claims - and thus higher losses. Insurers’ stress testing processes need to be enhanced in order to capture all the potential knock-on impacts that insurers could be facing.

In addition to these climate-related activities, the International Association of Insurance Regulation (IAA) established the Taskforce on Climate related Scenario Testing (TCR) Task Force to develop on several IAA activities related to climate-related risks. The objective of these activities is to contribute to global efforts to further identify climate and manage climate risks. The Taskforce has, to date, released three papers in a series aimed at creating awareness and promoting actualised approaches in climate-related risk management and reporting including the use of, and formulation and implementation of climate-related scenarios that insurers employ in order to manage and limit such risks and the resultant reputational damage.

Reporting landscape

Whilst ESG reporting is becoming more mainstream, some challenges remain. Under the ESG reporting frameworks, standards, and the amount of data that companies have access to in reporting fatigue and confusion in deciding on where and how much to report are major obstacles, and the effects of ESG-related risks are not covered. Several reports and procedures are in place to improve this.

In South Africa, insurance companies have begun to respond to the changing landscape. Performance in terms of environmental and corporate social investment commitments is more common amongst reports. For example, disclosure around alignment to UN Principles for Responsible Investment (UN PRI), SDGs and the Code for Responsible investing in South Africa (CIRIS4). Momentum is gathering in terms of alignment, even among insurers, with the CIRIS4 and Climate Related Financial Disclosures; however, many are still grappling with how this is to be implemented.

In a partnership between the World Economic Forum International Business Council, Bank of America and the Big Four professional services firms resulted in a White Paper entitled “Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation”. The White Paper does not create new standards or metrics, but provides a framework and standard setters are starting to provide meaningful, comparable and transparent information to stakeholders.

In South Africa, the National Treasury in its draft Ezekwezel Report released in May 2020 “Pathing a growth path for financial institutions to better disclose public information on their green products and investments” includes specific recommendations for authorities to develop more explicit and comparable disclosure requirements. These tools help businesses and investors make more informed decisions about which companies to invest in.

Conclusion

The rapidly changing landscape is driving businesses to evaluate their purpose and redefine their strategies, products and range of operation. Businesses need to understand, evaluate and measure their economic, social and environmental impacts and be responsive to the changing future. Whilst the focus on the environmental impact is ESIA continues to remain important, the social impact requires much more attention and insightful action. Success and resilience will be measured by businesses’ ability to understand and embrace the three areas equally.

Notes


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