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How ESG is shaping business decisions and delivering value: A conversation with Sustainability Executives

We know from our regular conversations with clients that ESG has become a board-level priority. Insurers are making the connection between sustainability and optimised business models, and so ESG is becoming increasingly integrated into insurers' value propositions and firm-wide strategies. Operating with sustainable principles tied to core business functions provides strategic advantage – offering a license to operate, an area of competitive advantage as well as attracting investment.

In this article we interviewed a Chief Sustainability Officer, the Head of Investor Relations and ESG, as well as a Chief Legal Officer at three South African insurers, to understand how sustainability has been integrated across their businesses. This information has been distilled into several key themes, to provide insight into some of the common success factors and pain points in implementing ESG initiatives by insurers in South Africa.

Where the Chief Sustainability Officer (CSO) sits will help define their success

For the CSO or equivalent to make an impact, it is imperative that they have the sponsorship of the executive office, such as the Chief Executive Officer, Chief Strategy Officer or equivalent. This level of sponsorship indicates to the business how serious the company is about the integration and uptake of sustainability throughout the business, rather than taking a business line view. This sponsorship can also make key investment and business decisions easier to initiate. Implementing a sustainability framework or ESG performance-linked renumeration may have quicker adoption and buy-in if mandated by the Board and C-suite.

ESG has grown globally as a theme, but domestically it is still catching up

There was a consistent view by those interviewed that South African insurers are on par with global peers when it comes to 'G' (governance) issues. This is largely to do with the action by regulators since 2018 and the uptake of the King IV Code (the Code). The aim of the Code is to provide a practical, principle-based approach to good corporate governance, which also incorporates both global public sentiment and international regulatory change[1].

On the 'E' (environmental) side, insurers have always taken climate risk into consideration when modelling catastrophic weather events. Actuaries at insurers use historical data to estimate the frequency and severity of future weather-related events - information that is then incorporated into premium calculations. What is new however, is the financial disclosures linked to climate risk which many banks and insurers are now grappling with. This is topical given the recent guidance notes from The Prudential Authority.

[1] Beyond Governance (2022) The King IV Code. Available at The King IV Code – Beyond Governance (https://beyondgovernance.com/king-iv-code/). (Accessed on 06.09.2023)

The Prudential Authority released two proposed guidance notes for insurers on this topic in August 2023. The first aims to assist insurers with complying with the requirements outlined in the Governance and Operational Standards for Insurers (GOI). The guidance notice provides guidelines on managing climate related risks, specifically addressing GOI 3 (Risk Management and Internal Controls for Insurers) and GOI 3.1 (Own Risk Solvency Assessment for Insurers) as they apply to climate-related risk. The second proposed guidance note provides guidance to insurers on climate-related disclosures, aligning with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)[2]. The objectives of the proposed guidance note include promoting market discipline, building capacity and capabilities, and providing meaningful information to stakeholders. The guidance covers four key areas: governance, strategy, risk management and metrics and targets. It also encourages insurers to be proactive in managing and disclosing climate related risks and highlights the need for internationally comparable metrics.

Not surprisingly, "S" (social) factors are top of mind for South African insurers, but these are difficult to address as the quantification of social outcomes is complex. With catastrophic weather events becoming more prevalent, many non-life insurers need to make decisions about continuing to underwrite assets that are in high-risk weather zones. Continued pay-outs due to catastrophic weather events can risk the solvency of some insurers. For many people living in flood or fire prone areas however, lack of insurance coverage could severely compromise their ability to generate income. In this way, socio-economic factors need to be played off against environmental factors. Many insurers are increasing the price of premiums and letting the market dictate whether or not people continue to live or do business in certain areas. In some foreign jurisdictions, insurers are leveraging industry-wide efforts to educate policyholders and lawmakers about how to fortify properties against severe weather events.

The South African context is also unique due to additional ESG factors such as loadshedding (which is arguably an environmental, social and governance issue), as well as the increased likelihood of political unrest. For many non-life insurers, the list of policy exclusions is becoming longer to ensure that the insurer is not taking on undue risk in the event of grid failure or riots and looting. Insured losses for the 2021 Kwa-Zulu Natal riots were estimated at R15 billion, a reason why Sasria SOC Limited is required to be adequately capitalised to respond to such events[3].

Leading insurers helping to drive their stakeholders to behave in more sustainable ways through incentivisation schemes

Some insurers have integrated sustainability into their remuneration cycle - this means including ESG metrics in incentive scorecards that meaningfully support the organisation's sustainability strategy. In Old Mutual's Renumeration Report 2022, remuneration varies depending on performance in the areas of customer growth and experience, employee engagement and contribution to investing in a sustainable economy[4]. Many leading financial institutions are now integrating ESG metrics into the performance rating of staff, using this to drive more sustainable behaviours or consider aspects of their portfolios that could be carried out in a more sustainable way.

For insurers serving a certain demographic, many are aware that financial literacy proves an ongoing challenge for their clients. With the backdrop of a national literacy crisis, many clients do not fully understand the financial products they are purchasing.

2 Prudential Authority (2023) Proposed Guidance Notice-Climate related disclosures for insurers. Available at: Proposed Guidance Notice-Climate related disclosures for insurers (resbank.co.za). (Accessed on 05.09.2023) (https://www.resbank co.za/en/home/publications/publication-detail-pages/prudential-authority/pa-documents-issued-for-consultation/2023 Proposed-Guidance-Notice-Climate-related-disclosures-for-insurershttps://www.resbank.co.za/en/home/publications publication-detail-pages/prudential-authority/pa-documents-issued-for-consultation/2023/Proposed-Guidance-Notice-Climate-related-disclosures-for-insurers)

3 Sasria Soc Ltd (2021) Parliamentary Committee Presentation 24 August 2021. Available at Unpacking Government's economic rebuilding package (thedtic.gov.za) (http://www.thedtic.gov.za/wp-content/uploads/SASRIA.pdf) (Accessed on 11.09.2023).

4 Old Mutual (2022) Renumeration Report for the Year End 31 December 2022. Available at Old Mutual Remuneration Report 2022 (https://www.oldmutual.com/v3/assets/blt566c98aeecc1c18b/blt1bd39a1605b9e6a3/64463d4239d7ae499433946e/Remuneration_Report_2022.pdf). (Accessed on 11 September 2023).

A recent study from the Financial Sector Conduct Authority highlighted that 40% of respondents surveyed indicated that their understanding of financial products and services was either neutral or they did not understand the products and services they had purchased[5]. This knowledge asymmetry is one of the reasons that customers can be sold policies that are unsuitable for their needs and can risk being exploited. Some South African insurers are combatting this by providing online education programs to help their clients become more familiar with financial terminology and financial planning. In the case of Old Mutual for example, completion of these online courses can result in incentives for customers, such as reinvesting points earned to qualify for certain products.

Discovery is another insurer looking to influence behaviour change through incentivisation schemes. For example, Discovery's Discovery Insure app tracks their customer's driving, and deducts points based on poor braking, screen time whilst driving or other key metrics. Points accrued through good driving can be used for fuel discounts and other partnerships. Discovery's products, such as their Vitality scheme, demonstrate their belief that customer education is driven through behavioural education. The outcome of these schemes – better driving and better health - are not only good for the customer, but good for Discovery's bottom line. This shared value model transforms a traditional grudge purchase into a driving force for social change.

Regulation – tying it all together

Whilst South Africa now lags behind Europe in terms of ESG reporting, many insurers are cleaning house to ensure that if ESG reporting is mandated, they are ready to report. With the International Sustainability Standards Board's (ISSB) disclosure requirements now released, insurers are checking to see if there are any gaps in their data collection to report against IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures*. Whilst the standards will be effective from 1 January 2024, it will be up to the Prudential Authority to decide if this is mandated in South Africa. Some countries will adopt it all, others, like Canada, have indicated they are likely to adopt parts of this regulation. Although daunting, the ISSB has not started from scratch - the standards consolidate and build on existing frameworks, including the TCFD and Sustainability Accounts Standard Board (SASB).

Consistency in how companies report globally - provided by the ISSB standards - is important to support investor decisions as it creates a level playing field for companies seeking investment. It is no coincidence that insurers with foreign investors are ahead of the curve when it comes to reporting. Many insurers are focussing on reporting readiness as a competitive strategy, using data to tell a meaningful story about their ESG focus areas and tying these back to their strategies.

Yet keeping up with, let alone ahead of, regulatory requirements is difficult and expensive. Legacy systems, a lack of a qualified staff, double counting and patchy data are just a few of the issues we've heard about from our clients, both in South Africa and abroad. Challenges around data are compounded for insurers - for example, data in respect of greenhouse gas emissions of the companies that insurers underwrite will need to be validated and reported on under IFRS S2. Many insurers have adopted the mantra 'don't let perfection get in the way of progress' and acknowledge that ESG data collection will likely be a process of trial and error for several years. Once ESG data is audited, clients will be better able to identify their pain points and put processes in place for better data capture and validation.

Whilst the insurers interviewed are at different levels of maturity, all are working towards a business model that integrates ESG. The competitive advantage that can be unlocked from integrating ESG into the business was recognised by those interviewed, who were incorporating ESG into all aspects of the business including strategy, underwriting, reporting and product design. By aligning operations with environmental, social, and governance principles, insurers position themselves as integral partners in safeguarding both financial stability and the well-being of our environment, as well as driving commercial value for their investors.

With thanks to the contributors:

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- David Danilowitz, Head of Investor Relations and ESG, Discovery Limited

[5] Financial Sector Conduct Authority (2023) Press Release, 3 August 2023: Release of inaugural FSCA Financial Customer Behaviour and Sentiment Study Results. Available at FSCA Press Release - FSCA Retail Financial Customer Behaviour and Sentiment Study results_03 August 2023.pdf (https://www.fsca.co.za/News%20Documents/FSCA%20Press%20Release%20-%20FSCA%20Retail%20Financial%20Customer%20Behaviour%20and%20Sentiment%20Study%20results_03%20August%202023.pdf). (Accessed 3 August 2023).