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How to develop and integrate an ESG strategy

Environmental, Social and Governance issues have undoubtedly become key priorities for (re)insurers. However, most action to date has focused on internal operations, regulatory requirements and the asset side of the balance sheet. The next step is for (re)insurers to start thinking about how they tackle, and indeed can benefit from, incorporating ESG into decision-making across their entire business, including underwriting.

ESG is still evolving and will be for the foreseeable future. (Re)Insurers must have a plan but they need to be flexible and ready to adapt to changes in industry trends and best practices as they occur. They need to be ready to meet the demands of their stakeholders and have an ESG strategy that is consistent with, and even stems from, their core business ethos, agenda, and strategy. They also need the data and analytics to enables this. (Re)Insurers that rise to this challenge can take advantage of being at the forefront of innovation for ESG. Their broad reach across sectors, provision of capital, and large balance sheets, ideally places them to invest in technology and other capabilities. This allows them to influence real change in corporate behaviour and disclosures, in relation to sustainability.

Auditable, purposeful and authentic: a recipe for success

A successful ESG strategy must be auditable, purposeful and authentic. (Re)Insurers need to carefully consider their priorities, who they really are, what they care about, and what they want to achieve. It is essential to take the entire business into consideration to provide consistency across all functional areas, for example underwriting, operations, investments and risk. The business, as a whole, first needs to identify and define its sustainability principles. Then it needs to establish which metrics it targets across all functions so that the entire business can ensure it is working to them. Ultimately, decisions must be made around incorporating ESG at the point of underwriting and more broadly across the entire business. A baseline of ESG performance enables (re)insurers to understand their performance against targets for both underwriting and investment portfolios and see what is driving the performance, whether positive or negative. Only once this is established can the business move onto the next challenge of sourcing the relevant, reliable data at a granular level. This can be a particular challenge in the private sector, since many companies do not currently make these types of disclosures.

One effective approach is a strategy that includes a balanced scorecard. This should be "co-designed" by all key stakeholders, with the primary objectives and metrics set out from the start. The scale of this task can seem a daunting prospect, which is why Moody's Analytics and Chaucer have drawn on our combined experience. Chaucer has developed a Balanced Scorecard and Moody's Analytics provided data and analytical capabilities. Together, we introduce this step-by-step guide to help insurers create their 'own view' of ESG and ultimately place ESG at the heart of their business.

A step-by-step guide to creating an ESG strategy for the whole business

1. Identify risk criteria across E, S, and G – The UNEP FI Principles for Sustainable Insurance (PSI) criteria are a useful starting point for this exercise but they shouldn't be used verbatim as a default option. The critical part of identifying these criteria is that each insurer establishes what is important to them specifically rather than just following the crowd or including everything, which is counterproductive. It is also important to consider each factor (Environmental, Social and Governance) to capture an accurate and holistic picture of the risk exposure. Environmental factors have taken centre stage in recent times but Social and Governance factors should not be overlooked, nor the potential for correlations between these factors and underwriting profitability. Weighting can be adapted at different times as priorities develop. Currently climate is key but (re)insurers need to be able to pivot, if and when that changes, and a balanced scorecard approach allows for this.
2. Define data points that measure each of the risk criteria in scalar and vector ways – These data points should establish a baseline to capture both good and bad ESG performance for each business, allowing improvement to be tracked, and focusing on trend data, not just a single point in time. The model should also be able to take into consideration a company's intentions or transition plan. In fact, measuring progress against a transition plan is crucial to the required flexibility and reflection of the real world.
3. Define what is important and weight the risk criteria, and underlying data points accordingly – One method for weighting is aligning to the UN Sustainable Development Goals (SDGs). Insurers must identify which of the SDGs they can influence, both directly and indirectly. This reinforces the central theme that to be auditable, purposeful, and authentic, insurers need to agree what is important to them specifically.
4. Find a partner who can provide the data and the platform to build and implement your ESG balanced scorecard – (Re)insurers need a partner which has the scale and resources to access reliable, auditable data, and who can bring a standard approach. A winning combination is a partner which has both depth of data (for each scored entity), the breadth of coverage, and also the flexibility to allow (re)insurers to define their 'own view'.
5. Embed into the decision making across all functions of the business – ESG must be integrated into workflows in order to be used for decision making. To truly incorporate the ESG strategy, all business areas must be committed to it. The best way of ensuring 'buy in' is to involve all business functions, including underwriting, operations, investments, and risk in the scorecard design process. This gives all business areas the confidence that their priorities and concerns are being reflected.
6. Measure – Once it is finalised, the balanced scorecard can be used to measure ESG across the entire portfolio. There will almost certainly be gaps, with private companies presenting a particular challenge.
7. Build a data roadmap to ensure quality – once these gaps are identified, (re)insurers should prioritise them so that their data provider can set out a credible plan for developing the data coverage and quality. This should include public and private entities to support enhancement of the assessment of ESG risk.
8. Assess – When (re)insurers understand the footprint of their portfolio and can report on it, they can begin to create strategies to close the gap to their agreed targets.
9. Define targets and associated metrics – A balanced ESG scorecard approach is a live and iterative approach. Insurers should be using the results to see how they can improve in line with their corporate ESG strategy. For some (re)insurers, this may include improving the overall portfolio ESG score by a certain amount over the next year, as well as more specific objectives connected to individual areas. For others, the availability of required data and driving the transition is key. This should lead to a natural upwards trend and identify which counterparties are properly disclosing data, therefore enabling the (re)insurer to make informed judgements.

Using a balanced ESG scorecard approach, where all key stakeholders have input into defining the key risk criteria and underlying data points, will ensure consistency and accountability across all functions of the business. As all stakeholders have been involved from the outset, insurers can be more confident that the ESG strategy will be embedded into the business.

Why start now?

ESG, as a new risk factor, creates risk but also opportunities for (re)insurers to grow their business. It has the potential to be another lens through which to view risk selection and appetite. If implemented properly, this could open the door for (re)insurers to build competitive advantage.

By starting now, (re)insurers can give themselves the best possible chance to identify new growth opportunities, differentiate themselves in a crowded market, improve underwriting profitability, and attract new capital.

(Re)insurers that start this journey will be able to take advantage of the data and the analytical tools that are available to them now and take a multi variant review of their portfolio to consider ESG alongside other risks and make informed decisions.

They will also be able to adapt quickly as techniques and resources evolve to stay at the forefront of the industry. As we have discussed, it is vital that insurers have a plan but it is equally important that they are flexible and ready to adapt to changes in the environment and market.

(Re)insurers who start thinking now about an ESG Balanced Scorecard that reflects their business, will be at the forefront of the drive to incorporate ESG in a world that increasingly demands it. This presents an opportunity to consider the wider (re)insurance ecosystem and their position in it. (Re)insurers have a unique place in this ecosystem as they have a responsibility to work with their customers on transition but also the opportunity to work with Brokers. These three players have different roles but consistency and a common approach give confidence in the industry.

An ESG strategy to grow with your business

The ESG journey is still in a relatively early stage but it is evolving fast. To date, the (re)insurance industry has been behind other financial services. (Re)insurers need to move quickly, and data, methodologies, and models exist to enable them to start making progress in incorporating ESG into their whole business including underwriting decisions. These will evolve, as will the industry and regulatory requirements. But by taking steps now, (re)insurers can position themselves to be resilient and thrive in a fast-changing world.

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