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ESG: threat or opportunity?

How can the insurance sector tackle ESG effectively?

Research suggests that insurance companies are keenly aware of both the threats and the opportunities arising from today's ESG trends. However, a new approach is needed if they are to tackle ESG effectively for the long term and avoid their efforts being perceived as mere "greenwashing". We offer some pointers for a more holistic sustainability strategy.

"Beyond managing reputational risks, there is a lack of awareness amongst insurers in general of the need for strategic adaptation to ESG requirements in a radically changing world."

Opportunities beckon…

Recent research for the FTI Consulting Resilience Barometer™ 2021 found that almost 90% of asset management and insurance companies see ESG as an opportunity – and there is good reason for their positivity. Insurers can offer cover for new and potentially profitable types of business, such as renewables. They can also invest assets in new areas that offer major long-term growth opportunities: sustainable infrastructure, for example.

More broadly, there are opportunities to ensure that the industry makes a worthwhile contribution to society's aims. Insurers can play an active role in bringing about a more sustainable and fairer economy, for example by investing in social housing. They can take part in social initiatives to improve financial inclusion and financial literacy amongst the public. And they can collectively re-establish the industry's relevance for customers and regain their trust: introducing parametric products to make the claims process more transparent and predictable is just one option here.

…but threats remain

The industry is already shaping up to realise these significant opportunities. However, insurers also appreciate that it is too early to shift the focus entirely away from the accompanying threats.

Our recent survey found that 31% of participants feel that they are falling short on ESG performance and reporting. With around a quarter expecting to be investigated over their sustainability or ESG practices by regulatory or government bodies over the next 12 months, this threat needs to be dealt with promptly to avoid penalties and reputational damage.

However, an even more significant threat lies around the corner. Companies that don't measure up in ESG terms may find themselves in an unforgiving environment. A wide range of stakeholders (staff, customers, media, regulators, state, investors) are ready to vote with their feet if a company is seen as ineffective or – perhaps even worse – inauthentic in ESG terms.

Limitations of current approaches

Companies are keenly aware of reputational risk, as their concerns about reporting and investigations show. However, our client experience suggests that there is less awareness of the need for strategic adaptation to a radically changing world. Rather than paper over cracks, companies need to position themselves for a sustainable future, creating appropriate products and market positioning. This way, they can demonstrate that they are part of the solution to ESG issues, rather than part of the problem.

Currently, the steps that insurance companies are taking to improve their ESG positioning are often somewhat piecemeal. For example, many view divestments, exclusions or mergers & acquisitions (M&A) as a solution, with 36% of survey participants mentioning improving ESG credentials/capabilities as a reason to conduct M&A over the next 12 months. This approach could easily backfire.

The perils of M&A as an ESG tactic

Companies sometimes acquire others with a "green" image in the hope of improving their own reputation. The risk is that the acquired company's reputation will instead be tarnished – or that the whole transaction will be seen by stakeholders as "greenwashing".

Disposing of a less sustainable operation can also be counterproductive if it is perceived as just offloading the issue or moving it out of sight. Disposal only works if the new owner of the issue quickly demonstrates the ability and the will to deal with it more effectively.

Reactivity is another acknowledged drawback of some current approaches. For instance, around 39% of asset management and insurance business leaders admit they are mainly reactive at managing operational disruption from climate change issues, and 31% are mainly reactive at managing ESG and sustainability developments.

To sum up, though they are keenly aware of ESG threats and opportunities, many companies have yet to formulate a clear, holistic and proactive strategy for addressing them. Once again, they often know that they have more work to do: our survey found 29% of participants are concerned about their firm's inconsistent or uncoordinated approach to tackling climate change.

"In the case of investments, concerns over the ESG approach may reflect a lack of confidence about which assets really constitute responsible investments. The underlying challenge here is the poor quality and lack of consistency of the data that is currently available about ESG-related characteristics of available investments."

Towards a holistic ESG strategy

So what can companies do to strengthen their overall ESG positioning? We recommend the following steps.

1. **Proactively embed ESG at all levels of the organisation,** combining centralised and decentralised approaches. This gives early warning of threats as well as identifying opportunities for improvement.

2. **Make sustainability everyone's responsibility,** and enforce accountability by aligning with objectives, remuneration and performance metrics.

3. **Collaborate and engage across the industry,** and with stakeholders such as regulators and customers, to formulate strategy and push for consistent, well-defined and practical regulations and standards.

4. **Commit to measurable actions** and full transparency of disclosures.

5. **Work on collecting the data** and designing the metrics needed to steer the ESG journey.

Above all, the strategy must recognise that realignment with ESG goals represents a major transformation for the business. This transformation requires strong leadership and must be reflected in plans and budgets.

We'll return to these ideas later in other FTI Consulting articles. Meanwhile, please get in touch if you would like to discuss the best way to make sure your company is part of the ESG solution and not part of the problem.

All statistics in this article refer to the asset management and insurance subgroup of the Resilience Barometer™ research.

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GRAHAM HANDY
Managing Director
graham.handy@fticonsulting.com

DARKO POPOVIC
Senior Director
darko.popovic@fticonsulting.com

MARC LOH
Director
marc.loh@fticonsulting.com

1556 - 09/21