

# Sustainability in insurance

In a mini roundtable with Risk & Compliance magazine, Graham Handy and Darko Popovic from FTI Consulting's Global Insurance Services team discuss the growing importance of sustainability for the insurance sector, as well as the key risks and opportunities.

## To what extent are sustainability issues now firmly on the insurance industry's radar? Why has it climbed the boardroom agenda in recent years?

**Handy:** Sustainability is now being regularly discussed by boards as a key part of the corporate strategic agenda – in particular, around the suitability of the investment portfolio, and for which client types, if any, the insurer might wish to reduce its exposure. One key accelerant in the last 18 to 24 months has been the inbound interest that customers, or partners, have shown in the industry's environmental, social and governance (ESG) footprint. Pension trustees – when looking to transfer liabilities to insurers – are now asking substantive questions as part of their selection process. And retail customers, perhaps for the first time, are contacting their insurer to ask about the uses to which their money is being put.

## To what extent are regulatory initiatives driving sustainability-related measures for insurers? What recent developments have you observed?

**Handy:** While we are seeing insurance companies embrace sustainability for what they see as good solid commercial sense, there is a limit to how far and how fast a private enterprise will move. It helps that regulators are setting

explicit and timebound objectives, which form a catalyst for action that the private sector might generally wish to take but cannot take in isolation from competitors. Some of the regulatory and legislative changes, particularly the European Union (EU) Sustainable Finance Disclosure Regulation (SFDR), are serving to bring a collective focus on data quality, which needs to be addressed if financial services firms are to confidently put sustainability at the heart of their business processes. The upswell in compulsory requirements has also contributed to a deeper take-up of voluntary commitments that have been an option for some time – for instance, more companies are signing up to the United Nations (UN) Principles for Responsible Investment (PRI).

## What key risks and opportunities related to sustainability do insurance companies need to consider?

**Handy:** There are undoubtedly big opportunities ahead. Given the sheer scale and pace of change that sustainable economies are going to require, smart and forward-thinking companies should be able to find a valuable role to play – and the insurance industry has always found a way to support that kind of change. That said, there is substantial

execution risk as the changes to policy and decision making are complex. There is communication risk – sometimes the best of intentions can be misinterpreted. And there is a risk that governments backpedal or move out of alignment with each other. There will be some major consequences over the next 20-plus years for large parts of society, and it would be unfortunate for the financial services industry to be painted as the enemy.

### **What steps can insurers take to properly assess and quantify sustainability issues, and how do they apply to their particular organisation? What methodologies are available to assist this process?**

**Popovic:** The logical place to start is to agree the sustainability goals which align with the company's vision and values, thereby defining what the company wants to be known for in the context of sustainability. It then becomes a question of methodically identifying the areas of the business operations which are most linked to sustainability issues and diving further to develop specific future goals and metrics for these areas. In the insurance sector, companies are quickly realising that their role as an asset owner is likely to be the area where there is the most impact on sustainability issues. In the past year, we have seen insurers placing significant effort into identifying, measuring, monitoring and managing the impact of their investments on sustainability, in addition to managing an ever-increasing list of mandatory and voluntary reporting and disclosures on the topic.

### **What lessons around sustainability have insurers been able to learn from the impact of the coronavirus (COVID-19) pandemic?**

**Handy:** The single biggest lesson has been just how quickly a supposedly long-term risk can crystallise. In the case of coronavirus (COVID-19), while the first order – mortality and morbidity – threat was well understood, it was the large-scale government policy decisions to lock down economies and interrupt businesses that has been lifechanging. In the same way, climate change itself might well take decades, but the transition risks are likely to hit much sooner and transform the world we live in as we take action to avoid the worst long-term outcomes. Insurers are asset owners – with over \$30 trillion dollars of their and their policyholders' money invested in global economies, according to Statista. That provides our industry with a loud voice and influence, but also demonstrates a valuable self-interest in ensuring that those economies can flourish over the long term. According to our latest 2021 Resilience Barometer, 90 percent of financial services firms in the G20 see COVID-19

as a catalyst to accelerate or materially enhance their approach to ESG and sustainability, with 80 percent of these firms placing greater focus on the 'social' pillar. Furthermore, 76 percent say their commitment to climate change has increased in the last 12 months as many large economies race towards net zero.

### **What advice would you offer to insurers on effectively integrating sustainability principles into their business processes? How important is it to create a responsible culture across the organisation?**

**Popovic:** Conceptually, it is not difficult to incorporate sustainability principles into day-to-day decision making. The 'trick' is to do it in a way that does not lead to a significant increase in workload and headcount, and a significant increase in process complexity and duration. Incorporating these principles from the ground-up is key, as opposed to simply trying to overlay sustainability considerations onto the existing business processes. Creating the right culture is very important in this regard as there is likely to be some resistance to doing things differently across the organisation. It really is key that the board instils a sense of purpose in the context of sustainability across the organisation.

### **Looking ahead, do insurers need to prepare to meet increasing demands around sustainability reporting and risk mitigation? What trends do you expect to see in the months and years ahead?**

**Popovic:** Increased reporting and risk management in this context is a natural outcome of a broader point, that it is ultimately customer and stakeholder expectations that are a key driving force of the focus on sustainability. We can already see this in the current trend of committing to various voluntary reporting requirements, such as the PRI guidelines, where the number of signatory companies has increased from under 2000 to over 3000 over the past two years. We also cannot lose sight of the opportunity ahead. Sustainability is not just about managing the downside but equally about optimising the upside, and there is a belief across the market that those companies which best align their products, processes and investments to take sustainability considerations into account will be the companies most likely to succeed in the future.

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