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Insurance-associated GHG emissions: The PCAF measurement standard

November 2022 saw the Partnership for Carbon Accounting Financials (PCAF) launch the first global measurement standard for insurance-associated Greenhouse Gas (GHG) emissions. Insurance-Associated Emissions (IAEs) are a type of Scope 3 emissions associated with an insurer or reinsurer's underwriting activities. For many insurers making the commitment to transition to net-zero, IAEs can be a significant source of overall emissions. Yet their measurement and disclosure are far less well developed than other sources such as investments and business operations. PCAF has already developed a widely adopted standard for financed emissions (emissions associated with lending and investments)[1]. They have since set up an Insurance-Associated Emissions Working Group to develop equivalent standards for emissions associated with underwriting. The first PCAF Insurance-Associated Emissions Standard[2] follows a period of public consultation where feedback was sought on various methodology options proposed by the Working Group[3].

Many insurance companies have acknowledged the urgent need to account for underwriting activities in the transition to net-zero. A growing number are joining the Net Zero Insurance Alliance (NZIA); a group of insurers who have made the commitment to transition their underwriting portfolios to net-zero GHG emissions by 2050. The NZIA was formed in July 2021 by eight large European insurance groups: AXA, Allianz, Aviva, Generali, Munich Re, SCOR, Swiss Re, and Zurich Insurance Group. It has grown rapidly since, with 29 members (at November 2022) and increasing diversity in company location and size. The NZIA set itself an ambitious objective to publish a target-setting protocol by January 2023, with members committed to individually making intermediate targets public within six months of that date. Version 1.0 of the NZIA's Target-Setting Protocol was published on 31 October 2022 for a period of public consultation. On emissions accounting, this document specifies that "NZIA members shall use a recognized and consistent IAE accounting approach (e.g. PCAF Insurance-Associated Emissions Standard) for setting and tracking progress towards their targets."[4] The publication of the PCAF IAE Standard thus represents a key milestone in meeting insurers' broader efforts to set emissions targets and transition their underwriting portfolios to net-zero.

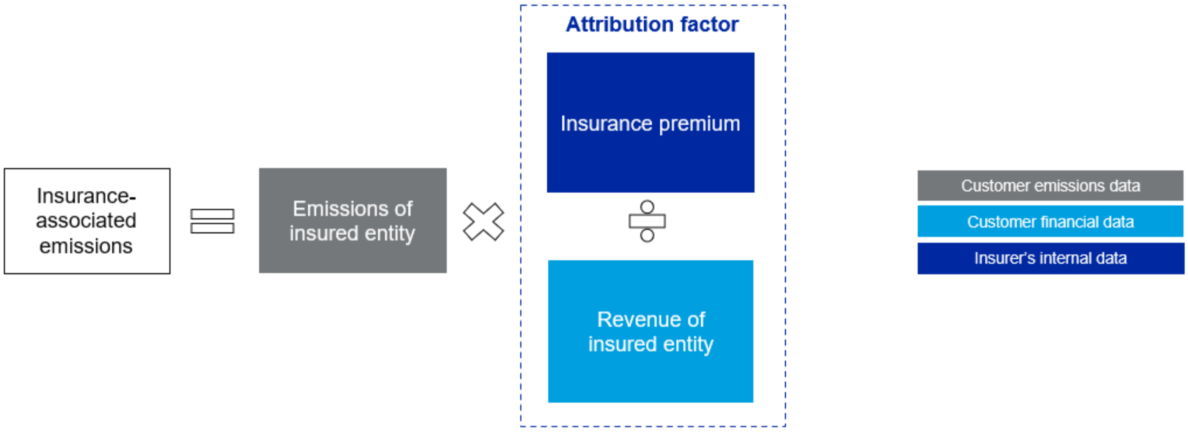
[1] The Global GHG Accounting and Reporting Standard for the Financial Industry, PCAF (2020)
[2] The Global GHG Accounting and Reporting Standard Part C: Insurance Associated Emissions, First Version, PCAF (November 2022)
[3] Global GHG Accounting and Reporting Standard for the Insurance Industry, Progress Report for Consultation, PCAF (14 July 2022).
[4] Net-Zero Insurance Alliance Target-Setting Protocol, Version 1.0 for public consultation, UNEP FI Principles for Sustainable Insurance (2022).

PCAF measurement methodology: Commercial insurance

The initial PCAF IAE Standard covers two lines of business: personal motor lines, and commercial lines. In each case, the insurance-associated emissions for a specific insurance policy are calculated by taking the total emissions of the insured customer or asset, and multiplying by an 'attribution factor'. The attribution factor reflects the proportion of emissions associated with the insurance cover provided.

In particular, for commercial insurance, the IAEs for an individual policy are calculated as shown in Figure 1.

Figure 1



Emissions of the insured entity should cover Scope 1 and 2 emissions at a minimum. Where their Scope 3 emissions data is available and reliable, this should be reported separately.

This choice of attribution factor depends on two sources of data: the insured entity's financial data (revenue) and the insurer's internal data (premiums). This contrasts with an alternative method considered in the progress report for consultation, where the attribution factor depended only on the insurer's internal data. The final choice of attribution factor shown in Figure 1 means that revenue data, in addition to emissions data, will need to be sourced either directly from the insured entity or via third party data providers.

This choice of attribution factor also means that revenue is a source of volatility in IAEs that must be considered when analyzing movements over time. With this choice of attribution factor, movements in IAEs may occur not only due to changes in the underlying entity's emissions, but also in their revenues, and changes in premiums due to insurance market cycles. Given the numerous potential sources of change, insurers will need to interpret IAE dynamics with care.

In addition to commercial lines, similar formulae are defined for personal motor lines. Further lines of business may be added in future iterations of the standard.

Note that IAEs are a distinct category of an insurers' Scope 3 emissions, separate from financed emissions. PCAF highlight that Insurance-Associated Emissions and financed emissions are not directly comparable, should be reported separately, and should not be aggregated.

Challenges and opportunities

One of the major challenges in calculating IAEs will be the collection and management of emissions data. Availability, completeness, reliability, and timeliness of emissions data are recognized challenges with other sources of Scope 3 emissions including investments. However, these challenges are likely to be acute for the emissions associated with the underwriting portfolio. Company emissions data is often challenging to obtain; particularly for the Small, and Medium-sized Enterprises (SMEs), who typically make up a large proportion of commercial insurance portfolios. PCAF has acknowledged this lack of reported data, and in such cases estimates or proxies may be required. There is an expectation that data quality scores are calculated and reported alongside emissions, with PCAF defining scores on a 1-5 scale depending on the type of data used. This approach recognizes that data quality is not binary, and data limitations should not prevent insurers from getting started on their net-zero underwriting journey. Insurers should use the highest-quality data that is available, but improve data quality over time where possible.

This collection of data - company emissions (both reported and estimated) and revenues, along with the insurers internal data (premiums) - must be aggregated across the entire underwriting portfolio. This requires automated name-matching to ensure that external and internal data sources are correctly aligned. Data quality must also be quantified and aggregated.

Despite these challenges, the resulting collection of data provides insurers with an opportunity to understand their emissions exposures in detail, and to use this information to effectively engage with customers on their transition to net-zero. Insurers may perform detailed attribution and what-if analyses. In particular, they can measure how emissions can be attributed to different sectors and sub-portfolios, how they have changed over time, and how those changes are attributed between changes in underlying emissions and changes in portfolio composition. Insurers may also seek to measure the marginal contribution of new accounts, or more generally how their IAEs might change in future under different assumptions. For example, they may explore the impact of potential reductions in customers' emissions based on the customers' own targets.

While the PCAF standard is focused on GHG emissions, there are a host of other Environmental, Social, and Governance (ESG) considerations that are increasingly being factored into insurance companies' strategies and underwriting workflows[5]. Insurers may also take this opportunity to build a broad analytical capability for their underwriting portfolios, allowing them to measure and manage a range of ESG factors in addition to GHG emissions.

[5] Integrating ESG into portfolio management and underwriting workflows: the state of the market, Moody's Analytics (2022)