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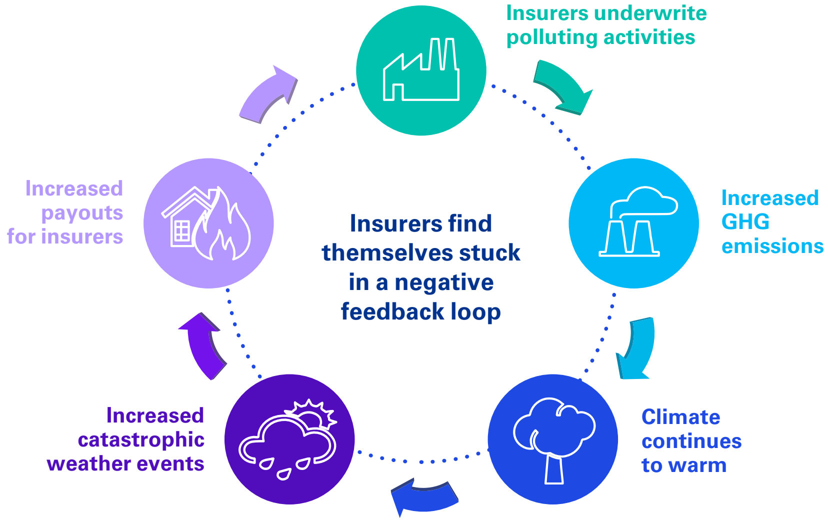
A reporting burden or a strategic imperative: the emergence of transition planning in the insurance industry

Since the 26th United Nations Framework Convention on Climate Change (also known as COP26) was held in Glasgow in 2021, there has been an upswell in the sentiment that financial institutions have a responsibility to accelerate the transition to a greener future[1]. The concept of fiduciary duty in this regard has been largely re-examined, extending beyond just financial returns for investors, to sustainable outcomes for society[2].

With climate conditions continuing to warm and persistent and more severe catastrophic weather events occurring at higher rates of frequency, scientists have made it clear that we need to significantly reduce green-house-gas (GHG) emissions. Either this, or we must accept the reality of increased destruction of physical assets, the loss of livelihoods and the fragmentation of communities[3].

These scenarios will become increasingly expensive for insurance companies to provide protection. There is also the possibility that these risks are not feasible to finance and/or are uninsurable – as has been the case for properties in parts of California[4]. The Bank of England's 2022 climate stress testing highlighted that risks captured in the Climate Biennial Exploratory Scenarios are likely to create a drag on the profitability of banks and insurers domiciled in the United Kingdom (UK). In South Africa, during the recent April 2024 storms that occurred in the Western Cape, non-life insurers received 160 claims in two days, which included claims over several heritage properties where the reinstatement thereof would cost 'millions'[5].

If we zoom out, we can see that insurers are caught in a negative feedback loop - insurers continue to underwrite polluting industries such as mining operations, with these industries contributing to warmer climate conditions, resulting in catastrophic weather events continuing to occur and insurance payouts eventually ensuing once disaster strikes.



[1] United Nations Environment Programme (2021) What does COP26 mean for adaptation? Available at: https://www.unep.org/news-and-stories/story/what-does-cop26-mean-adaptation (Accessed: 11 August 2024).

[2] Principles for Responsible Investment (PRI) (n.d.) Building on fiduciary duty in the 21st century: A legal framework for impact. Available at: https://www.unpri.org/fiduciary-duty/building-on-fiduciary-duty-in-the-21st-century-a-legal-framework-for-impact/12058.article (Accessed: 02 August 2024).

[3] World Resources Institute (2023) 2023 IPCC AR6 Synthesis Report: Climate Change Findings. Available at: https://www.wri.org/insights/2023-ipcc-ar6-synthesis-report-climate-change-findings (Accessed: 04 August 2024).

[4] CNN (2024). California's wildfires and housing insurance crisis. [online] Available at: https://edition.cnn com/2024/08/18/business/californias-wildfires-housing-insurance-crisis/index.html [Accessed 21 Aug. 2024]

[5] Cape Times (2023) Cape of Storms to cost millions. Available at: https://www.iol.co.za/capetimes/news/cape-of-storms-to-cost-millions-92f84afb-b7fc-4f9c-8109-da736fa9984a (Accessed: 04 August 2024).

This leads us to consider and explore the answer to a very important question - how can insurance companies support those insured to become greener and more sustainable? This is important not only for those insured, but for the long term resilience of the industry.

It can be argued that financial institutions are relatively non-polluting when compared to other industries like mining and agriculture. Yet, through the respective underwriting services provided, insurers can inadvertently enable businesses to continue to pollute. Non-for-profit institutions, such as Reclaim Finance, aim to address this incongruence with a mandate to 'put finance to work for the climate'[6]. Many of these institutions have lobbied that financial institutions should take the route of 'robust exclusion and engagement policies'[6] to tackle polluting activities like fossil fuel expansion. Yet with the mining sector continuing to be a source of high profit generation for many large asset managers, this is wishful thinking. In the South African context, where the mining sector posted a net profit of USD15.7 billion in 2022[7] and employs nearly half-a-million people, this sector remains critical for job and energy security.

Leading insurers recognise that there is a need to transition away from polluting industries. For example, in April 2024 Zurich Insurance announced that it will no longer provide new insurance underwriting for oil and gas projects[8]. It also intends to mandate its highest-emitting corporate clients to implement strategies for reducing carbon emissions. On home soil, Santam also released a 'climate change position statement', emphasising the need to divest from a coal to low carbon economy[9]. Taking local considerations into account, Santam also highlighted the need for the just transition and consideration for stakeholders who are vulnerable to the effects of a low carbon transition[9].

Whilst insurers are at various stages of maturity, the concept of transition planning and understanding what a move to a low-carbon economy for high emitting sectors entails, is responsible as well as strategic. With many insurers having committed to net zero, insurers need to understand how to monitor and reduce their own GHG emissions, and importantly the GHG emissions of their underwriting book.

This leads us to a second set of important questions - what is a transition plan, and can it accelerate the myriad of competing environmental, sustainability and social factors insurers grapple with?

6 Reclaim Finance (2022) Scorecard: Which asset managers are pushing back on fossil fuel expansion? Available at: https://reclaimfinance.org/site/en/2022/04/20/scorecard-which-asset-managers-are-pushing-back-on-fossil-fuel-expansion/ (Accessed: 19 August 2024).

7 London Mining Network (2023) Corporate mining and Southern Africa. Available at: https://londonminingnetwork org/2023/08/corporate-mining-sa/ (Accessed: 08 August 2024).

8 Insurance Business Magazine (2023) Zurich Insurance stops underwriting new fossil fuel projects. Available at: https://www.insurancebusinessmag.com/us/news/environmental/zurich-insurance-stops-underwriting-new-fossil-fuel-projects-484241.aspx (Accessed: 02 August 2024).

9 Santam (n.d.) Climate Change Position Statement. Available at: https://www.santam.co.za/media/e0inhc0v santam-climate-change-position-statement_final-draft_exco_.pdf (Accessed: 02 August 2024).

What is a transition plan?

Whilst there is no single definition of a transition plan, this can largely be defined as an *externally-oriented* statement intended to inform stakeholders about an entity's ambitions and high-level actions in response to climate change, as well as its accountability mechanisms. Transition plans can also be used to facilitate co-operation and co-ordinated action between value chain partners and are explicitly required under most corporate climate disclosure standards.

As with many emerging fields, guidance on the scope of transition plans differs. A few examples are set out below:

Guidance	Definition
European Financial Reporting Advisory Group (EFRAG)	The exposure draft of European Sustainability Reporting Standards (ESRS) E1 Climate Change[10] defines a transition plan as the "Aspect of an undertaking's overall strategy that lays out a set of targets and actions supporting its transition toward limiting climate change to 1.5°C"[11].
International Financial Reporting Standards (IFRS) Sustainability Standards	Accompanying guidance on climate-related disclosures defines a climate-related transition plan as, "an aspect of an entity's overall strategy that lays out the entity's targets, actions or resources for its transition towards a lower-carbon economy, including actions such as reducing its greenhouse gas emissions"[12].
Glasgow Financial Alliance for Net-Zero (GFANZ)	The GFANZ final report for financial institutions[13] defines a net zero transition plan as "a set of goals, actions, and accountability mechanisms to align an entity's business activities with a pathway to net-zero GHG emissions that delivers real-economy emissions reduction in line with achieving global net zero"[14].
The UK Transition Plan Taskforce (TPT)	The TPTs' Disclosure Framework[15] builds on definitions such as those set out above and suggests that a good practice transition plan clearly articulates an entity's "objectives and priorities for responding and contributing to the transition towards a low GHG-emissions, climate-resilient economy. It also sets out whether and how the entity is pursuing these objectives and priorities in a manner that captures opportunities, avoids adverse impacts for stakeholders and society, and safeguards the natural environment"[16].

Although these frameworks are nuanced, there are several overlapping themes which are important for all transition plans. Broadly, transition plans should cover objectives and priorities to:

- decarbornise business models, strategies, operations and value chains in the short-, medium- and long-term;
- enhance resilience to the ever-changing climate and respond to the risks and opportunities that arise from transition; and
- embed and accelerate the economy-wide transition to a low-GHG emissions, climate-resilient society.

It is also important that transition plans address ESG risks and opportunities that have been identified as material for the insurer. A double materiality assessment (DMA) for example, is a good exercise for insurers to perform to identify material ESG risks and opportunities.

A DMA is the process for prioritising sustainability topics. Material topics are those that have an impact on the company (financial materiality) and/or through which the company has an impact on society and/or the environment (impact materiality)[17].

The outputs of the DMA can then be used to inform the transition plan and key activities in response to the risks and opportunities surfaced. A DMA is currently used by insurers to identify material topics for Corporate Sustainability Reporting Disclosures (CSRD).

10 https://www.efrag.org/sites/default/files/sites/webpublishing/SiteAssets/ED_ESRS_E1.pdf

11 European Financial Reporting Advisory Group (EFRAG) (2023) Draft European Sustainability Reporting Standards (ESRS) E1. Available at: https://www.efrag.org/sites/default/files/sites/webpublishing/SiteAssets ED_ESRS_E1.pdf (Accessed: 02 August 2024).

12 International Financial Reporting Standards (IFRS) (2022) Climate-related disclosures: Strategy and decision making and climate-related targets. Available at: https://www.ifrs.org/content/dam/ifrs/meetings/2022/november/issb/ap4a-climate-related-disclosures-strategy-and-decision-making-and-climate-related-targets.pdf (Accessed: 10 August 2024).

13 https://assets.bbhub.io/company/sites/63/2022/09/Recommendations-and-Guidance-on-Financial-Institution-Net-zero-Transition-Plans-November-2022.pdf

14 Bloomberg (2022) Recommendations and guidance on financial institution net-zero transition plans. Available at: https://assets.bbhub.io/companysites/63/2022/09/Recommendations-and-Guidance-on-Financial-Institution Net-zero-Transition-Plans-November-2022.pdf (Accessed: 04 August 2024).

15 https://transitiontaskforce.net/wp-content/uploads/2023/10/TPT_Disclosure-framework-2023.pdf

16 Transition Plan Taskforce (TPT) (2023) Disclosure framework. Available at: https://transitiontaskforce.net/wp-content uploads/2023/10/TPT_Disclosureframework-2023.pdf (Accessed: 03 August 2024).

17 https://kpmg.com/be/en/home/services/sustainability-services/double-materiality-assessment.html

What do transition plans look like in the insurance industry?

GFANZ provides an overview of some of the first transition plans that have been released into the market across the asset management, banking and insurance sectors. As with any new reporting initiatives, these reports vary in specificity.

From an insurance perspective, there are several key themes across many of these reports. The information below is derived from publicly available transition plan reports.

Theme	Example commitments, initiatives and metrics
Reduction in GHG emissions from own operations and supply chain	Own operations: Allianz committed to sustainable aviation fuel purchases for remaining air-travel emissions as of 2023[18]. Supply chain: Dia-ichi Life holdings built a sophisticated GHG data management system and engaged with 55 investees to understand GHG emissions[19].
Investments in climate solutions	Allianz committed to engaging with 20 million motor retail customers to support transition to electric mobility as well as offered clients incentives for reducing emissions in the motor retail sector[18].
Sustainable investment mandates	The Phoenix Group committed to a 25% reduction by 2025 in the carbon emissions intensity of its listed equity and credit assets over which it has control (c. EUR160 billion)[20].
Stakeholder engagement	Allianz is taking a lead role in the UN-convened Net Zero Asset Owner Alliance[18], a member-led initiative of institutional investors committed to transitioning their investment portfolios to net zero GHG emissions by 2050 – consistent with a maximum temperature rise of 1.5°C.
Policy and advocacy	The Phoenix Group is developing innovative commercial models, both unilaterally and in collaboration with others, to overcome market barriers to scaling up investment in proven technologies such as heat pumps[20].

Many of the commitments highlighted above indicate the importance of cross-sectorial engagement, industry collaboration and partnerships – all of which are important for insurers to reach its net zero goals.

Transition planning – opportunities for product innovation

If done thoroughly, transition planning extends beyond an onerous reporting obligation. This exercise can help insurers understand the decarbonisation pathways of different sectors and think strategically about their product mix. A recent study demonstrates that the number of patents for clean energy insurance has doubled in the last decade[21]. This trend underscores a strategic shift towards developing and targeting these specialised products. For example, industry leaders like Zurich, Aon and Munich Re are providing comprehensive insurance solutions for hydrogen projects and addressing the risks associated with clean energy infrastructure. Similarly, the patents for carbon capture within the insurance sector increased from 2 009 in 2014 to 5 143 in 2023. These collaborations play a crucial role in accelerating the energy transition and meeting net zero targets[22].

Although these are examples from abroad, our South African president, Cyril Ramaposa, has been clear that he plans to drive South Africa towards a low-carbon economy through the scaling up of renewable energy sources and reducing reliance on coal. To do so, we will need substantial investment to build sustainable infrastructure, develop green technologies and support social programmes[23]. Insurers in South Africa can help to support the renewable energy transition through innovative underwriting and product offerings, like parametric insurance, as well as investing their own assets in renewable projects. A transition plan can help insurers identify and articulate how they can help their customers and the country move towards a net zero target by 2050.

18 Allianz (2023) Inaugural Net-Zero Transition Plan. Available at: https://www.allianz.com/content/dam/onemarketing/azcom/Allianz_com/sustainability/documents/Allianz_Inaugural-Net-Zero-Transition-Plan.pdf (Accessed: 02 August 2024).

19 Dai-ichi Life Holdings (2023) Net-zero transition plan. Available at: https://www.dai-ichi-life-hd.com/en/sustainability/environment/nztransitionplan.html (Accessed: 02 August 2024).

20 Phoenix Group (2023) Net-zero transition plan. Available at: https://www.thephoenixgroup.com/media/vtlix0gh/net-zero-transition-plan.pdf (Accessed: 02 August 2024).

21 GlobalData (2023) Insurance industry sees surge in clean energy and carbon capture patents, reveals GlobalData. Available at: https://www.globaldata.com/media/insurance/insurance-industry-sees-surge-in-clean-energy-and-carbon-capture-patents-reveals-globaldata/ (Accessed: 11 August 2024).

22 https://www.globaldata.com/media/insurance/insurance-industry-sees-surge-in-clean-energy-and-carbon-capture-patents-reveals-globaldata/#:~:text=Similarly%2C%20the%20patents%20for%20carbon,ongoing%20innovation%20within%20these%20segments.

23 Mail & Guardian (2023) Ramaphosa: Just energy transition will need R1.7 trillion. Available at: https://mg.co.za business/2024-07-15-ramaphosa-just-energy-transition-will-need-r1-7-trillion/#:~:text=he%20Just%20Energy%2 Transition%20Investment%20Plan%20for%20the,decarbonisation%20commitments%20by%202050%2C%2 president%20Cyril%20Ramaphosa%20said.

Effective transition planning within the insurance industry is more than a strategic necessity - it is a proactive approach to ensuring business continuity, regulatory compliance, competitive advantage and long-term sustainability. Like the real economy, insurers also have a duty to play in the transition to a low carbon, greener future. The sustainability of the sector depends on it.

As the landscape continues to evolve, driven by technological advancements, shifting regulatory requirements and changing customer expectations, insurers must embrace a forward thinking mindset. By implementing robust transition plans, insurers can navigate disruptions, mitigate risks and capitalise on new opportunities. Ultimately, a well-crafted transition plan not only safeguards an insurer's competitive edge but also builds resilience, fostering confidence among stakeholders and positions the organisation for continued growth and success.