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# Using ESG as a framework to drive commercial benefit and opportunity

**Shifting population demographics, environmental patterns and emerging regulations are important to consider when creating innovative insurance products that will meet the demands of customers.**

By prioritising Environmental, Social, and Governmental (ESG) themes based on their capabilities and aspirations, insurers can create tangible value from the current focus on ESG. This article looks at some of the changes we see across E-Environment, S-Social and G-Governance elements in the South African context, and how insurers can take these factors into account when designing products that are impactful and commercially beneficial.

## E-Environment

Anyone living in Gauteng will be familiar with the smog that fills the air on a sunny and calm winters day and the sight of power plants is not unfamiliar to people living anywhere in South Africa. We rely on coal for 65% of our energy supply, on crude oil for 18% and the remaining 17% comes from gas, geothermal, nuclear and renewables and waste[1].

The World Health Organisation claims that exposure to high levels of air pollution can cause a variety of adverse health outcomes, including increased risk of respiratory infections, heart disease and lung cancer[2]. Both short- and long-term exposure to air pollutants have been associated with health impacts. An International Growth Centre (IGC) study indicates that 7.4% of all deaths in South Africa in 2012 were due to chronic exposure to fine particulate matter (PM), costing the country up to 6% of its GDP. The health impacts of emissions from power stations have received particular attention, with Myllyvirta (2014) and Holland (2017) calculating that around 2 239 deaths per year in South Africa are due to particulates from coal-fired power stations[3].

There are various ways the insurance industry can protect its policyholders from the adverse effects of poor air quality. These include:

- **Health insurance:** A study in 2017 found that short-term exposure to fine matter (PM2.5) and Ozone ($O_3$) was associated with increased health insurance claims related to respiratory diseases, cardiovascular disease and diabetes[4]. Real-time air quality insights can help insurance companies with better underwriting, especially for health insurance plans. Insurers could consider creating parametric insurance products, that provide coverage if the air quality index in a policyholder's area exceeds a certain threshold. This pay-out could help policyholders cover medical expenses related to pollution-related health issues. Parametric cover is an increasingly efficient, affordable and viable option in the market as data and models improve.

1 Mineral Resources and Energy: Republic of South Africa. (2021) South African Energy Sector Reporting. Available att 2021-South-African-Energy-Sector-Report.pdf (https://www.energy.gov.za/files/media/explained/2021-South-African-Energy-Sector-Report.pdf) (Accessed, 31.01.2023)

2 World Health Organisation. (2019) Health Consequences of air pollution on Populations. Available at: Health consequences of air pollution on populations (who.int) (https://www.who.int/news/item/15-11-2019-what-are-health consequences-of-air-pollution-on-populations#:~:text=Exposure%20to%20high%20levels%20of,people%20who%20are%20already%20ill.) (Accessed: 28.07.2023)

3 Altieri, Katye and Keen, Samantha (2015). The Cost of Air Pollution in South Africa. Available at: The cost of air pollution in South Africa | International Growth Centre (theigc.org) (https://www.theigc.org/blogs/cost-air-pollution-south-africa) (Accessed 28.07.2023).

4 deSouza P, Braun D, Parks RM, Schwartz J, Dominici F, Kioumourtzoglou MA. Nationwide Study of Short-term Exposure to Fine Particulate Matter and Cardiovascular Hospitalizations Among Medicaid Enrollees. Epidemiology. 2021 Jan;32(1):6-13. doi: 10.1097/EDE.0000000000001265. PMID: 33009251; PMCID: PMC7896354.

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- **Crop and agricultural insurance:** Air pollution effects can manifest visually in plants through "yellowing" - a term that refers to reduced growth, injury, or premature crop death. Yellowing is a sign of nitrogen deficiency, demonstrating how short-lived air pollutants as well as ground-level ozone disrupt crop cycles and development[5]. Agricultural insurance products can be adapted to cover crop losses or damage resulting from adverse air quality conditions, such as pollution-induced yield reductions.

- **Climate risk insurance:** Insurance products can be designed to address climate-related risks, including those arising from poor air quality due to pollution and wildfires. In a South African context, those who still struggle to afford insurance might pay for climate risk cover through an insurance for assets (IFA) scheme. Here, they will be awarded cover in exchange for taking part in disaster risk reduction activities, such as building firebreaks in their communities. If fires are kept under control, they are more likely to be extinguished quickly and less particulate matter will be emitted into the atmosphere.

- **Product innovation:** Insurance programmes that incentivise emission reductions and air quality improvements can indirectly contribute to climate change mitigation efforts. Developing products that encourage cleaner technologies and practices can lead to improved air quality and reduced greenhouse gas emissions. Product innovation in this area is ramping up, with insurers offering cover in areas such as credit line and project finance risk cover for renewable energy products, renewable energy project tax credits as well as traditional renewable energy insurance to name a few. In 2021, The Insurance Task Force (ITF), as part of His Royal Highness The Prince of Wales' Sustainable Markets Initiative (SMI) published the *Sustainable Products and Services Showcase* detailing the wide-ranging insurance products and services that are empowering customers to develop, invest in and scale their sustainability initiatives[6].

Insurers can abate unhealthy $CO_2$ emissions in their own business operations and by reducing the $CO_2$ emissions caused by upstream and downstream activities. This is especially relevant for insurers who invest in and underwrite fossil fuel companies.

For example, one UK-based insurer 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, the insurer stopped underwriting insurance for companies making more than five per cent of their revenue from coal or unconventional fossil fuels, unless they have signed up to science-based targets; and

- The insurer is expected to invest a further £10 billion in assets from auto-enrolment default funds (default funds for clients who do not express an opinion or choice) and other policyholder funds into low carbon strategies[7].

## S-Social

South Africa's population is estimated at 60.8 million per the 2022 Mid-Year Population Estimates census, making it the twenty fifth most populous country in the world. According to the census, the country's population has hit a "sweet spot", with a highly favourable age distribution profile: a large youthful and working-age population and proportionally fewer very old citizens and very young children[8].

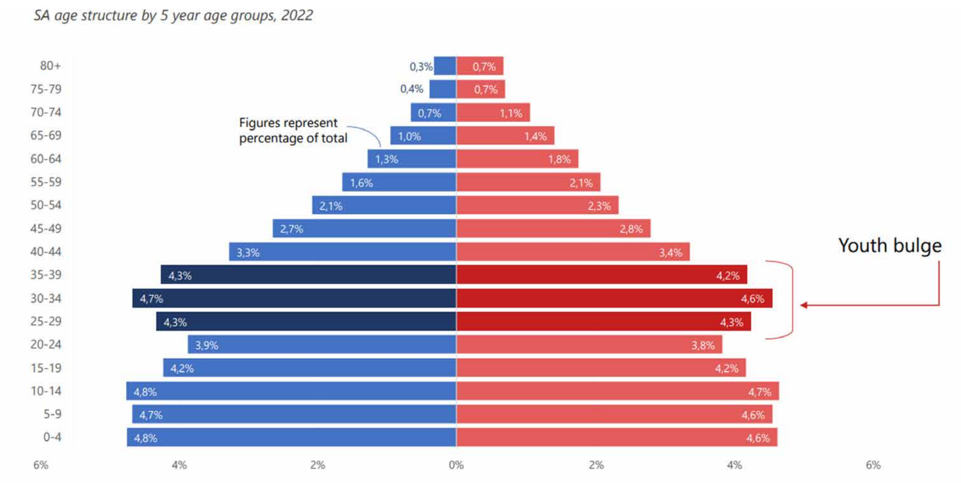
[5] Bishop, Sienna. (2022) The two-way relationship between agriculture and air pollution. Available at: Agriculture and Air Pollution: how are they related? (clarity.io) (https://www.clarity.io/blog/the-two-way-relationship-between-agriculture-and-air-pollution). (Accessed: 31.07.2023)

[6] Sustainable Markets Initiative (2021). Sustainable Markets Initiative: Insurance Task Force. smi-itf_products-and-services-showcase.pdf (storyblok.com) (https://a.storyblok.com/f/109506/x/c0c3181f7e/smi-itf_products-and-services showcase.pdf) (Accessed 10.08.2023).

[7] Aviva (2021). Aviva's Climate Transition Plan: First Release. Available at: 2021-climate-transition-plan (1).pdf https://www aviva.com/sustainability/climate/. (Accessed 08.10.2023)

[8] Statistics South Africa, Republic of South Africa (2022), Stats SA Media Communications – 11 November 2022. Available at: Stats SA Media Communications | Statistics South Africa (https://www.statssa.gov.za/?p=15916) (Accessed 31.07.2023)

**South Africa has a youthful population, with a significant youth bulge aged 25-39**




*Key: red is female, blue is male*

*Source: Stats SA, Department of Statistics, Republic of South Africa. Mid-year population estimates, (2022) Mid-year population estimates, Available at: Mid Year 2022 _Finalpptx.pptx (live.com) (https://view.officeapps.live.com/op/view.aspx?src=https%3A%2F%2Fwww.statssa.gov.za%2Fpublications%2FP0302%2FMid%2520Year%25202022%2520_Finalpptx.pptx&wdOrigin=BROWSELINK)*

Demographic trends can help to shape insurers' thinking around products and the needs of certain constituencies.

Different generations have unique preferences and expectations when it comes to insurance products and services. Insurance companies are increasingly designing products and marketing strategies that cater to different preferences in the following ways:

- **Affordable premiums:** Young people, especially those starting their careers or still studying, often have limited budgets. Insurers in South Africa are increasingly making use of the relatively new micro-insurance regulations to design less expensive products.
- **Customization and flexibility:** Young consumers appreciate insurance products that can be tailored to their specific needs and life circumstances. Flexible coverage options that allow them to choose what they want to insure and adjust coverage levels as needed are attractive. For example, innovative insurers such as SNACK, a Singaporean insurer, offer micro-insurance and investment policies that customers can stack or stop at any time for financial flexibility. Flexible payment and underwriting mechanisms that are quick to execute via mobile app, for example, can be added to any purchases at the time of the purchase.
- **Digital access and convenience:** Everyone has an aversion to slow, telephonic customer service. With most financial service provider platforms now available through sophisticated but user-friendly apps, insurance companies that offer digital platforms and mobile apps for managing policies, making claims and accessing customer support will be able to achieve competitive advantage.
- **Transparent, simple and clear policies:** Insurers are renown for having complex insurance products with exclusions written in very small font. Complex insurance jargon can be overwhelming. This is particularly salient in South Africa, with the backdrop of a national literacy crisis. It is essential that insurers are transparent and clear – developing the trust their clients have in them and ensuring products that are sold are fit for purpose and easy to understand.
- **Support for emerging risks:** With rapidly changing lifestyles and technologies, people face new risks that may not be adequately covered by traditional insurance products. Insurance offerings that address cybersecurity, digital asset protection and provide gig economy-related coverage, are needed. Many insurers are now integrating products that safeguard crypto currencies, virtual real estate and digital artworks.
- **Incentives and rewards:** Insurance companies that offer rewards for maintaining a good claims history or offer incentives for engaging in healthy or sustainable behaviours (e.g., wellness programmes) can be appealing. Research has demonstrated that younger consumers are more socially conscious and tend to purchase goods and services that resonate with their personal moral standards.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## G-Governance

In March 2023, South Africa's Financial Sector Conduct Authority (FSCA) released a statement on sustainable finance and its programme of work[9]. In it, the FSCA outlines some of the market conduct risks that could affect the efficient operation of a sustainable finance market. These include inter alia, a lack of standardised terminology; inaccurate or misleading information; weak or undeveloped understanding of sustainability concepts; and inconsistent, unreliable disclosure and reporting requirements. Risks like these address mis-selling which is a key consideration for the FSCA and the governance around how insurance products are designed and distributed.

Greenwashing is a type of mis-selling and occurs when financial products are marketed as environmentally friendly, but they have little or no tangible positive impact on the environment. For example, a fund might be marketed as a "green" fund, but it may still invest in companies with poor environmental records.

The risks the FSCA outlines is not unlike those in other jurisdictions, where greenwashing has occurred and litigation has ensued. For example, in the USA, the Securities and Exchange Commission (SEC) fined a large bank over greenwashing citing that numerous investments held by certain funds did not have an ESG quality review score at the time of the investment[10].

Insurers should be proactive in mitigating the risk of allegations of misleading statements or greenwashing to avoid enforcement action and complaints, particularly regulatory investigation and censure, civil litigation and the negative financial impacts arising from reputational risk.

To build robust products that are also in-line with these governance factors, insurers can consider the following:

- **Consistency across the business:** Insurers should define clear policies to ensure a consistent approach across the business so that products and investments are consistent with the organisation's overall sustainability agenda and targets; for example, reaching net zero by 2040. These policies should be backed up by data collection, reporting, a clear controls framework and diligent assurance practices. This will ensure that what is reported is correct and reduces the risk of greenwashing.

- **Regulatory compliance:** Several insurers are carefully examining existing features and products that may qualify under product sustainability guidelines. Insurers with products in South Africa, for example, could begin by looking at South Africa's Green Finance Taxonomy. Under 7.8.1 'Non-Life Insurance', the taxonomy sets out several activities/assets that are covered by the taxonomy, which are important elements for climate change adaptation[11]. For example, products that drive climate-positive action, such as offshore wind insurance, may qualify. As South Africa's taxonomy is interoperable with the EU taxonomy, it is likely that products will also be classified as 'green' in other jurisdictions.

- **Data and analytics:** Identify ESG data sources (e.g. ESG ratings and principal adverse impact indicators) and assess their quality and provenance given that these may be the basis of their annual sustainability reports. A centralised, dynamic data and analytics platform can help here. It is also essential that this data can be assured.

Whilst many insurers may be looking at ESG through a risk lens, there are plenty of opportunities that ESG considerations present. Staying abreast of key trends in demographics, the unfolding environmental crisis as well as regulatory considerations, can help insurers stay future focussed and relevant. These ESG-related products and services not only lower the risk for insurers, but also provide opportunities to have a positive impact in the broader community.

[9] Financial Services Conduct authority (2023). FSCA Statement on Sustainable Finance and Program of Work (2023). Available From: Decision-making powers in respect of FSB Budget (fsca.co.za) (https://www.fsca.co.za/Regulatory%20Frameworks Temp/FSCA%20sustainable%20finance%20statement%20Final%20March%202023.pdf). (Accessed 31.07.2023).

[10] U.S Securities and Exhange Commission (2022). PRESS RELEASE: SEC Charges BNY Mellon Investment Adviser for Misstatements and Omissions Concerning ESG Considerations. Available from: SEC.gov | SEC Charges BNY Mellon Investment Adviser for Misstatements and Omissions Concerning ESG Considerations (https://www.sec.gov/news/press-release/2022-86) (Accessed, 28.07.2023)

[11] National Treasury, Republic of South Africa and International Finance Corporation (2022). South African Green Finance Taxonomy: 1st Edition. Available from: SA Green Finance Taxonomy – 1st Edition.pdf (treasury.gov.za) (https://www treasury.gov.za/comm_media/press/2022/SA%20Green%20Finance%20Taxonomy%20-%201st%20Edition.pdf). (Accessed: 31.07.2023)