Outsized capabilities, outsized impact

November 21, 2022

*The effects of climate change are increasingly evident. Who better than re/insurers – blessed with the advantages of data, expertise, and balance sheets – to play an outsized role in driving broad-based adaptation to changing global climate, as well as the transition to net zer*o?

Climate change is now

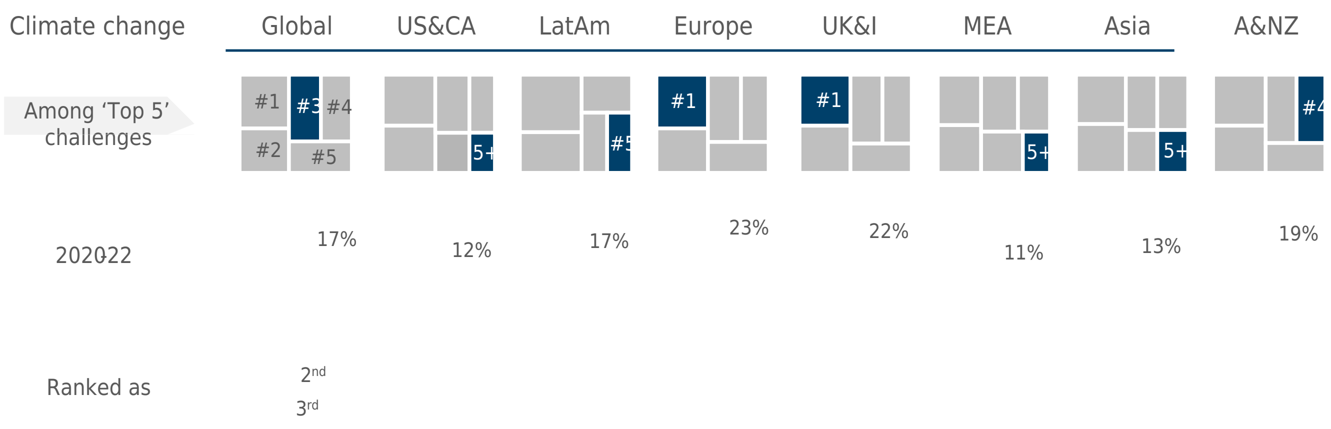
Humanity's collective impact on the global climate presents a clear and immediate challenge for insurers. Increasingly so.

That concerns about climate challenge have reached a high-water mark in a period of such great volatility positively highlights levels of awareness within the industry, but also foreshadows the difficulties that lie ahead.

Heightening recognition of climate risk as a 'leading challenge' within the insurance community carries even more significance given it is made in comparison to a basket of other commercial and operational challenges (from business growth to digital transformation, see Exhibit 1).

Exhibit 1: A new high-water mark for climate change challenges

17% of insurance executives rank climate as a leading challenge, more than doubling over 12 months to third overall (behind only reinsurance costs and capacity). Nearly one-half rate climate as the single biggest challenge for their company



Source: NMG Consulting – Global P&C Re Study – 2022

Nevertheless, ESG falls short of wider adoption

The considerations that have come to be known as ESG were developed over several decades, with governance factors most prominent and widely accepted.

Its rise to maturity is, among other things, evidenced by the mushrooming use of the term in corporate earnings calls across most industries (to 19% of earnings calls in 2021, according to PIMCO). In asset management, ESG is used to describe a range of activities and now borders on ubiquity. This has recently begun to take hold in insurance circles too.

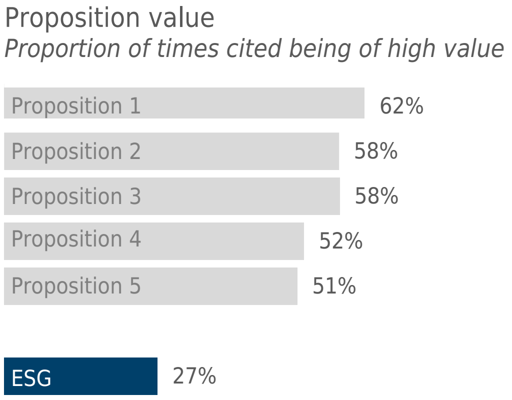
Full adoption of ESG across the value chain will ultimately deliver the greatest impact. The good news is that reinsurers already play a leading role in driving ESG agendas, using engagement approaches of several forms, including negative screens, advisory-level contributions and thought leadership.

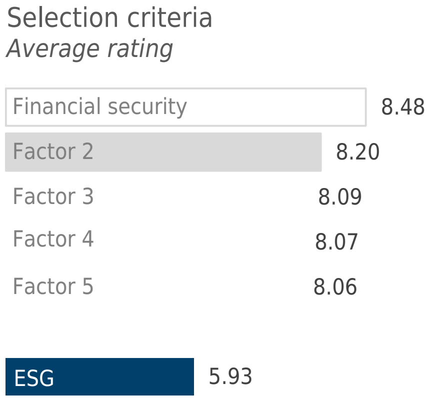
In recent years, more proactive ESG models have emerged, and are set to become a leading area of competition between re/insurance groups.

Despite their efforts, as an aggregate, ESG does not yet offer reinsurers broad-based potential for differentiation (ie proposition value in Exhibit 2). By extension, ESG has yet to gain meaningful traction in terms of how insurers and reinsurance brokers select reinsurance partnerships.

Exhibit 2: The ESG bundle, lacking broad appeal

Leading proposition elements are more than twice as likely to be seen as high value than ESG. ESG attracts relatively low ratings in reinsurance partner selection





Source: NMG Consulting – Global P&C Re Study – 2022

Climate change dominates ESG

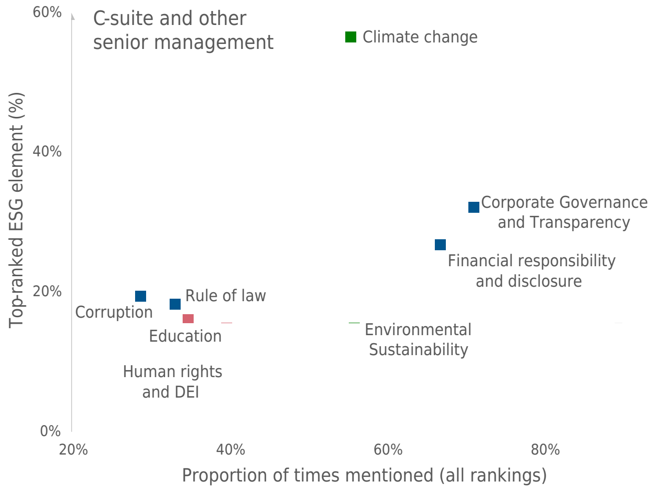
The case for using ESG as a leading agent of transformation in the insurance industry hinges on its broad recognition. E, S and G are however largely independent phenomena, each carrying different degrees of relevance by region. Even within ESG factors, major differences between industries exist.

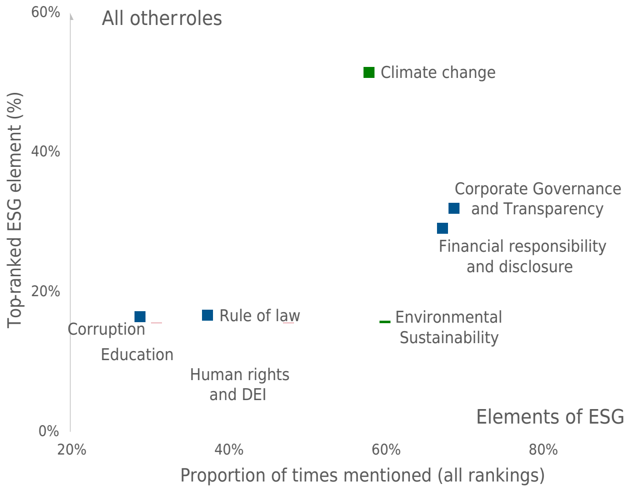
Insurance is a clear example of an industry where climate change dominates other ESG factors, given the enormous implications of more extreme weather on catastrophe exposures. The leading concepts of preparedness (for 'known' future changes, ie up to +1.5°C), and the journey to 'net zero' (2050, hopefully sooner) are of high relevance and an opportunity for value creation.

Exhibit 3 demonstrates the difference in importance of climate change versus other factors. Notably, there are similar views across all roles and experience levels, with C-Suites and Senior Executives significantly engaged given its linkage to strategy.

Exhibit 3: Climate change – twice resonant

Nearly 60% of senior management at insurers rank climate change as the most important element of ESG, more than twice the average of other ESG factors. S factors generally carry less weight





Source: NMG Consulting – Global P&C Re Study – 2022

Horses for courses

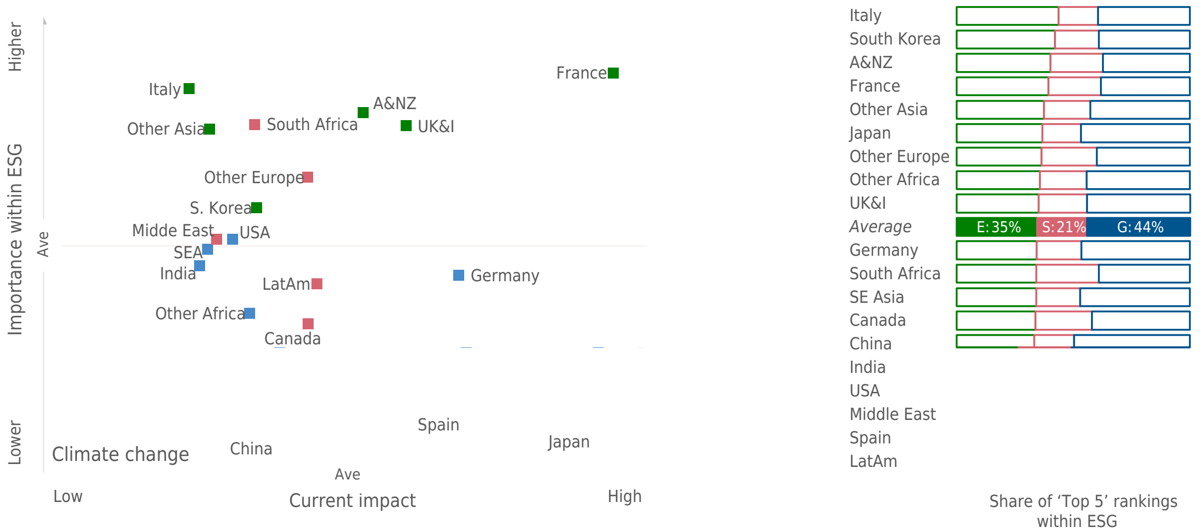
The emphasis of climate change within ESG can be a useful framework for understanding the differing dynamics between markets. For insurance these mostly come down to the balance between E and G sentiments, although S factors do carry increased sway in some markets.

A heavy ‘climate change’ orientation does not necessarily convey moral ascendancy, as those markets with lesser emphasis may have proactively adopted a broader ESG philosophy, or recognised that other elements are more important for their particular circumstances. Nevertheless, markets with a high focus on climate change can be thought of as being on the right track.

Exhibit 4 illustrates that the focus on climate change within ESG is mostly uncorrelated with the perceived current impact of climate change within a given market/region, indicating that ESG emphasis is to a significant extent about philosophy and strategy.

Exhibit 4: Emphasis within ESG

Dot colours for a given market depend on which ESG factor is most above the global average



Source: NMG Consulting Global P&C Re Study 2022

Exhibit 4 also illustrates that:

- Most European and Asian markets have a high emphasis on climate within ESG
- Governance factors drew the largest share of top 5 rankings in Japan, Germany, Spain and China, largely accounting for the lesser focus on climate. Japan is nevertheless a high E market
- South Africa, France, A&NZ, Canada and Other Europe demonstrate the most balance in weightings across ESG factors, resulting from their higher S focus
- No markets were both high G and high climate, but high S and high climate does co-exist

More customisation

In general, the downside of bundled messaging is the unavoidable reduction in emphasis on the most essential elements of a particular package. Merit-worthy exceptions exist when the sum is greater than the parts individually, although that is not the case for climate change within ESG for the insurance industry.

Re/insurers have thus logically looked beyond the ESG aggregate, focusing instead on the underlying individual factors, or variations thereof. Prominent examples include: Swiss Re (‘Resilience’), AXA (‘Climate’), Munich Re & SCOR (‘Sustainability’). More recently, in the asset management industry, where climate change is also the most resonant factor, we note that competitors are seeking out attributes ‘other than climate’.

Making it count

By virtue of its data advantage, deep expertise, and collective balance sheet (including 3rd party capital), the re/insurance industry has the scope to generate an outsized global impact (ie beyond the size of the insurance industry itself). In other words, the benefits of progressively applying re/insurers’ capabilities on a proactive ‘inside-out’ basis should be core to their purpose and responsibility.

Climate change – and environmental factors more generally – represent a huge opportunity for the re/insurance industry. But considered execution is advised. A lesson to be learnt from asset managers is to ensure that demonstrable evidence follows any ESG commitments. ‘Walking the talk’ is crucial to demonstrate leadership and avoid criticisms of ‘greenwashing’.

By Mark Prichard

By Mark Fox