

INFORMED INSURANCE 2022/23

**Unlocking the potential of ESG:
resilience, sustainability and collaboration**





Unlocking the potential of ESG: resilience, sustainability and collaboration

Collaboration is the key to ensuring resilience in the face of today's challenges and building a sustainable future. The insurance industry and the businesses that comprise its complex supply chain are key players in shaping and supporting the way commerce and society responds.

There is a need for joined-up thinking, drawing on deep expertise as never before, as we face an almost relentless conveyor belt of disruptive issues that have the potential to undermine insurers' value propositions and cause societal dislocation: Brexit, pandemics, climate change, war in Ukraine, energy crises, recession, high inflation, governmental instability and globalisation going into reverse form a daunting list. Past certainties have been replaced by unprecedented uncertainties.

Just a few years ago, many firms would have placed the likelihood of having to face up to just these issues on a spectrum of probabilities. Some, such as climate change, have been looming ever larger for some time and boards have been developing strategies to cope with the implications. Others, with war in Ukraine prime among them, would have been at the far end of that probability spectrum and would have occupied little serious thought, let alone serious planning for the consequences.

In 2022 we face all these issues without the luxury of separating them out, taking them one at a time, asking business teams to explore the potential disruptions they might cause. These issues are the here and now for every business.

ESG - THE THREAD THAT CONNECTS

The thread that runs through them is ESG – Environmental, Social and Governance factors – and few now doubt the inter-connectivity of those three broad concepts. Businesses need to embed coherent ESG strategies throughout their operations – from the boardroom to the front office. Shareholders, investors and clients increasingly judge firms by how well they do this and how far they ensure their supply chains meet the same expectations.

Resilience and sustainability have many manifestations: physical, mental and financial. Climate change, COVID-19 and geo-political instability have combined to re-set perceptions and responses under all these headings.

In such an era, no-one should under-estimate the enormity of the threat this poses to business and society. Harnessing the power of a coherent, joined-up ESG strategy is going to be key in meeting the challenges we face.

For the general insurance market, ESG has quickly moved from a slightly peripheral, almost 'nice to have' strategic tool to a key part of the operation of most progressive firms. This is essential and should be almost instinctive for insurers:

"ESG is not just about ethics. It is about risk. Insurers have real skin in the game as they have been looking at climate hazards and other major risks for many years," says Professor Paul Watchman, Special Legal Adviser to the United Nations Environmental Programme (UNEP) Principles of Sustainable Development and the Net Zero Insurance Underwriters Alliance.

Helen Faulkner, Head of Insurance and ESG in Insurance Lead at DAC Beachcroft, says the realisation insurers are central to shaping society's response is already manifest in their management of key supplier relationships:

"ESG has become more central to conversations over the last year, and it is already turning into clear actions. For instance, we have clients starting to ask suppliers to work to KPIs about reducing carbon footprints.

"There is an all-round pressure to make ESG central to business strategy. It comes from shareholders. It comes from clients. And it also comes from staff, where it is vital in attracting and retaining talent. It is exciting to see young people asking some really intelligent questions about ESG issues."

A GLOBAL PRIORITY

The ESG agenda has become a priority across the globe, although the pace and stage of adoption may vary, says Gustavo Blanco, Head of International Business at DAC Beachcroft.

In Europe, the emphasis tends to be on the environmental aspects, says Bastian Finkel, Managing Partner of BLD Bach Langheid Dallmayr, a Legalign Global partner, in Cologne. "We are seeing more German insurers asking us about our ESG policies and credentials. We can share our sustainability report which shows where we are having an impact."

In Latin America, the focus on ESG as a concept is strong but it is still relatively new and there are different priorities in different countries.

According to Blanco: "In Latin America, where social unrest and political stability are more pressing, the social dimensions are more important. The governance aspects depend on the civil institutions and the rule of law which varies considerably across the region.

"Across Latin America firms have been focusing on how they should insure all these risks. We are on a journey with insurers about training, sharing information and creating covers for Latin American countries."

Conversations with clients about ESG are also becoming deeper and require a firm wide response, says Blanco:

"Making sure the cultural values are right is essential. We need to understand our clients' values and culture. We need to align with and adhere to those values as well. We have a holistic approach to the E, S and G factors and look to implement them throughout the firm consistently."

Lois Duguid, Head of Responsible Business at DAC Beachcroft, says the insurance sector is leading the way:

"We are working closely with our clients and learning together at a rapid rate. This experience is then being shared across all sectors. ESG issues have moved up the boardroom agenda but there are still some businesses looking at them as three separate priorities. Not everyone is miles ahead but there is significant momentum. They want to understand how to address ESG but are not always sure how to go about it."

The synergies between the three elements are crucial but for Professor Watchman one stands out: "Governance is probably the most important element. If you get the G right, you'll probably get the E and S right."

The synergy between underwriting and investment is not lost on the major international insurance groups, says Blanco: "Insurers know they also have responsibilities as investors and how they link their governance on the investment side with their operation as insurers."

"There is an all-round pressure to make ESG central to business strategy. It comes from shareholders. It comes from clients. And it also comes from staff, where it is vital in attracting and retaining talent."

Helen Faulkner
DAC Beachcroft, Bristol

A DYNAMIC RESPONSE IS ESSENTIAL

One consistent theme that emerges from exploring ESG implementation with a range of experts is that, while the principles might be gaining greater clarity and acceptance, the way they are applied needs a dynamic response. This applies to each of the three pillars and failure to remain flexible and sensitive to changing pressures can have consequences.

"One of the things that has come out of the pandemic is a greater recognition of the S, the social dimension of business," says Professor Watchman.

"We now have more focus on the mental health of employees and the benefits of flexible working. The MeToo and Black Lives Matter movements also brought gender and racial equality to the fore.

"Businesses learned that they had to pay attention to all aspects of ESG. The Deliveroo IPO ran into problems because of the way they treated their staff. It was originally valued at £8bn but only achieved £5bn due to the S concerns."

In the UK this has definitely led to a sudden change of focus, says Duguid, and the implications quickly spread out to other crucial areas of public policy:

"The government has turned its back on many of its COP26 commitments, especially as it tries to manage the impact of Ukraine. Food reliance has become an issue with a change of emphasis on land management. There is now a risk we will go back to the bad old days of intensive farming."

The connectivity between the top line global issues is evident in the pressure on food prices and increase in food waste, says Duguid:

"There is a shortage of seasonal labourers due to a combination of factors, including COVID-19 and Brexit. UK workers don't want to do the jobs, with the result that viable crops are having to be ploughed back into the fields. As well as being extremely wasteful, this is putting pressure on food prices."

The Ukraine war is clearly a social and governance issue - especially when it comes to sanctions - but it is impacting the environment too. It has pushed back the work done by the environmental lobby on reducing dependence of fossil fuels, but it has also given a kick start to the development of renewables as an alternative, says Duguid, as the insurance industry moves into an innovative gear to provide effective cover for the new technologies.

Sometimes the big issues combine in unpredictable ways, no more so than with climate change and the impact of Russia's invasion of Ukraine (see box).



REGULATION WILL COME INTO PLAY

As if there is not already enough uncertainty around how the insurance industry should embrace and implement ESG, there is the regulatory dimension to consider too. This is a mixed picture with many regulators moving slowly, says Professor Watchman.

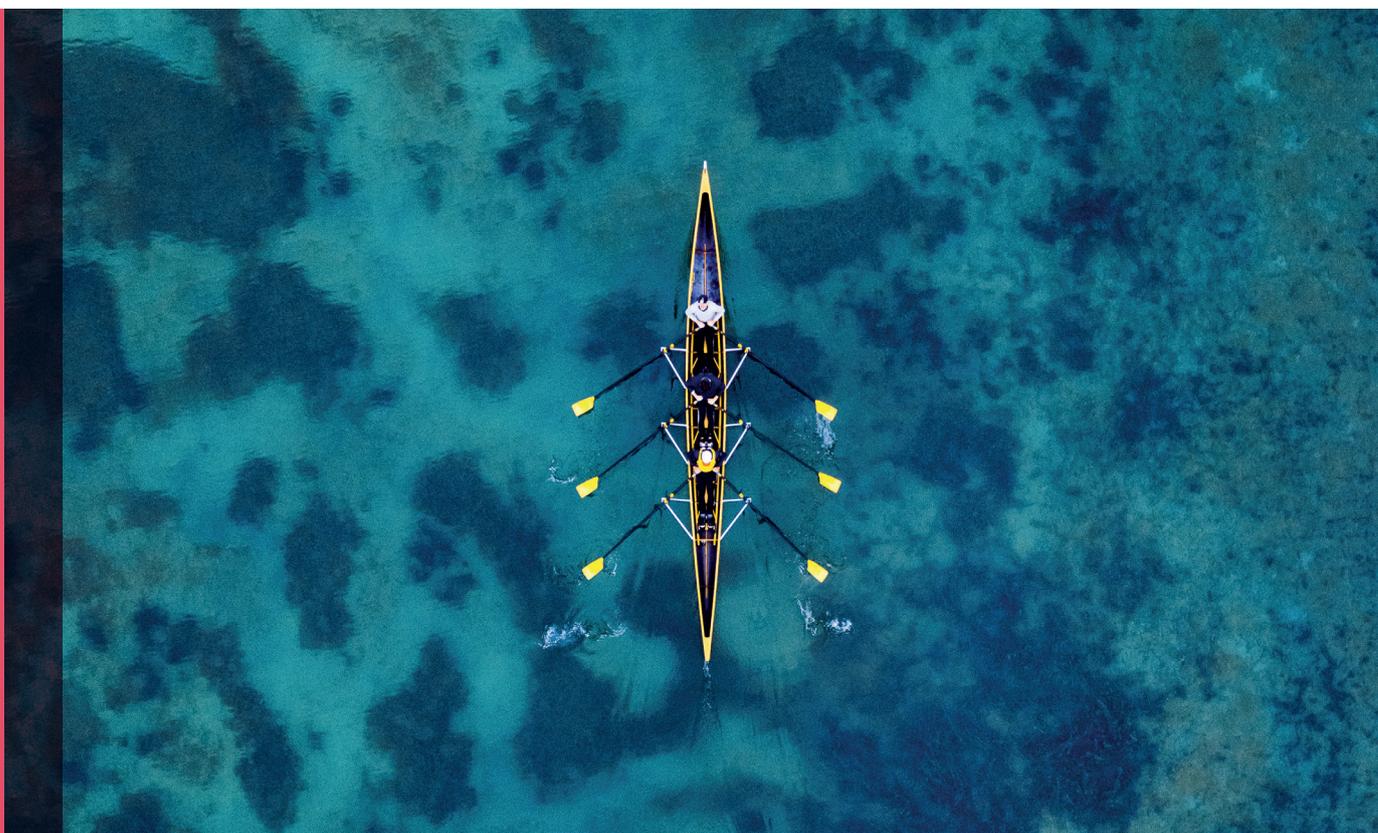
“Regulators move very slowly because the whole process of developing policy, consulting on it and refining it takes time. Once agreed, the people enforcing the rules are then engaged in a learning process. They have to establish some clear policies for effective implementation. How is compliance reported? How is that enforced? What happens when it is not adhered to? This is where transparency and accountability come in. It needs regulators to act as you cannot have a situation where businesses are policing everything.

“If we don’t have government, business and civil society all rowing in the same direction, we are not going to be able to achieve anything. This is something on which we must have global co-operation,” says Professor Watchman.

Finkel says regulation must be shaped in a way that helps insurers. He has a plea to regulators:

“Don’t introduce such harsh frameworks because firms have difficulty following them. Introduce realistic frameworks where less is more,” although he acknowledges the scrutiny the industry will come under requires a robust regulatory framework: “There is a growing sensitivity to the danger of greenwashing which is why transparency is so important.”

Will effective, enforceable, transparent ESG strategies be too much of a challenge? The answer is not whether we can afford to embrace ESG but whether we can face the consequences of not doing so, says Finkel. “If we can’t afford ESG we will fail economically. ESG must interact with general economic risks and developments, and global competition.” The way to resilience and sustainability is through collaboration.



Fossil fuels, energy, Ukraine and the impact on Germany

Few issues more vividly illustrate the connections and overlaps between the big issues of the day than the enormous challenge Germany faces in keeping industry and homes supplied with energy.

Plotting a sustainable path to a carbon neutral world is already a major issue for developed economies that have grown successful on the back of their dependence on fossil fuels. Phasing out coal has been a priority but attention has also switched to oil and gas. The debate around how to lessen the reliance on all fossil fuels was already fraught and complex before 24 February when Russian bombs and missiles started raining down on Ukraine.

The insurance industry will have to be a key player in shaping the country's response, says Bastian Finkel: "More than ever we need to have a balanced ESG discussion, especially as the conflict in Ukraine has changed the discussion. We know what we need to do in the long-term but perhaps we now need to look at the short-term pressures. People here are afraid of running out of energy this winter.

"Germany struggles with renewable energy. We are not very sunny, don't have a big coastline and are not especially windy. We need to find smart ways of generating, importing and storing energy from new sources. This is a huge project and it will need the support of the insurance industry in terms of risk transfer and insurance cover.

"We need to define European projects, which need to include the UK. Governments need to be involved in the conversation but insurers and businesses should not be too reliant on governments or international bodies. Insurers have that international understanding and experience. That is what will be needed. Collaboration is key."

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