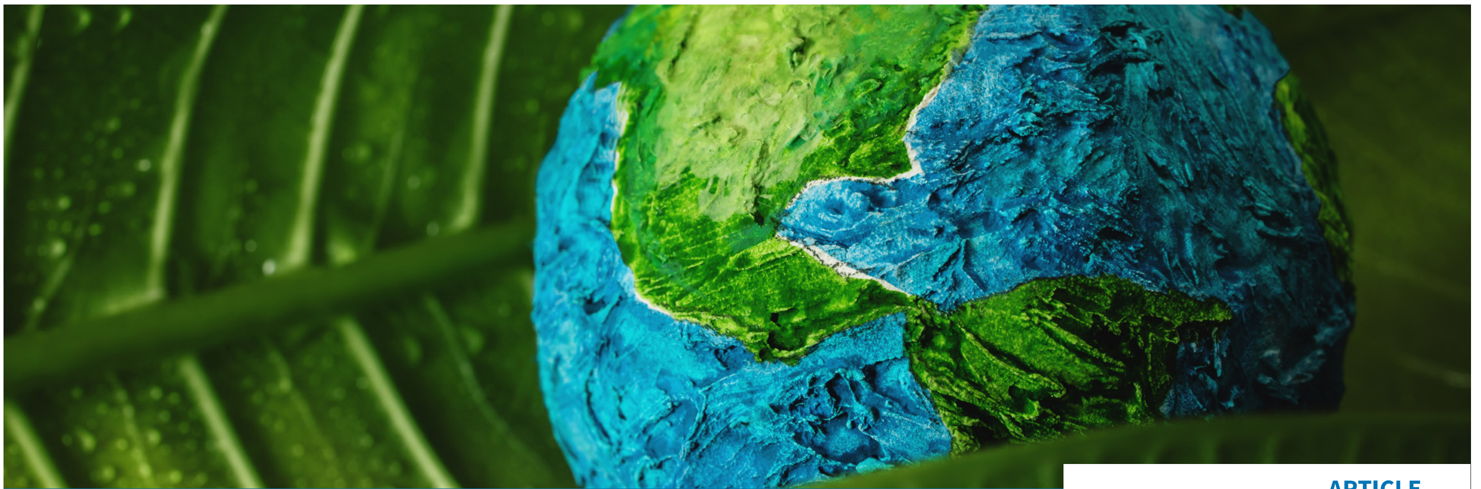

ARTICLE

How insurers can ride the wave of change

Key reflections from COP26

As COP26 drew to a close, conference participants debated whether the pledges made would achieve the goal of limiting global warming to 1.5°C – with new reports suggesting they would not. Meanwhile, announcements were made on topics including the decarbonisation of transportation and the built environment.

As a variation of our ESG in insurance article series, this one takes a more personal form as I share my views from COP26.

I've been privileged to have been present on the ground in Glasgow with insurance and financial services clients and partners. For obvious reasons, it was a much more emotive occasion than the typical business conference. Thought-provoking conversations ranged from the macro (for example, about financing change) to the personal (including talking with members of indigenous communities threatened by climate change).

The opportunity ahead for insurers

In addition to the prevailing determination on all sides to achieve real progress, as an insurance specialist I saw a palpable sense of opportunity for those organisations prepared to contribute and ride the wave of change. There is considerable value to be created (or destroyed) over the next 10 to 15 years as this necessary change is executed.

Insurers – as material asset owners and as risk-enablers – have an important role in this, and that seems to be recognised at all levels and by all participants.

The data gap

Our previous articles have touched on the difficulty of getting the data needed to distinguish genuine sustainability from greenwash, and good intentions from impactful change. Attending COP26 brought home just how big that data gap is.

The gap doesn't only affect investors, of course. The significant corporate presence and the energetic participation of the private sector can either be impressive, or to a cynic, can be dismissed as greenwash or virtue-signalling. I witnessed both responses from people to the same material. It takes hard data to distinguish the two, and to change hearts and minds, and I realise just how hard it is for consumers, activists and other interested

parties to tell whether the promises that are being made are genuine and will make a real difference.

The data gap must be bridged if global financial services are to make a difference to climate change by backing the right initiatives. As well as high-quality data, better reporting and an auditable environment will be needed.

Fortunately, several promising initiatives in this area seem to be gathering pace. Likely developments include:

- a more consistent global price for carbon markets
- mandatory disclosures of climate risks and opportunities
- additional rigour and objectivity from projects like science-based targets

Reviewing ESG scoring methods

Scoring of companies by outside parties can also add objectivity to the ESG aspect of comparing investments. At COP26 there was discussion of a variety of scoring methods, some of them highly sophisticated.

For asset owners, there is active consideration of the adequacy of information available from third parties, or the necessity of building an in-house research capability and scoring method. The scale of investment here is non-trivial.

For underwriters, the ideal dataset only loosely intersects with that of asset owners. Given the activist focus on insurers' underwriting activities, my sense is that the urgency to address this has increased since the last COP, and more work needs to be done.

The need for better communication and knowledge-transfer

Another aspect of the data gap is that vital information may exist but isn't reaching the people who need it. Some investors I met at COP26 noted that corporates pitching for funding assume too much prior knowledge of their intent and capabilities. This was particularly the case with corporates that are not viewed as green but that are trying to explain their transition plans.

Corporates should be prepared to 'over-communicate' their own strategies to outsiders at a realistic level of detail.

Conversely, I observed instances where insurers (and other FS firms) have been judged harshly for failing to exclude certain sectors from their client list. Often there are well-thought-through reasons for continuing to engage sectors rather than exclude – but it takes significant effort to communicate these in a way that persuades a jaundiced listener. This goes beyond data to recognising that stakeholders often have substantially different needs and priorities.

Defining a clear ESG strategy

Another striking message that emerged is relevant not just to investors and the enterprises they are investing in, but also to insurers deciding what types of risk to cover.

Many groups on the fringes of COP26 came with a very strong focus on a single issue. A company that decides to insure an oil and gas project is always going to be marked down by stakeholders for whom ending the use of fossil fuels is the main priority. Say the company has decided to cover oil and gas projects during a limited transitional period to avoid ripping the carpet from under less developed nations who are currently strongly dependent on fossil fuels. That justification probably will not convince the pressure groups who are adamantly opposed to any use of oil and gas.

However, the justification will make sense to many other stakeholders. Hence the importance of establishing a coherent narrative around a well thought through position, and then publishing that narrative and abiding by that position

Whilst you cannot please everyone all the time, a leader in sustainable insurance ought to be able to articulate (and evidence) the principles that underlie their choices. They ought to be prepared to explain how they have considered the particular issue in question, and robustly justify the stance they have chosen to adopt.

Every business should do this, even if being "seen to be green" is not a priority. It is dangerous just to try to keep your head below the parapet – in fact, that may increase the likelihood that if you do become the focus of attention from pressure groups, you are ill-prepared to engage on the topic.

Risk sharing and risk bearing in response to climate change

Insurers have an important structural role in quantifying and bearing the increasing physical, transitional, and litigation risks arising from climate change. They also play an equally important enabling role in managing the risks and uncertainties that may get in the way of necessary action. The role of the state and private sector around both sides of this equation was a subject of much discussion, and I was pleased to see significant work has been done to identify practical action to cement those roles.

More questions than answers

Inevitably, COP26 raised more questions for the insurance industry than it answered, but we will propose some possible answers – or approaches to finding answers – in follow-up articles, which you can subscribe to receive here. In the meantime, if you would like to discuss these issues further or hear more about our experiences at COP26, please do get in touch on the contact details below.

Contributing to the ESG agenda: five key actions for insurers to focus on now:

1. **Review** your current and expected future data capability needs
2. **Ensure clarity of narrative** and strength of articulation
3. **Conduct a gap assessment** of your near-term priorities
4. **Review your governance** process through a sustainability lens
5. **Determine and signpost** your disclosure commitments

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