ESG and the future of finance in insurance
About the Finance in insurance reimagined series

The EY Finance in insurance reimagined series sets out why now is the right time for insurers to rethink, redefine and transform their finance operations to drive insight-led decision-making and adopt a more holistic and cross-functional approach to financial management. Finance is moving into a new era where it can go beyond incremental efficiencies, which have been the focus of past transformation programs, to improve performance and deliver exponentially higher value to the business.
Executive summary

Environmental, social and corporate governance (ESG) matters have become one of the hottest topics in the insurance industry in recent years — and with good reason, given the huge risks associated with climate change and its significant impacts on nearly every part of the business. Certainly, finance organizations will feel the effects profoundly. Most CFOs and senior finance leaders recognize the massive amount of reporting that will be necessary to satisfy the requirements of regulators, capital markets and rating agencies, especially relative to the “E” in ESG. External pressures will set the timeline for CFO involvement, as the pace of action accelerates across the market.

It’s critical that CFOs take a strategic role and proactive stance in true partnership with chief sustainability officers (CSOs), chief risk officers (CROs) and other executives. CFOs will also be instrumental in integrating the ESG strategy within the overall business strategy. That is a vital role because ESG is not just a compliance exercise, but rather an imperative to mitigate severe risks, create long-term value and secure the future of the organization. And, for many insurers, ESG will be an enabler of business growth.

Further, the industry as a whole is uniquely positioned to help individuals, businesses and communities around the world transition to a greener economy. This requires meticulous understanding of ESG risks and its drivers. Indeed, we believe the future success of insurance companies is directly proportional to their management of ESG risks, their execution of ESG strategies and their leadership in the dynamic transition to a green economy.

In this sense, CFOs and finance leaders can serve as forward-looking advisors to the business, an idea that is central to the EY vision of the future of finance. ESG transformation will be a huge part of the future of insurance; finance functions that continue to evolve their roles will also have pronounced influence on that future. That’s why we believe now is the time for insurers to reimagine finance and reassess the value it can contribute to the organization.

Certainly, finance can provide value by generating insights to shape purpose-led ESG strategies and support their execution. The need for and value of strong data management and reporting capabilities for ESG is not to be underestimated. And it will require a heavy lift, both in terms of investment and management attention. Additionally, CFOs have an important role to play on the strategic front. For instance, they can help the organization define its overall strategy and determine the right metrics to measure progress toward key goals, as well as sharing the story with investors and other constituencies. That’s an important external responsibility for finance leaders.

Looking internally, CFOs can work with risk, actuarial and business leaders, helping to identify the greatest threats and growth opportunities associated with ESG. They will also consult with chief investment officers and other senior leaders to pressure-test shifts in the portfolio strategy. They can work with product owners on potential incentives and new services to help accelerate the greening of the economy. CFOs will also seek to incorporate new nonfinancial metrics into performance management models, particularly relative to the sustainability of the business, as insurers rethink the bottom line.

By coordinating data management initiatives, CFOs will be able to determine that all parts of the organization are using timely, complete and consistent ESG data, whether they are modeling the impacts of climate change, measuring the potential of new products and services, or producing filings for authorities and oversight groups.

This paper, part of the EY Finance in insurance reimagined series, highlights both why finance leaders should provide leadership in the realm of ESG and how they should approach the most urgent ESG tasks now while also charting a clear course for the future.
The ESG agenda for finance leaders

The first task on the ESG agendas for all types of insurance leaders (i.e., not just CFOs) is to identify and model the impacts of climate change across the business. The task is enormous and ongoing, given that most insurance leaders recognize climate change as the greatest risk faced by the industry.

ESG risks include:

- **Regulatory risk**: noncompliance with current regulations and failure to keep up with evolving guidelines and standards
- **Reputational risk**: failure to track ESG performance or adopt suitable growth strategies and the inability to avert controversy (e.g., accusations of greenwashing)
- **Operational risk**: inefficient processes and large claims payouts due to subpar underwriting practices

The tax implications raised by ESG and sustainability also need to be considered. By embedding ESG factors into risk management frameworks and decision-making processes, insurance CFOs can help their organizations avoid the negative consequences of these risks.

CFOs won’t build scenario models or run the assessments themselves, but rather provide inputs and help define materiality within integrated ESG risk frameworks as the organization looks to operationalize its key strategies. CFO-CRO collaboration is also critical to confirm that the organization has a broad and holistic view of ESG risks and their drivers.

CFOs should work with business leaders to define and scope the upside opportunities to create value. As insurers develop new types of products (e.g., parametric policies) and services (e.g., risk prevention resources for commercial customers), finance teams can model the revenue impacts to help prioritize investments and allocate resources. CFOs should examine the value-creation levers across operations, including how they can help all of their customers make smooth and effective transitions to a greener economy.

The broad-based impact of ESG will affect nearly every part of insurance companies, from underwriting and product development, to risk and investment teams, to branding and communications. CFOs will be involved on multiple fronts.

Identify and measure the impacts – including both risks and opportunities
Finance teams must work to understand the many different standards in jurisdictions around the globe — including the mix of mandatory and voluntary standards. The number of ESG regulations and standards globally has nearly doubled in the last five years. The climate-related financial risk disclosures developed by the Task Force on Climate-related Financial Disclosures (TCFD) is among the most visible. There is good news: The TCFD can be used globally. For instance, TCFD recommendations, which were initially designed to be voluntary, have been instilled in regulatory frameworks in the EU, the UK, Canada, Japan, Singapore, South Africa and New Zealand. Still, it’s important to note that differences across markets (e.g., the US, the UK, Europe and Asia-Pacific) mean that adoption is more difficult for some companies than others.

The “Group of Five,” formerly the Carbon Disclosure Project (CDP), has issued various reporting frameworks in its pursuit of a global standard. Many regulatory commissions of stock exchanges have also released their own guidelines for reporting. Collectively, these efforts are helping to mainstream ESG, not just as a measure of ethical business practice but also relative to long-term value creation.

In total, there are more than 600 ESG reporting provisions in place around the world, with many different definitions and interpretations of sustainability. The most rigorous standards, especially for financial services organizations, have come from the EU and the UK, though the latest proposal from the U.S. Securities and Exchange Commission (SEC) is significantly more detailed than its previous guidance.

Examples of current guidance include the following:

- The EU Green Deal will aim to streamline the classification, identification and application of “green” products and services. More accountability will be expected of financial services providers, which stand to benefit a great deal from this added level of benchmarking and transparency.

- The UK has been a pioneer in the adoption of resilient business practices and took the lead by adopting a net-zero emission target for the country by 2050. TCFD reporting has also been mandated and is applicable to 1,300 of the largest British companies from April 2022 onward.

- In North America, Canada is looking forward to mandate TCFD disclosures by 2022, while US regulators at the federal level are lagging their counterparts in other jurisdictions. Stock exchanges are requiring more transparency in South America.

- In the US, the SEC has proposed that all funds disclose to investors the ESG factors they consider and their ESG strategies, if applicable. Further, ESG-focused funds will need to provide more details about their strategies, their criteria and the data they use to achieve investment goals. Certain ESG funds would also have to disclose relevant metrics (e.g., their funds’ total carbon emissions). This guidance goes beyond guidance provided by the International Sustainability Standards Board (ISSB).

- Countries in the Asia-Pacific region are shaping regulations based on the reporting guidelines issued by oversight bodies of their stock exchanges.

CFOs must understand the unique requirements in their key markets and — where possible — engage with regulators and industry initiatives to help shape future standards. There is no doubt these guidelines and requirements will continue to evolve. Thus, insurers should participate, both to strengthen their own reporting and to gain new visibility into the risk exposures of their commercial customers.
Defining the right strategic metrics

Defining the specific metrics insurers can use to measure the impact of ESG policies and track performance relative to peers is among the most important strategic ESG-related activities for CFOs. In doing so, they must balance short-term performance targets with longer-term ESG goals (e.g., nonfinancial metrics, including diversity and social goals).

EY ESG research and active engagement with market leaders has led us to identify four top-line metrics that can serve as leading indicators of the efficacy of ESG strategies, as well as insurers’ ability to create long-term value.

In other words, these are the right financial metrics to gauge performance in a world where nonfinancial metrics are also increasingly important:

1. **Total shareholder return (TSR):** This critical metric incorporates both near- and long-term perspectives and tracks how effectively insurers present and execute their ESG strategies. TSR is an important component of many external ESG ratings. Though there are significant challenges in decomposing TSR into sub-metrics, the following metrics, which all correlate with TSR to some degree, are more easily broken down.

2. **Brand value:** The ultimate long-term value metric, brand values have typically oriented around perceptions of financial strength, stability and longevity. ESG principles, including transparency and accountability, can be excellent complements to the traditional positioning. Conversely, brands that don’t demonstrate a commitment to a greener economy, diverse workforces, ethical business practices and a more equitable society may face decreases in favorability ratings and, ultimately, financial value. Accusations of “greenwashing” – embracing ESG only for marketing and public relations purposes or falsely representing products and services as environmentally friendly when they are not – could also damage brands.

3. **Economic net worth (ENW):** Because of the short-term focus of past accounting standards, insurers have for some time been disclosing various non-GAAP measures, including market-consistent embedded value and Solvency II own funds, to show shareholders their ENW and ability to create long-term value. With the introduction of IFRS 17 in 2023, investors will also be able to infer a GAAP measure of ENW. Risk and return profiles evolve on both the asset and liability sides as a result of ESG considerations; we expect the approach to ENW evaluation will evolve, too, in light of new data, assumptions and valuation techniques related to green assets and liabilities.

4. **Return on capital (ROC):** Many insurers already have sophisticated risk modeling, often mandated by regulatory capital standards, and perform stress tests against key risk factors. There is growing momentum in the industry to include climate risks, including both physical and transition risks, in insurers’ internal capital models. There are also regulatory moves toward climate scenario testing. We expect to see significant evolution as data on climate impacts and exposures evolves, with ROC likely to become an important indicator of success in managing exposures.

These metrics are useful for several reasons. Certainly, they are pragmatic and universally accepted, which creates clarity in a complex – and often confusing – reporting environment. Further, many insurers already track and report them, with sign-offs in standard audit procedures, which means they can be adopted relatively easily. Perhaps most importantly, they will help insurers maintain strong ESG scores that are being developed by investors, ratings agencies and other market stakeholders. These ratings are essential for insurers to be included in ESG indexes.
It is impossible to overstate the need for and importance of high-quality data as insurers prepare to report against both mandatory and emerging standards and assess their own risks and opportunities. At a high level, insurers need to establish integrated reporting and data management capabilities based on current, complete and consistent data and an agile, flexible architecture. Building new centralized databases for ESG, designing ESG and sustainability data models, and adopting visualization tools for both internal and external reporting are other important steps.

Combining ESG data together with revenue, cost and capital data will be important both to track the progress of sustainability initiatives and to further inform the business strategy. Given the vast amount of nonfinancial data to capture, ESG requirements will likely accelerate the move of the finance function into the cloud.

In working to analyze the risks and opportunities, CFOs will be involved in validating the quality of the inputs and accuracy of the outputs, as well as engaging internal control and audit teams to confirm the integrity of key data and information. ESG due diligence and reviews will become standard operating procedures. The ability to provide auditable data will be key to pushing back against accusations of greenwashing.

On a practical level, finance teams will build on their traditional role as data gatekeepers by providing access to data and insights as necessary. They may also advise the business on the right types of data to collect. For instance, CFOs will engage with CROs to understand how sustainability affects liability measurements and solvency assessments. Specifically, they will corroborate that risk and financial models use consistent data. Such consistency is vital both to meet reporting requirements and to support strategic decision-making.

CFOs should think long term as they set up the necessary data infrastructure and data management and analytical capabilities. The ESG landscape will continue to evolve as new data becomes available and standards are refined. As with business forecasting and performance analysis, those finance groups most proficient in data management and analysis are likely to be the most successful in adding value to the business.
CFOs can't overlook the talent agenda. ESG, and in particular decarbonization, is a very technical area, and ESG knowledge and expertise are scarce. Business schools are just beginning to incorporate ESG into their curricula, and industry certification programs are in their nascent stages. Among the top ESG professionals that insurers need are data analysts and risk managers; AI specialists and data scientists with ESG experience are also in high demand.

Insurers will need to get creative in finding and accessing the necessary skills. Certainly, they will have to develop some internal training and development programs to fill the gaps. But they should also look to partner with external firms and even consider outsourcing some data management processes and tasks.

When CFOs find partners they trust, their first priority is to tailor recommendations to their firms' unique strategies, product portfolios, customer segments, operating models and geographic footprints. That's true whether they are looking to devise a roadmap to operationalize ESG strategies, assess the sustainability of their own products, streamline their reporting processes or infuse ESG into an updated operating model. It's important to remember that ESG is new to everyone, though first-moving and fast-following firms have learned a lot in a relatively short period of time.
Shape and share a persuasive external narrative

CFOs often serve as the public face of insurers to financial markets, investors, rating agencies and regulators. Thus, they must help shape their firms’ ESG stories for these audiences. Such narratives are also consumed by the media and general public.

 Investors have long found insurers’ financials to be complex and hard to understand. Adding ESG metrics without a clear narrative could make the problem worse. That’s why CFOs should provide leadership in crafting the story and providing the information investors need. The situation with ESG mirrors that of IFRS 17, in that there is a need for clear storytelling and guidance about how to interpret reported numbers.

At the highest level, investor stories should clarify insurers’ ESG strategies and the key metrics by which they’ll measure performance against those strategies, especially relative to future growth. The narratives should be structured and shared with an eye toward boosting investor confidence and, ultimately, improving external ESG ratings. Such steps are necessary to increase access to capital.

ESG narratives will also need to speak to investment strategies, risk exposures and liability impacts, long-term product plans and underwriting strategies, as well as broader consumer and public expectations. Beyond insurers’ plans to facilitate the transition to a greener economy (both as investors and providers of risk products), some investors will want to know about policies for covering high-carbon industries. Company commitments to environmental and social causes should also be taken into account in external ESG narratives.
ESG and sustainable finance in the context of finance transformation

The EY organization defines sustainable finance as any form of financial service that incentivizes the integration of long-term ESG criteria into business decisions, with the goal of providing more equitable, sustainable and inclusive benefits to companies, communities and society. That’s a big idea and bold ambition, and it’s become a top agenda item for CFOs in insurance because they are essential in making it happen.

Finance leaders who can propel finance transformation have the best chance in driving ESG success across the business. Futurizing the finance function means adopting new service delivery models, emphasizing insight generation over backward-looking reporting, deploying better technology, advancing data capabilities and engaging new types of talent. Any CFO that can lead such a transformation will see a big payoff. That’s especially true relative to ESG, which is just one of several reasons to embrace finance transformation now.

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