Embracing ESG: How insurers turn ambition into action

Welcome to Embracing ESG: How insurers turn ambition into action.

Environmental, social and governance (ESG) priorities are reshaping the global economy. In turn, regulation is adding further impetus to the ESG transition, especially in relation to investments, risk and reporting. Beyond compliance, these regulatory changes have significant implications for key aspects of strategic management including product development and investment decisions. This underlines the extent to which strategic ambitions and regulatory expectations on ESG go hand in hand in hand.

While stakeholder and regulatory pressures mean that Europe is at the forefront of this transformation, the Middle East and Africa are also feeling the growing impact.

Insurers in Europe, the Middle East and Africa (EMEA) need to keep pace, from rethinking their role within a fast-evolving economy to defining their level of ESG ambition and embedding ESG in their strategy, culture and operations. Eight out of ten insurers taking part in PwC's Global Insurance ESG Survey want to incorporate ESG into their strategy in ways that go beyond regulatory requirements.

A similar proportion believe that ESG will have an impact across all their functions, not only underwriting, investments, risk management and reporting, but also claims,tax, human capital, their own operations and sales practice.

The big question is how to turn need into action. ESG is a notoriously vast arena. The complexities are heightened by the crossovers and knock-on impacts between the environmental, social and governance priorities. Even knowing where to begin can therefore be challenging. It's telling that most of the insurers in our global survey have yet to take significant action on either the social or environmental aspects of ESG. This includes the key step of defining their ambitions.

Practical way forward

In this report, we therefore look at how you as an insurer and the industry as a whole can move forward on ESG.

Our primary focus is climate as this is currently likely to have the greatest impact on your strategy and the business model supporting your transition to a net zero economy. But we also cover other environmental goals that might have a significant strategic impact such as biodiversity and the circular economy, along with some of the key social and governance priorities that are shaping stakeholder demands and form a critical element of ESG overall.

Recognising the complexity of ESG, we seek to break down the strategic considerations and operational reconfiguration into manageable components. We begin by exploring how the transition to a green economy is transforming the risk landscape and client demand. We also look at ESG regulatory compliance, putting different regulations into context, highlighting the most complex challenges and outlining the strategic implications. We then drill down into what these strategic and regulatory developments mean for the fundamentals of product design, underwriting, asset management and your own operations. In the subsequent sections, we focus on the functional (especially risk, reporting and tax) and data management overhaul needed to deliver these changes and align them with the parallel digital transformation of your enterprise. We close by reflecting on the outlook ahead.

Start with your ambition

We don’t want to be prescriptive in this report – we recognise that this is a highly diverse industry. But what comes through strongly from both our analysis and work with clients is the importance of defining your ESG ambitions and how to realise them in line with your purpose and strengths as an organisation. Solely relying on regulation to guide and drive change can only result in a piecemeal and reactive approach.

What’s also clear is that ESG can’t be simply tacked on to existing strategic objectives and operational capabilities. ESG goes to the heart of what stakeholders expect and how your business is judged, and hence how you will conduct business in future. To deliver, ESG needs to be embraced and embedded within your organisation from the inside-out. By making your business more credible and relevant within a changing world, the result would be a virtuous circle of purpose, opportunity and sustainable growth. If you simply rely on surface change, you not only risk organisational tensions, but could also fail to live up to your promises and risk being called out for ‘greenwashing'.

At PwC, we’re putting ESG and the net zero transition at the forefront of our priorities by committing to net zero by 2030, globally. We’re also looking at all our actions through an ESG lens and supporting our clients around the globe during this critical transition. This report can play a part in this journey by bringing ESG strategy and regulation into context and showing how to take action in an efficient and effective way.

I hope you find this report useful and thought-provoking. I would like to thank colleagues from around EMEA for their contributions. If you would like to discuss any of the issues we raise or know more about how your business can embrace and embed ESG, please get in touch with us.

Christoph Schellhas

Partner, PwC Germany
German and EMEA Insurance ESG Leader

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List of Illustrations

Please note that all words highlighted in pink* in the following texts are hyperlinks leading to the corresponding sources or references.
*(*only relevant for the online version)*

List of Abbreviations

AuM	Assets under Management
APAC	ASIA-Pacific
BES	Biodiversity and Ecosystem Services
CBAM	Carbon Border Adjustment Mechanism
CbCR	Country by Country Reporting
COP	Climate Change Conference
CRO	Chief Risk Officer
CSDDD	Corporate Sustainability Due Diligence Directive
CSRD	Corporate Sustainability Reporting Directive
CSFI	Centre for Study of Financial Innovation
CSRD	Corporate Sustainability Reporting Directive
CSO	Chief Sustainability Officer
CRO	Chief Risk Officer
DJSI	Daw Jones Sustainability Index
DNSH	Do no significant harm
D&O	Directors & Officers
ECB	European Central Bank
EFRAG	European Financial Reporting Advisory Group's
EIOPA	European Insurance and Occupational Pensions Authority
EMEA	Europe, Middle East, Africa
ERM	Enterprise Risk Management
ESG	Environment, Social & Governance
ESRS	European Sustainability Reporting Standards
ETL	Extract, transform, load
EV	Electric Vehicle
FSB	Financial Stability Board
GHG	Greenhouse Gas
GRI	Global Reporting Initiative
GSSB	Global Sustainability Standards Board
HR	Human Resources
IBC	International Business council
IDD	Insurance Distribution Directive
IFRS	International Financial Reporting Standards
ILS	Insurance-linked securities
IOSCO	International Organization of Securities Commissions

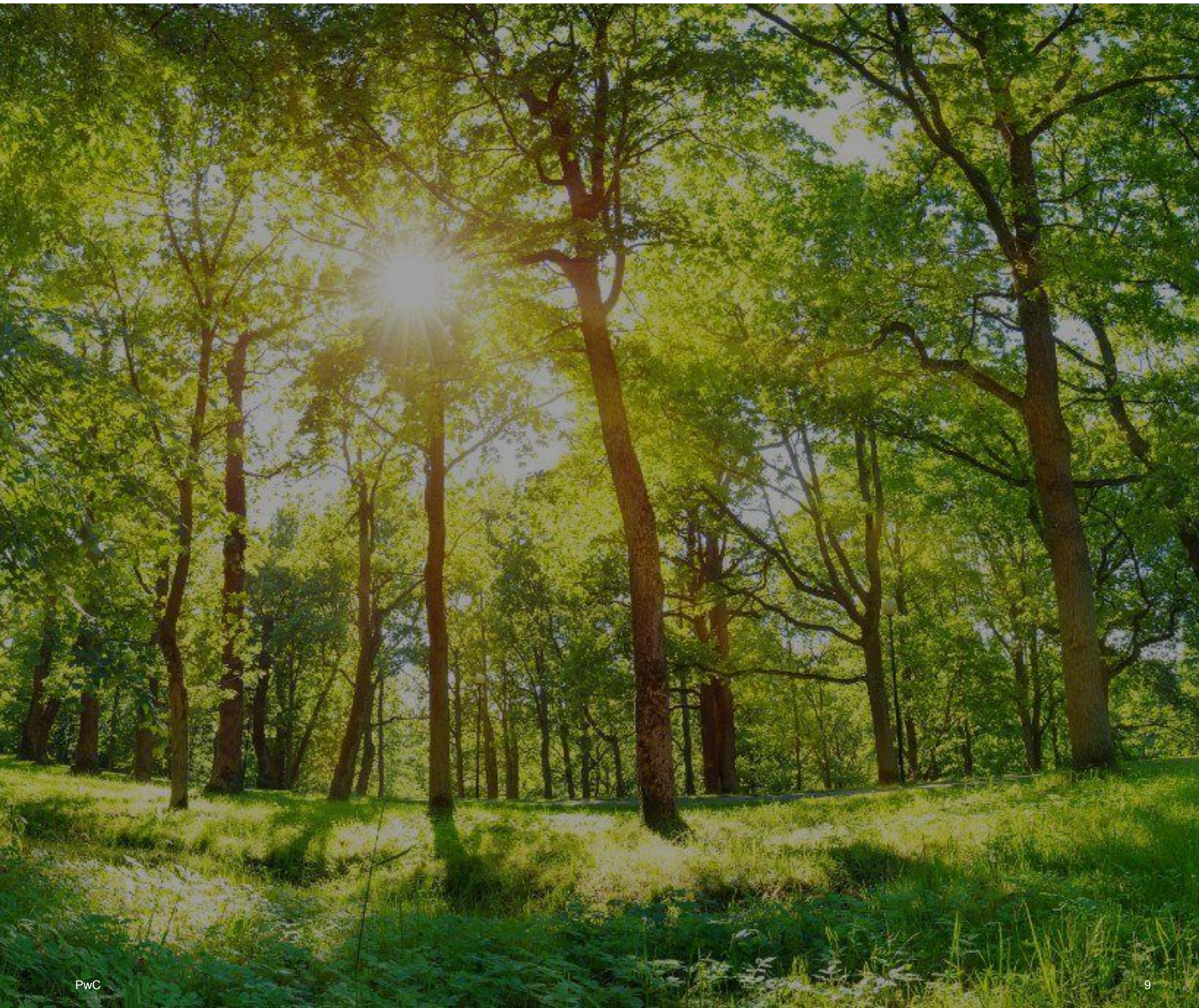
IoT	Internet of Things
IPCC	International Panel on Climate Change
ISS	International Services Shareholder
ISSB	International Sustainability Standards Board
KPI	Key Performance Indicators
MSCI	Morgan Stanley Capital International
NFRD	Non-Financial Reporting Directive
NGO	Non Governmental Organization
NZAOA	Net-Zero Asset Owner Alliance
NZIA	Net-Zero Insurance Alliance
ORSA	Own Risk and Solvency Assessment
PBAF	Partnership for Biodiversity Accounting Financials
PCAF	Partnership for Carbon Accounting Financials
PRI	Principles for Responsible Investing
PSI	Principles for Sustainable Insurance
QRT	Quantitative Reporting Templates
R&D	Research & Development
SASB	Sustainability Accounting Standards Board
SBTi	Science Based Targets Initiative
SDG	Sustainable Development Goals
SEC	U.S Securities and Exchange Commission
SFDR	Sustainable Finance Disclosure Regulation
SME	Small Medium Enterprise
TCFD	Task Force on Climate-related Financial Disclosures
TNFD	Taskforce on Nature-related Financial Disclosures
UNHCR	United Nations Human Rights Council
VUCA	Volatility, Uncertainty, Complexity and Ambiguity
WEF	World Economic Forum

Executive summary

To contain global warming within the 1.5°C increase agreed at the 2015 Paris Agreements, the world has less than ten years to halve global greenhouse gas (GHG) emissions and until 2050 to reach net zero. Failure could have catastrophic consequences for the world population and our way of living.

As the principal managers of risk within the real economy, the insurance industry needs to find ways to help businesses understand and mitigate the risks and uncertainties of the move to net zero. Without effective risk expertise and protection, it would be difficult for individual companies and wider economies to transition, certainly at the speed required. Insurers will need to play a key role in the transformation into a green economy with their investment and underwriting activities as well as their risk management capacity. That will also allow them to bring their own business model to the next level with new business opportunities.

The decarbonization of the economy is only one important part of the required ESG transformation. It is key to address all environment goals aligned and to cover 'S' and 'G' as well during that transformation (e.g. just transition).



Chapter 1: You are the agent of change

Bringing ESG to the forefront of strategy and governance

As an insurer, your business is in an ideal position to influence sustainability strategies and promote positive outcomes through your underwriting and investment decisions. This would allow you to move from simply absorbing the impact of climate change to becoming a vital enabler and accelerator for the development of a green and inclusive economy. This presents both a decisive test of purpose and a once in a generation opportunity to drive innovation and growth.

Key actions

Engage and change	Engage with stakeholders to understand what they expect, the implications for your strategy and how to respond.
Assess the material impact	Assess the material impact of climate & societal changes on your business in line with the principle of 'double materiality', determine the physical, transitional and reputational risks facing your business on the one hand and where you can make the most difference in enabling clients to accelerate green transition on the other.
Identify and bridge capability gaps	Compare current capabilities against what you need to realise your strategic objectives. Determine your approach to bridging the gaps (build, buy or partner).
Track progress and impact of your strategy	Track progress against a comprehensive list of defined objectives and tangible KPIs. Making and demonstrating progress is important to create the required momentum.
Firm up governance and accountability	To ensure that ESG moves to the centre of strategy and governance, it's important to establish active direction and accountability from a board-led ESG steering committee. Some businesses are going further by creating the post of chief sustainability officer (CSO) or chief value officer.

Chapter 2: New rules for realities

Getting to grips with ESG regulation

The influx of new ESG regulation and the policy goals that sit behind it are placing a whole new set of expectations on your business. The changing expectations have significant implications for your strategy, reputation and market valuation, as well as your compliance capabilities.

A lot of the rules are still being finalised and even more are likely to come in the future. But the timelines mean that you can't wait until everything is agreed before getting implementation underway. Further challenges centre on the inconsistencies and even conflicts between the various regulations. It's important to be able to communicate a clear strategy, embedding a ESG focussed culture and defining relevant KPIs, all backed up by firm evidence and honest proofs.

Key actions

Take a strategic lens	With so much at stake strategically and reputationally, it's important to assess what's coming through a strategic rather than just compliance lens.
Make it credible	At a time when sustainability disclosures are coming to match financial reporting in the levels of expectation and scrutiny by investors, it's important to be able to communicate a clear strategy and relevant KPIs backed up by firm evidence.
Identify and bridge capability gaps	Meeting the demands of ESG calls for active direction from the board and full buy-in and accountability from business teams. This can't be left to risk, compliance and reporting teams to tackle on their own. Key priorities include defining your goals and aligning this with day-to-day underwriting and investment decisions.
Embed change in the organisation	It's also important to define the metrics you will be using to assess materiality and inform business decisions, track progress and communicate performance.

Chapter 3: Be part of the solution

Embedding sustainability in your products, assets and own operations

Product development, asset management and the management of your own operations, including your supply chain are the building blocks for turning your ESG ambitions into concrete actions.

The insurers out in front are looking at how clients' risk protection needs are changing and how to put these new demands at the centre of their product design. They're also bringing their influence to bear as major investors. And to make sure they practise what they preach, they are looking at how to bring the sustainability, inclusion and ethical policies within their own businesses and value chains up to the standards they expect from clients and portfolio companies?

Key actions

Judge how client demands are evolving	Develop a clear understanding of the changing risk ecosystem and changed needs or business environments of your clients as a basis for portfolio steering and new product development.
Be innovative and design new products	Seize the opportunity to target new risks and drive product innovation and differentiation by putting sustainability at the centre of product development.
Align ESG and investment goals	Map climate and biodiversity risks against your investment strategy and build ESG into your performance goals. While this isn't about excluding whole sets of industries and activities, you would need to understand the risks, the associated reporting demands and how your business will come across as a result.
Win business buy-in	Develop awareness of how your own operations and those of your suppliers and partners impact on social and environmental priorities and drive positive change.

Chapter 4: Delivering on your promises

Turning reporting, risk and tax management into engines of ESG

Risk, reporting and tax management are the key engines of delivery on ESG.

Growing stakeholder demands for ESG disclosure are an opportunity to convey your ESG ambitions, build stakeholder trust and attract new business. But sustainability reporting remains fragmented, in parts inconsistent and challenging to use.

Without the burning platform of regulatory change, there may be a tendency to view ESG risk as largely a compliance exercise. But with the risk landscape changing so fast, ESG strategy and risk management need to be fully aligned.

Tax is coming under an increasing ESG spotlight, both in how much you contribute as a business and as an incentive for sustainable strategies and investments.

Legislative and sustainability developments as well as the shift from shareholders to stakeholders' capitalism have placed tax firmly on the sustainability agenda. Tax is coming under an increasing ESG spotlight, both in how much you contribute as a business in the societies you operate and as an incentive for sustainable strategies and investments.

Key actions

Be clear about the ask	Pinpoint what regulations and strategic commitments you need to report against and how to align the disclosure demands with your ESG strategy.
Identify the gaps	Determine the areas of your business that are most material and subject to scrutiny. Judge what resulting data, skill sets and technical understanding you need to report credibly and informatively to both boards and external stakeholders.
Judge risks from a holistic perspective	Determine what new and emerging risks ESG opens up. The assessment can provide the foundations for building ESG into your enterprise risk management (ERM) and business decision making frameworks, while judging what role your CRO should play in managing them.
Consider tax up front	Look at the tax implications of your strategy upfront, rather than vetting at the end. Tax to be an integral part of your ESG strategy.
Strengthen oversight and accountability	Ensure the governance, oversight and alignment between front office and reporting, risk and tax teams needed to protect your business and deliver on its promises?

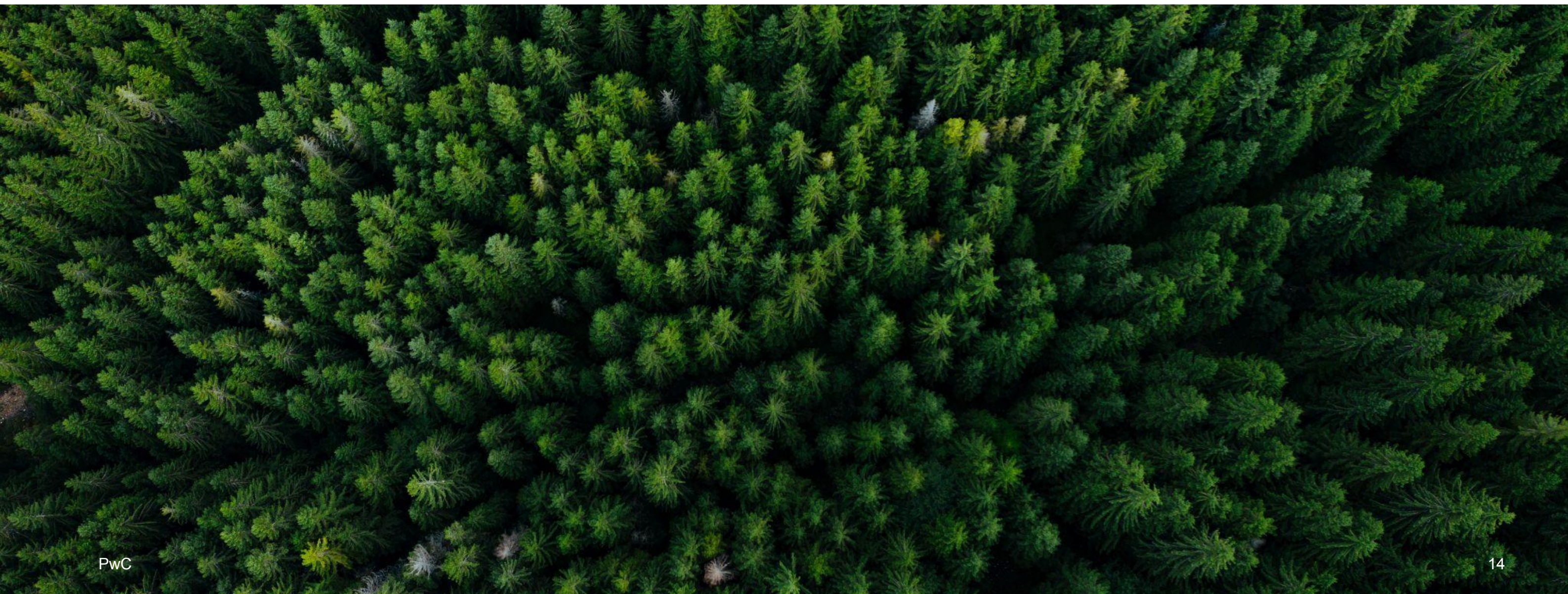
Chapter 5: From data to actionable insights

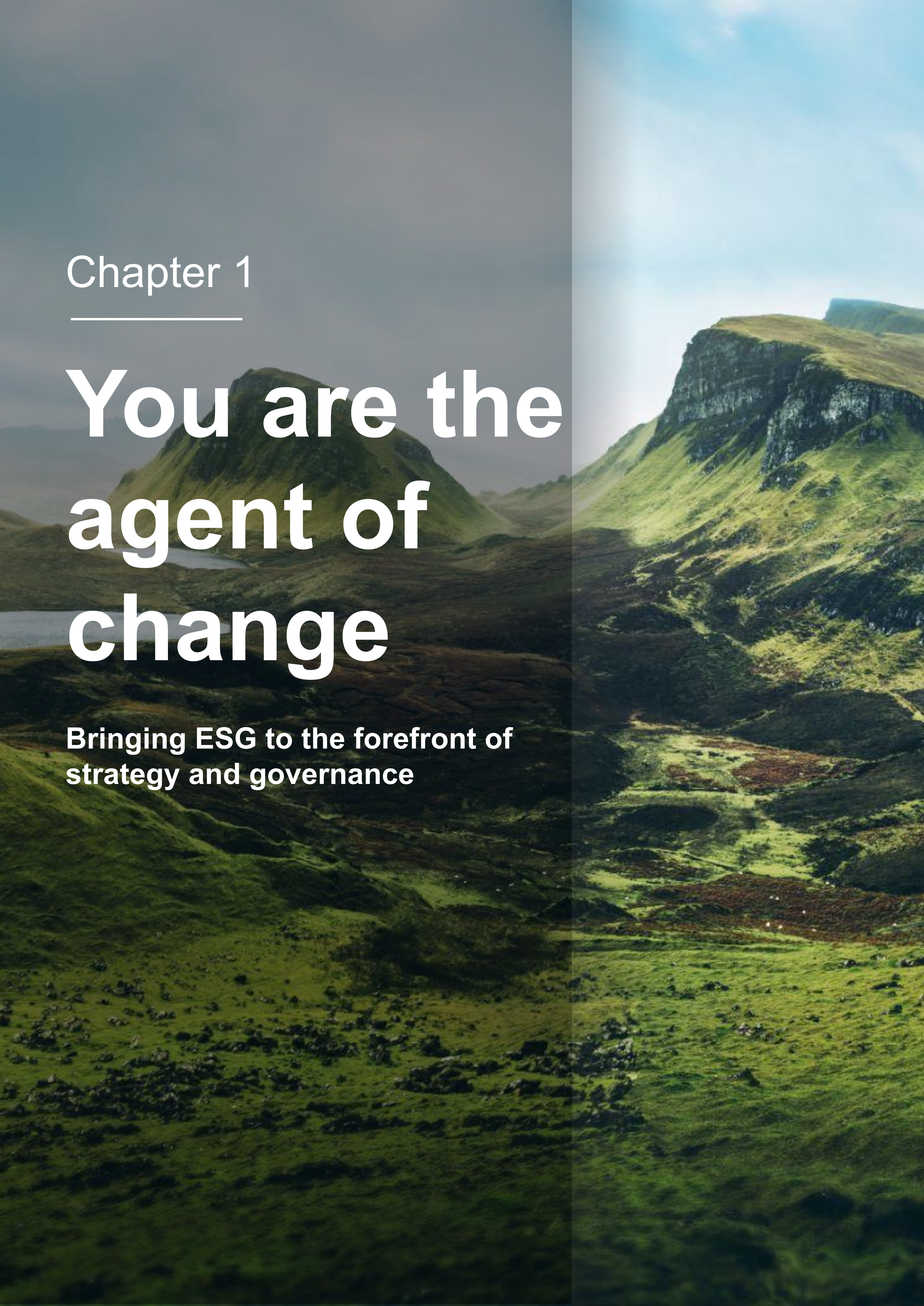
How a data rethink can sharpen insight, innovation and credibility

Your ability to realise your ESG ambitions depends on data. The main challenge isn't the lack of data – it's largely there if you can find it – but how to embed it into decision making and performance reporting in a way that turns information into insights and intentions into actions.

Key actions

Determine what you need	In evaluating data needs, the multiple data points within the CSRD can provide a good starting point. You can then build on this core data pool to assess what data is needed to meet your broader ESG ambitions and changing role within the economy.
Bridge the gaps	With your data demands clarified, you can look at what you have, what you need to gain access to and how. Do your homework – we've found that there is often a lot more data available in-house and in the public domain than many companies realise.
Strengthen quality control and assurance	The same rigour that's expected in the preparation of financial reporting should now be applied to sustainability and tax disclosures.





Chapter 1

You are the agent of change

Bringing ESG to the forefront of strategy and governance

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Bringing ESG to the forefront of strategy and governance

The world is at a crossroads. Already politically shaken and digitally disrupted, we now face the ever-increasing impact of climate change.

As developments ranging from record temperatures and devastating floods, droughts and wildfires to the shift in societal attitudes in the wake of COVID-19 lead to a new net zero industrial revolution, businesses are rethinking their objectives, strategies and risk assumptions. For insurers, specifically, the growing focus on climate change and ESG more broadly is reshaping insurance and investment portfolios.

This is also a world in which volatility, uncertainty, complexity and ambiguity (VUCA) have come to the fore. Mastering VUCA demands resilience, sharp risk management and a strong business strategy. Building ESG into your business DNA is an integral part of this.

As an insurer, your role in managing, mitigating and mutualising the systemic risks of climate change and facilitating the green transition through the right insurance policies, incentives for preventive actions and sustainable claims management are especially critical. This presents both a decisive test of purpose and a once in a generation opportunity to drive innovation and growth. How can you gear your strategy and governance to the ESG imperatives ahead?

From climate action to tackling inequality and discrimination, the stakeholder focus on ESG isn't new. But having barely moved since the term ESG was first coined in 2004, public interest (as highlighted in the Google search trend line) suddenly shot up as the COVID-19 outbreak erupted globally in Spring 2020. What COVID-19 did was to focus minds on the urgent need to address the threats we face today, not least by showing how quickly societies and economies can unravel. More than ever, people want change, and they want businesses, including yours, to be part of the solution.

If 2020 marked the point at which ESG erupted in the public consciousness, the preceding years had seen a raft of policy and regulatory changes that have moved ESG towards the centre of the business agenda. Political milestones include the 2015 Paris Agreement, 2018 EU Action Plan on Sustainable Finance, 2019 European Green Deal and the UN Sustainable Development Goals (SDGs). One of the key drivers for this transition is the EU Sustainable Finance Regulation to encourage more sustainable investment and increase transparency over sustainable investment.

All these developments show that the insurance industry should be the enabler, catalyst and risk taker, helping to move the world to a green and sustainable future. This brings a huge responsibility, but also a high level of new business opportunities.

Drivers of change

From an environmental perspective, the headline priority is containing global warming within the 1.5° C increase agreed at the 2015 Paris Agreement. To stay on track, the world has less than ten years to halve global greenhouse gas (GHG) emissions and until 2050 to reach net zero. But far from turning the tide, the world is on course for 3°C or even higher warming by 2100, a scenario that UN Secretary General António Guterres has described as a "fast track to climate disaster". Major cities could find themselves permanently under water and large parts of the world become uninhabitable. This would also be a world that is to all intents and purposes uninsurable. "It's now or never if we want to limit global warming to 1.5°C. Without immediate and deep emissions reductions across all sectors, it will be impossible," said Jim Skea, Co-Chair of the UN International Panel on Climate Change (IPCC) Working Group III.

In addition to climate change mitigation and adaptation, it's also important to look at other closely connected environmental issues. These include the transition to a circular economy, pollution prevention, protection of water and marine resources and protection and restoration of biodiversity and ecosystems – all of which are still to be added to the EU Taxonomy. Currently, however, the urgent need to tackle climate change is driving the environmental agenda of ESG.

The social agenda within ESG embraces a patchwork of interlocking issues ranging from discrimination to labour practices. One example of how climate and social issues are linked is the extent to which displacement is being triggered by areas of the world becoming uninhabitable as a result of climate change. According to the UNHCR, hazards such as cyclones and prolonged drought are already inducing some 23 million displacements of people from their homes each year. Without dramatic action, 200 million people will be in need of humanitarian assistance annually due to the effects of climate change by 2050.

Again businesses, insurers included, are coming under growing pressure to assess the impact of these issues and play their part in tackling them.

Down to you

So what's driving change within your business? A lot of the ESG agenda is viewed through the prism of new regulation (see Chapter 2). But just as important is the extent to which your customers and employees increasingly demand progress on ESG. So do your investors. A key part of this is the growing recognition within the investment community that an ESG focus can strengthen resilience and make your company more future-oriented.

Exhibit 1

Stakeholders want action on ESG

Customers
- Demand for **ESG-compliant insurance products** and disclosures
- Demand is **likely to grow across all insurance lines**

Shareholders/investors
- Institutional investors put **pressure on companies to act on climate change**
- Investors are increasingly including **ESG** in **investment decisions (e.g. ESG ratings)**

Value chain partners
- Increasingly assess insurers' ESG policies as part of **partnership due diligence checks**
- Insurers that don't respond to ESG adequately risk **narrower partnership opportunities**

Internal drivers
- Corporate **vision**, **mission** and **values**
- Management **ESG 'tone from the top'**
- **Proposition** and **business model**

Communities/press
- Companies are **held to higher standards** in their interactions with the public
- Companies that do not meet standards risk **potential reputational** impacts

Employees/unions
- ESG will be a **significant lever** for **talent management** given **changing employee attitudes**
- **Employee satisfaction** drives **higher productivity** and is positively correlated with **shareholder returns**

Regulators
- Reporting & Transparency
- Regulators are requiring that insurers embed **climate-related risks** within risk management frameworks
- Regulators are **demanding stronger ESG-related board governance**

Source: PwC

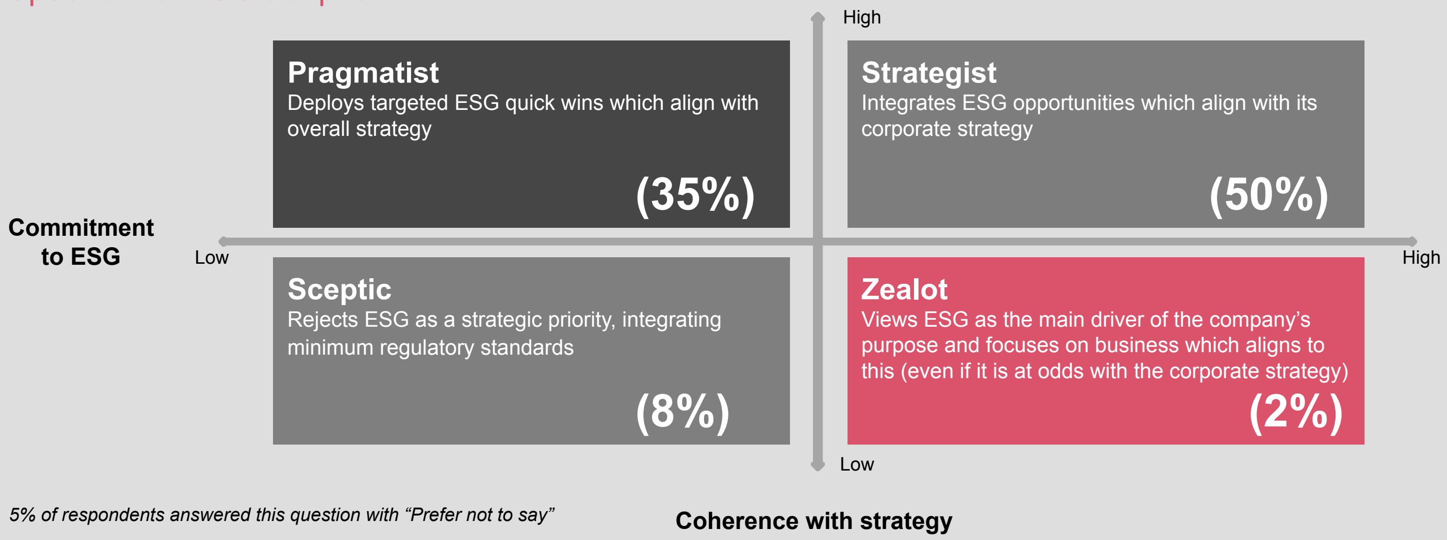
Businesses and consumers are gravitating towards green and socially conscious insurers. The European insurers taking part in our Global ESG Survey cite customers rather than regulators as their most important ESG stakeholders, even though this is the region in the world where ESG regulation is coming through fastest. Many investors now also look at ESG performance as closely as financial returns when judging where to commit their funds. In turn, a standout record on ESG could help your business to become a magnet for talent. This includes attracting the socially and environmentally conscious generations coming out of education and into the workforce.

Insurers recognise the strategic imperative. Eight out of ten insurers taking part in our Global ESG Survey want to incorporate ESG into their strategy in ways that go beyond regulatory requirements. When asked about the approach to ESG taken by leadership teams, 'strategist' came out on top, though there were also a significant number of pragmatists (see Exhibit 2).

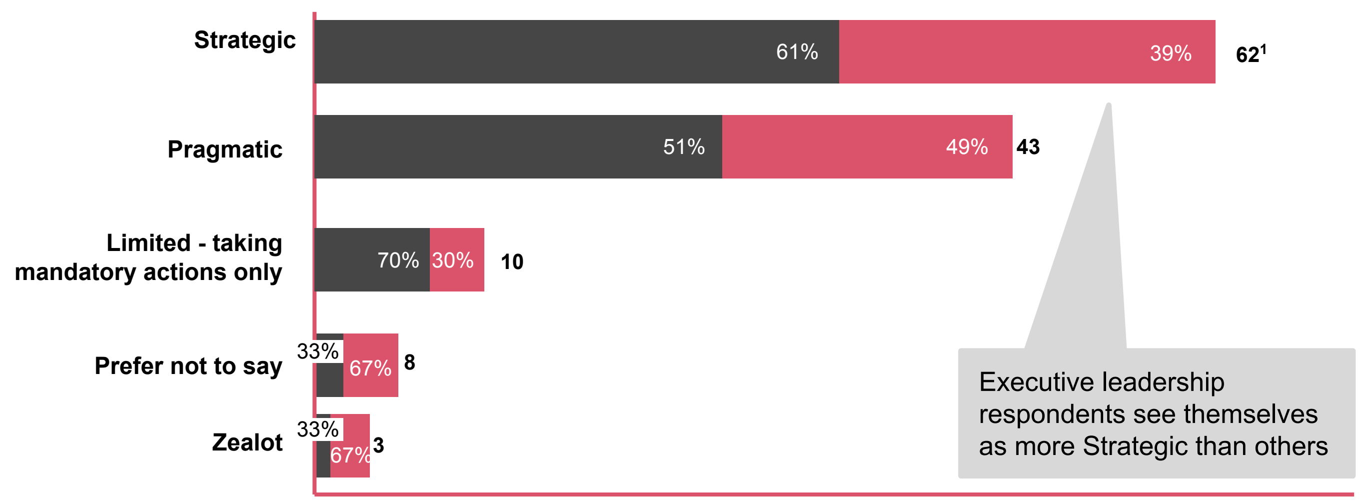
Exhibit 2

Leadership approach to ESG

Spectrum of ESG adoption



Approach of leadership



Source: PwC Global Insurance ESG Survey 2022

Making a difference

Alongside the stakeholder pressure are important commercial questions. Your business is already likely to be feeling the effects of climate change. As floods, wildfires and other high severity loss events become ever more frequent, climate change is the fastest rising risk in the latest PwC/CFSI Banana Skins survey of the threats facing the insurance industry. The scale of the losses is likely to demand an overhaul of your risk models and pricing assumptions. But this is also an opportunity to boost relevance and revenues by developing innovative new protection products. The reinsurer Swiss Re estimates that up to $183 billion of premiums could be generated globally by 2040 as a result of climate change, mostly in the property segment.

The other side of the ESG equation is your impact as an investor and underwriter on society and the environment. The need to look at the inside-out as well as outside-in impacts has come to be known as ‘double materiality’. From a strategic perspective (we explore the regulatory implications of double materiality in Chapter 2), the bulk of this inside-out impact is indirect. This includes the emissions from the companies you insure and invest in. You’re in a strong position to influence their sustainability strategies and promote positive outcomes through your underwriting and investment decisions. This would allow you to move from simply absorbing the impact of climate change to becoming a vital enabler and accelerator for the development of a green and inclusive economy. It would also open up opportunities for innovation, differentiation and growth in areas ranging from helping clients navigate the green transition to ensuring a new generation of climate technologies. The revenue potential could dwarf the property-focused coverage within traditional climate risk protection.

Making net zero possible

Why is insurance such a crucial part of the green transition and wider ESG agenda?

The move to net zero is an economic transformation on a par with the industrial revolution, which is made all the more impactful by the parallel and often dovetailing digital revolution. Businesses need to change sources of energy, production techniques and how they define and measure success. As the principal managers of risk and loss within the real economy, the insurance industry needs to find ways to help businesses understand and mitigate the risks and uncertainties of green transition. Without effective risk expertise and protection, it would be difficult for individual companies and wider economies to make the switch, certainly at the speed required.

The insurance industry is also the largest institutional investor in the EU, with over €10 trillion of assets under management (AuM), equivalent to more than 60% of the bloc's GDP. Inevitably, the size of these holdings is bringing the industry under intense stakeholder scrutiny from an ESG perspective. But it also gives insurers enormous influence over the companies in their portfolios and the direction of the economy as a whole (see Chapter 3). Through policy terms and risk selection, the influence over the businesses and householders you insure could be just as significant. As we explore in Chapter 3, examples might include encouraging the use of sustainable materials within home repairs or providing incentives for cutting road usage within motor policies.

You can also play an important role in fostering and facilitating green innovation, both through investment and risk protection. A lot of the technologies are quite new and have yet to be applied in mass settings. There are also commercial risks in developing what are in effect whole new business models. If we take automotive, which is one of the most affected sectors, as an example, the enabling and accelerating potential of insurance ranges from electric vehicle cover to warranties for a raft of newly developed technologies in areas such as e-fuels, battery storage and hydrogen-powered vehicles.

These two alliances are guiding an insurers way

Two UN-convened alliances are helping to move insurers along this net zero pathway. The Net-Zero Insurance Alliance (NZIA) is a group of 29 leading insurers representing more than 14% of premium volume globally. Members have committed to transition their insurance and reinsurance underwriting portfolios to net zero GHG emissions by 2050. The emphasis is very much on practical steps including changes to underwriting guidelines, engagement with high emissions clients and providing risk cover for sustainable technologies. On the investment side, the Net-Zero Asset Owners Alliance (NZAOA) is an international group of 74 institutional investors with $10.6 trillion in AuM. Members, who include a number of leading insurers and reinsurers, are committed to transitioning their investment portfolios to net zero by 2050. While setting emission reduction targets within portfolios, the main focus is supporting high emission companies through their transition rather than immediate withdrawal of investment. An important part of both alliances' commitments is creating baselines and key performance indicators (KPIs) to track progress and make it publicly transparent (see Chapter 4).

Facing up to the challenges

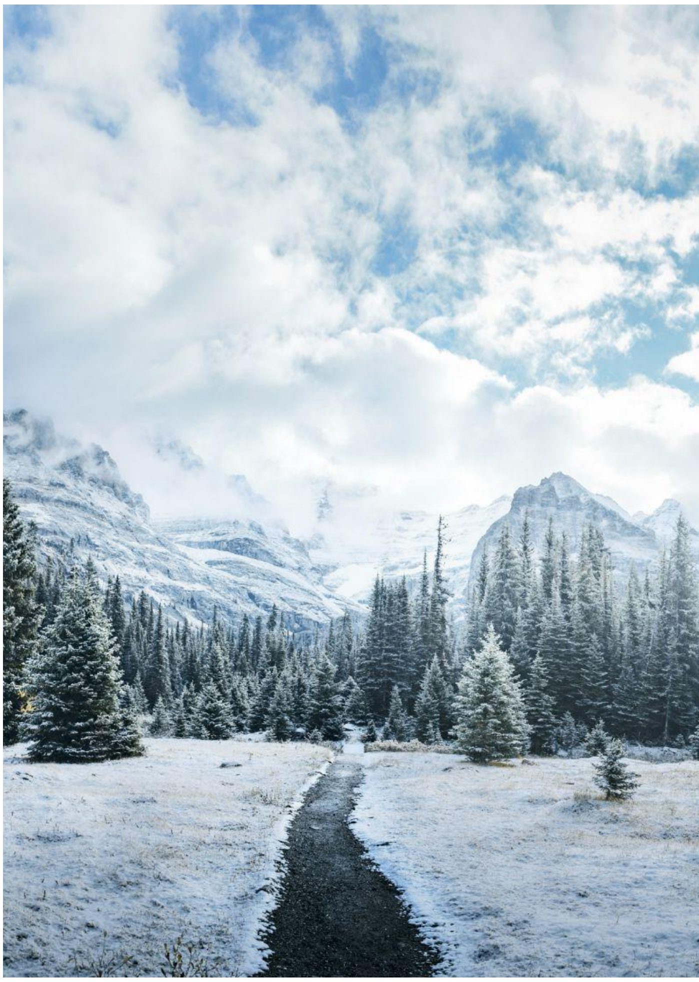
With the opportunities come challenges. Economically, the transition is daunting, not just in its scale and impact, but also the speed it needs to be achieved to meet climate change mitigation targets. These challenges are exacerbated by strains within the energy market created by geopolitical tensions and the slow pace of renewable development. There is also likely to be uncertainty and upheaval in financial and consumer markets. Rather than a smooth transition, there may be a series of shocks and setbacks along the way.

For you as an insurer, the challenges include supporting clients and portfolio companies through this complex and uncertain transition, while safeguarding your own balance sheet. In turn, a new generation of sustainable business models is ushering in an unfamiliar set of risks, with limited expertise and historic data to inform pricing, underwriting and reserve allocation. For example, once tried and trusted claims tables for motor cover are becoming less and less relevant as more and more drivers switch to electric vehicles. Your insurance offering also has to adapt to more sustainable ways of living and working such as greater use of public transport or the move to mobility as a service.

Transpose the upheaval in motor cover onto the insurance of other significantly affected sectors ranging from power generation to construction and the need to review strategy, operations and underlying assumptions is clear.

Ten sectors most affected by green transition

1	Power generation
2	Steel production
3	Cement production
4	Automotive
5	Logistics
6	Ammonia & synthesis production
7	Plastics manufacturing
8	Agriculture: animal husbandry
9	Commercial real estate
10	Construction



Source: PwC analysis based on sector impact in Germany(PwC/WWF Pathways to Paris)

Fundamental Questions

From a strategic perspective, the fundamental questions your business needs to address include what can be insured and at what price? It's also important to consider how to use your risk expertise to mitigate climate change and help clients transition to net zero in the most effective way. As we explore in Chapter 3, this is likely to require a significant investment in product development and the expertise and technology to support this. It's also going to require some hard choices. These include which assets and activities can no longer be part of your insurance and investment portfolio.

The other big questions centre on how to operationalise your ESG ambitions and align these with your fast-expanding regulatory obligations. Operationally, the shift in the risk landscape and scrutiny facing your investment portfolio would suggest that risk and investment management would be first in line for change. But they aren't the only aspects of your business affected. The wide-ranging impact of the transformation in society and the economy is reflected in the fact that 85% of the participants in our Global Insurance ESG Survey believe that ESG will impinge on all their functions, from sales to HR and IT.

For many of you, meeting these operational demands is likely to require a significant overhaul of data and systems. You need capabilities that are not just sufficiently powerful to deal with an eruption of new ESG data, but also agile enough to steer through regulatory change. They would also need to be reliable and credible enough to sustain public trust and prevent greenwashing.

Just transition

Currently, many stakeholders and initiatives are putting pressure on insurers to remove carbon-intensive businesses from their investment and insurance portfolios. But immediate disinvestment and decline of cover might not necessarily be the best course. You may be able to do more to advance the green transition by engaging with and supporting companies who are willing to move towards a more sustainable strategy and operations.

A key strategic consideration is balancing the urgent need for climate action with the impact of accelerated transition on jobs, prices and energy security. These are valid concerns. But rather than requiring a pullback on ESG, they highlight the need to balance the social and the environmental as part of a 'just transition'. Only by ensuring that the costs and benefits of the transition are fairly distributed will the world be able to tackle the climate emergency at the pace and scale demanded. That means distributing the opportunities equitably and mitigating the risks effectively. As an insurer, your ability to absorb and mutualise risk is critical to this.

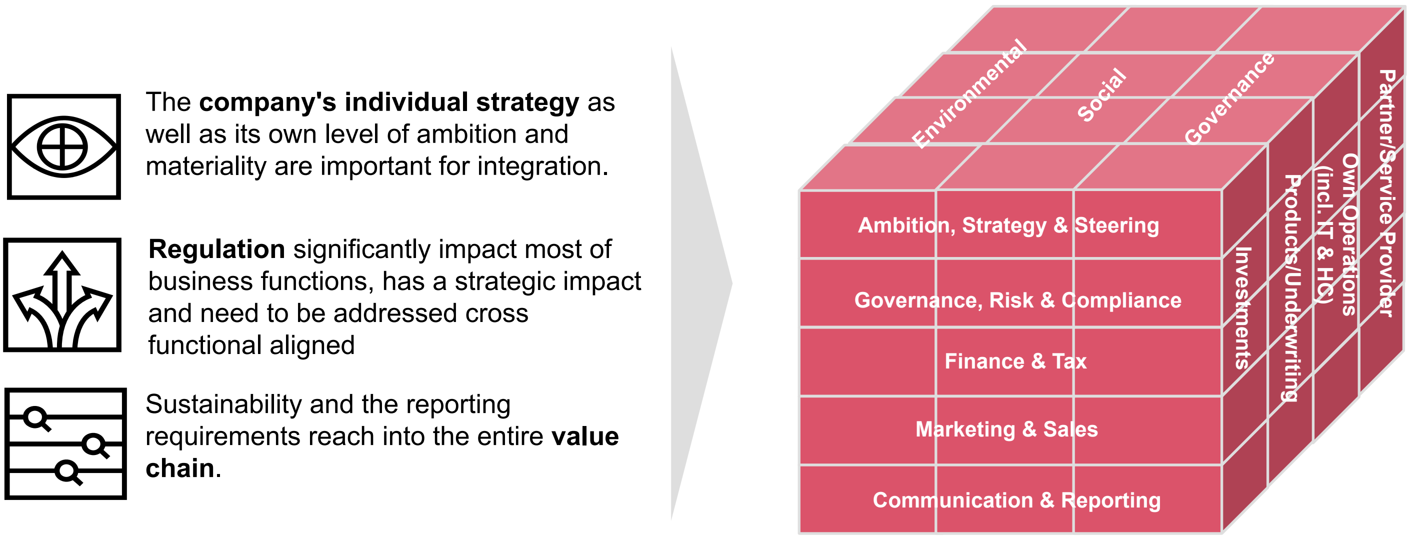
Struggling to make headway

Are insurers moving far and fast enough on climate action and wider ESG? Yes and no. Our Global Insurance ESG Survey finds that ambitions across each of the environmental, social and governance aspects of ESG are advanced. But most insurers have yet to take significant action on either the environmental or social aspects of ESG. And while they report that governance is reasonably mature, these capabilities could become increasingly stretched as scrutiny intensifies, new regulations come on stream and the risks of greenwashing escalate.

What's holding back progress? ESG is a vast and potentially bewildering arena of priorities and challenges. As Exhibit 3 illustrates, ESG impacts almost everything your business does and therefore the transformation needs to be holistic. Given the enormity of the task, common questions include "where do we begin and how can you make the most impact?" One of the key difficulties highlighted in our survey is how to translate high level ambitions into structured implementation and day-to-day operations on the ground. Specific challenges range from the interpretation of regulatory expectations to matching ESG initiatives to customer demands. Many insurers also report shortfalls in finance and capabilities, along with underlying issues in creating a compelling business case for ESG.

Exhibit 3

ESG: Holistic transformation



Source: PwC

The way forward

So how can your business move forward? Real progress on ESG demands a clear vision of what your business stands for and a realistic roadmap for change. It's also likely to require a rethink of objectives across all fundamental areas of your business. Just as important is a cultural leap as you look to secure buy-in and build relevance and credibility among clients, investors and other key stakeholders. Underpinning all this is durable governance, accountability and risk and reporting framework to ensure that what is being promised is delivered.

Drawing on our survey findings and work with clients, five priorities for delivering on these objectives stand out:

1. Engage and change

Engage with stakeholders to understand what they expect, the implications for your strategy and how to respond. It's important to gather internal perspectives from staff in different areas and levels of your business as well as external perspectives as needed. You can support these assessments by running focus group sessions with different stakeholders. The results will help you to build on strengths and target areas in need of intervention or a fresh approach.

Understanding expectations, identifying the actions that will make the most difference and gauging their operational and financial impacts will help you to develop a pragmatic and realisable set of strategic objectives. These solid foundations will also help you to define your risk appetite on ESG and align the opportunities with your strengths. Exhibit 4 sets out a sample framework to help you break the immensity of ESG down into understandable and actionable components.

2. Assess the material impact on your business

In parallel with stakeholder engagement, it's important to carry out impact and materiality analysis. This will help you to judge the physical, transitional and reputational risks facing your business on the one hand and where you can make the most difference in enabling clients to accelerate green transition and realising the business opportunities on the other.

This assessment should look at both the changing regulatory landscape and the emerging commercial openings. We recommend aligning this with the materiality assessment needed for the incoming EU Corporate Sustainability Reporting Directive (CSRD) – see Chapter 2 (regulation) and Chapter 4 (reporting). The assessment should also gauge the implications of a range of adverse climate scenarios that go beyond the 1.5°C baseline. A number of industry groups are developing and refining structured frameworks for impact analysis, including the UNEP FI Impact Radar.

3. Identify and bridge capability gaps

Compare current capabilities against what you need to realise your strategic objectives. Determine your approach to bridging the gaps (build, buy or partner) and carry out a cost versus benefit analysis to prioritise initiatives in order of 'must have', 'should have' and 'nice to have'.

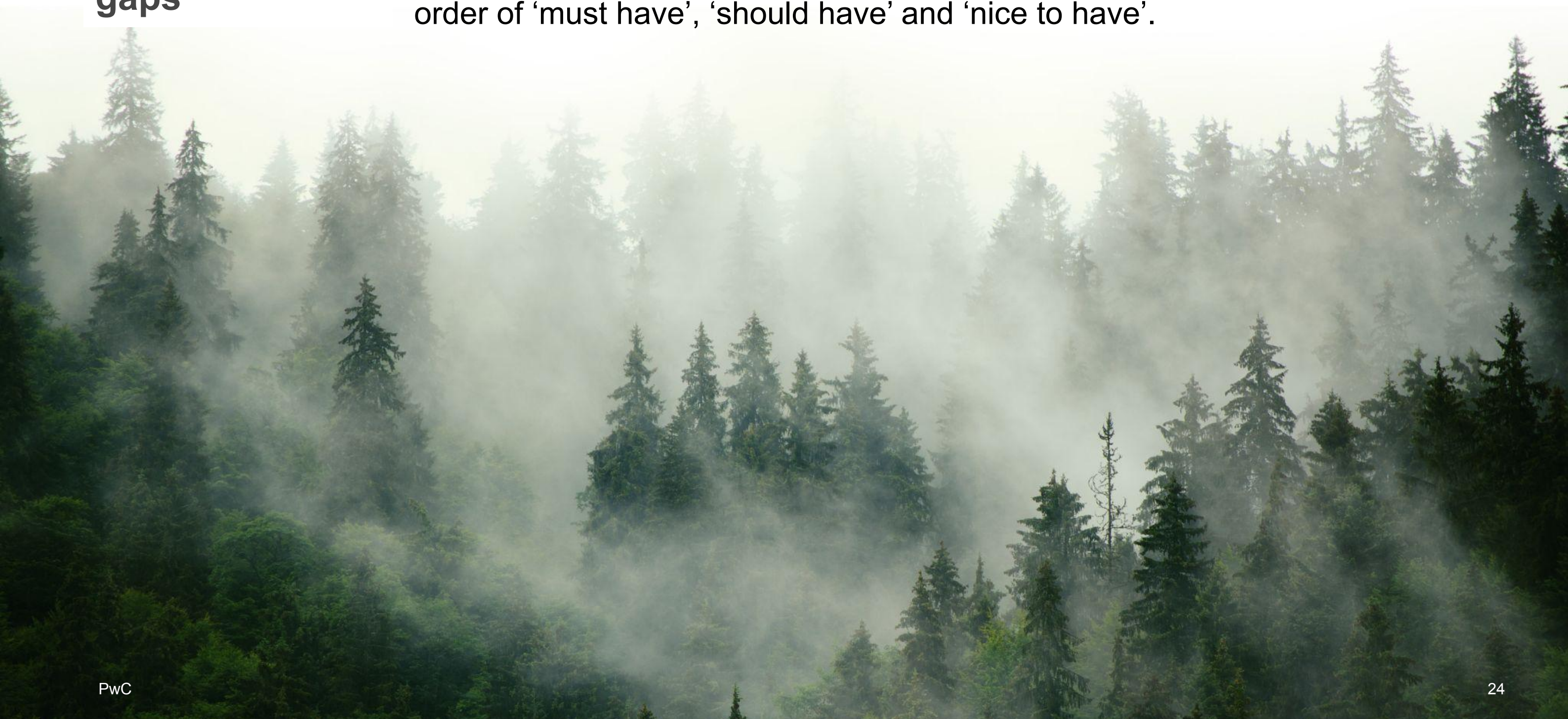


Exhibit 4

Breaking ESG down into actionable components

Dimensions		Examples
Environmental Minimising the impact of a company on nature	**Operations** **Products & services** **Supply chain & distribution**	• **Carbon emissions** from offices and data centres • **Waste to landfill** and incineration e.g. non-recycled computers, servers, photocopiers and general office waste • **Business travel** including emissions from flight and train travel and vehicle fleets • **Underwriting** to support development of renewable energy assets (e.g. solar/wind farms) and companies reducing emissions (e.g. providing specialised D&O cover for renewable energy companies) • **Financing** such as issuing green bonds • **Investments**: Sustainable Investment approach with ESG next to risk and capital as a strong side target • **Claims management:** Sustainable claims management by ESG additional ESG criteria within claims handling service provider onboarding and inventive for sustainable claims handling (e.g. sust. recovering after fire accident) • **Non-renewable resource** use for electronics and office materials
Social Contributions of a company to fairness in society	**Workforce** **Products & services** **Supply chain & distribution**	• Diversity & inclusion across employee categories (e.g. gender), social mobility, and pay equality • Health & safety and wellbeing – programmes to support health & wellbeing, including employee mental health programs • Human capital development, including upskilling of employees and training provided (e.g. digital analytics) • Customer privacy & data security e.g. investing in personal data protection for customer data • Underwriting to support social services, such as by providing preferential rates to not-for-profit enterprises • Diversity & inclusion in supplier base (e.g. contracts to office services for catering/ event)
Governance Quality of processes for decision making, reporting and ethical behaviours	**Transparency** **Accountability** **Independence** **Ethical behaviour**	• Providing accurate and timely reporting to stakeholders vs. recognized standards –on corporate purpose, strategy, financial performance and ESG tax benefits • Ensuring leaders are accountable for performance and risk management, across both ESG and other decisions, and pay is aligned to ESG-outcomes within company, especially include sustainability targets into board remuneration in line with sustainability strategy • Ensuring appropriate independent oversight, incl. board composition, diversity, remuneration, and limiting controlling shareholders and concentrated voting rights • Corporate governance: undertaking business in an ethical manner (e.g. avoiding bribery and corruption)

Source: PwC

4. Track progress and impact of your strategy

Track progress against a short list of defined objectives and tangible KPIs. Practical examples we've seen in the market include measuring the sustainability of claims settlement in areas such as choosing green materials for repairs and recycling or reusing undamaged parts. In turn, social KPIs range from progress against targets for women in management to boosting the availability and affordability of cover for underinsured sections of the community.

While all the steps we outline here need to be agile and flexible enough to deal with climatic developments and changing stakeholder expectations, this is especially so in gauging and tracking progress. You would need to revisit your strategy and ambitions at least annually. You would also need to track developments within your business and outside on a daily basis to make sure they are keeping pace with the rapidly changing regulatory landscape.

By harnessing the latest advances in risk modelling, unstructured data analysis and rules-based underwriting, you can begin to overcome any information gaps and develop the necessary risk understanding (see Chapter 5). You can also work with technology and infrastructure developers to gain a better idea of the types and levels of risks they face.

Again, industry bodies are developing valuable new methodologies. These include the NZIA and NZAOA, which are working with the Science Based Targets Initiative (SBTi) on a target setting protocol for insurance portfolios. The alliances are also working with the Partnership for Carbon Accounting Financials (PCAF) to develop a specific standard to measure insurance emissions. We explore these reporting developments further in Chapter 4.

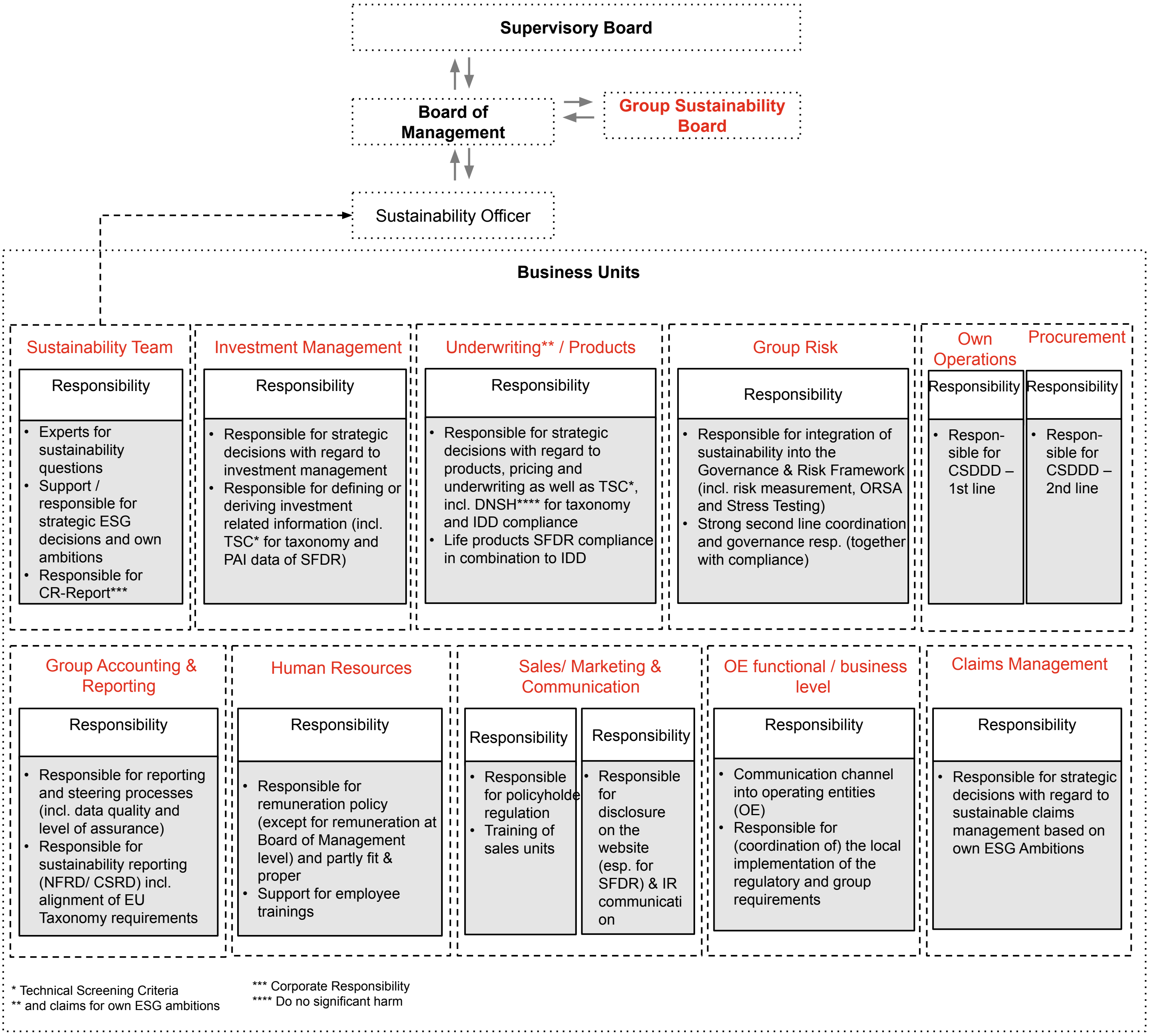
5. Firm up governance and accountability

To ensure that ESG moves to the centre of strategy and governance, it's important to establish active direction and accountability from a board-led ESG steering committee. Some businesses are going further by creating the post of Chief Sustainability Officer (CSO). Having a CSO on the board sends a strong signal to investors, customers and employees that sustainability is a key consideration in both strategic and operational planning. Similar trends we see of CFO's becoming chief value officers, underpinning the need for accountability and investor grade quality information on ESG.

As Exhibit 5 illustrates, all departments and layers of your organisation influence your ESG transition and should therefore be included in your governance framework. However, you shouldn't let every department work on their own. There must be some kind of overall coordination and steering to ensure all the links in the chain work together and move your overall strategy forward. Based on our extensive work with a range of clients, it would appear that only two approaches are working. The first is an ESG programme set-up, which aligns, steers and monitors all ESG activities. Second is a comprehensive ESG project with a number of interfaces across all areas of risk and reporting. There is support by a steering committee to oversee board-level reporting and decisions, which allows it to act as the integration hub for all activities. In addition, it's important to develop a clear understanding of the set-up and interactions between project and business-as-usual governance as in most cases both are developed in parallel.

Exhibit 5

Organisation-wide governance



Source: PwC

Seizing the opportunity

Accelerating progress on ESG is an opportunity to boost innovation and growth, secure customer and employee loyalty and change perceptions of the industry as a whole, at a time when trust in the financial services sector is near an all-time low according to the 2022 Edelman Trust Barometer. There is a real risk of acting too late, which will likely lead to lasting commercial and reputational damage. There is also a risk of overpromising and under delivering, which can pave the way for greenwashing.

Score your ESG performance

Since ESG data is getting more and more measurable ESG ratings play a key role for investors. In the current market there are a variety of different rating agencies with only little correlation between the ratings, as the methodologies are very different. This leads to issues when comparing ESG ratings, you cannot make reliable conclusions between different ratings because they have a very low correlation and most of the time have different data sets to measure their scores (e.g. focus on ESG risks versus transparency, focus on "E", "S" and "G" as individually versus ESG controversies). Currently there are no guidelines regulating these agencies which leaves room to come up with their own methodologies. A clear regulation for more transparency in ratings is more than called for.

Because there are so many different methodologies and approaches, it is difficult to give `one fits all advice`. Therefore, in order to make reliable judgments about the ESG performances you need to take several scores into account. The best thing you can do to improve your ESG ratings across the board is to face the issues head on and to deal with them to your best capabilities. Do not neglect or ignore ESG issues as this can then negatively influence your rating scores.

Are you ESG-ready?

- The climate crisis and wider focus on ESG are changing what society and your clients want from insurance and insurers. Sustaining relevance and delivering your purpose requires you to become an enabler for green transition and the sustainable economy of the future.
- What are your ambitions on ESG and how can you deliver?
- Which clients are most affected by climate change and how can you help them manage the risks and accelerate their transition?
- How can you make the most of the opportunities (incl. tax incentives and subsidies) for innovation and growth opened up by the green transition?
- How can you align your ambitions with the demands of regulatory compliance?
- How can you use industry initiatives to help you develop a baseline, set KPIs and manage reporting?
- How does climate change impact your risk profile? What ESG impact do you want to make in your investments and underwriting?
- How can you bridge the knowledge and capability gaps needed to manage climate change risk and your impact on climate change?
- What are the most effective governance and accountability frameworks for ESG in your company?
- Which agencies do you want to be rated by and how can these ratings positively influence your strategic decisions?

Chapter 2

New rules for realities

Getting to grips with ESG regulation

New rules for realities

Getting to grips with ESG regulation

What started with the Paris Agreement and the UN Sustainable Development Goals has led to a series of enacting regulations for insurance and wider financial services within the EU and worldwide.

In this chapter, we look at the thinking behind the regulatory shake-up, the key developments ahead and what they mean for your business.

The EU Green Deal seeks to deliver the Paris agreement's commitment to create a sustainable economy capable of containing global warming and safeguarding future generations. Recognising the vital importance of insurance and wider financial services in enabling the Green Deal, the EU has developed its Action Plans on Financing Sustainable Growth and its Renewed Sustainable Finance Strategy.

Spearheading delivery of these ambitious plans are a series of legislative and regulatory packages, which aim to accelerate the transition to net zero, boost investment in green and sustainable finance and apply the same rigour to social and environmental disclosures as financial reporting. Some of the regulatory developments are specific to financial services such as the Sustainable Finance Disclosure Regulation (SFDR), while others are economy-wide such as the Corporate Sustainability Reporting Directive (CSRD).

The EU developments form part of a wider global move to include sustainability in financial regulation and reporting. This includes the work being carried out by the US Securities and Exchange Commission (SEC). It also includes the setting up of the International Sustainability Standards Board (ISSB), which is seeking to create a global baseline for sustainability reporting.

Regulatory fragmentation

The breadth and depth of this regulatory wave creates challenges. These don't just include how many new requirements are coming through in the EU and globally, but the lack of alignment between them. Some of the regulations are still open to considerable interpretation and further development, such as the application of the SFDR Articles 8 and 9 'sustainable' designations to insurance products. In turn, there is as yet limited harmonisation in the KPIs and reporting templates within the various regulations (e.g. the SFDR and Taxonomy).

The European Green Deal and EU Action Plans on Financing Sustainable Growth recognise the need to connect all the different dots. Nonetheless, it is proving difficult to deliver this patchwork of regulatory initiatives at the desired speed while ensuring consistency between them. In the absence of regulatory consensus, sustainability information can be hard to interpret without deep immersion in a scattered and rapidly changing set of standards. The disclosures could also conflict. You could even find yourself reporting different numbers for the same aspect of your business, and then having to explain why. The resulting fog undermines the clarity, consistency and comparability of disclosure upon which stakeholder trust depends (we explore this further in Chapter 4).

Moving targets

A lot of what is being asked is still vague. And that applies to existing as well as incoming regulations. For example, the SFDR classifies life and pensions policies within one of three categories – a non-ESG-orientated Article 6, a light green 'environmentally and socially promoting' Article 8 or a dark green 'products targeting sustainable investments' Article 9. But it's not clear how green a policy needs to be to qualify for Article 8 or what would need to be included to meet the Article 9 specifications. And far from being esoteric questions for compliance teams, getting the designation wrong opens up the risk of mislabelling and being called out for greenwashing

A lot of what is being proposed is also controversial and still subject to heated debate. The disagreements have led to delays in finalisation and implementation. It can also be difficult to plan when so many of the fundamentals are still to be agreed. In an especially contested development, the European Parliament has designated both natural gas and nuclear power as sustainable investments within the EU Taxonomy. But this surprise move has been met with pushback. This includes opposition from Germany, the EMEA region's largest economy.

Immense detail

Further challenges centre on the level of detail within these regulatory developments. The European Financial Reporting Advisory Group's (EFRAG) initial working papers for the European Sustainability Reporting Standards (ESRS), the reporting side of the CSRD, ran to hundreds of pages. The length does in part reflect the fact that the papers cover all sectors rather than just insurance – industry specific papers are due in 2023. Nonetheless, there is a huge amount to process. Furthermore, the CSRD applies the double materiality principle, which means that in addition to disclosing the ESG risks for your business, you also have to report the ESG impact of your business model. And alongside EU regulations are parallel developments in other parts of the world (e.g. Sustainability Accounting Standards Board (SASB) in the US and taxonomies in Asia) and ISSB globally. Alignment between them is minimal. It's little wonder then that participants in our Global Insurance ESG Survey see 'understanding regulation' as the biggest challenge they face in seeking to push forward on ESG. Even most of the insurers who know the regulatory requirements still find understanding them difficult.

The step change in sustainability reporting comes at a time of parallel upheaval in financial reporting (e.g. IFRS 9 and IFRS 17), heightening the implementation hurdles. And while the technical compliance challenges are considerable, the implications for your strategy and how you operate in areas such as the carbon footprint of your assets and insurance portfolio could be just as significant.

Ratings and valuations at stake

It's important to note that policymakers and regulators aren't just driving change on ESG, but also responding to irrevocable shifts in public attitudes and investor preferences. Indeed, regulators can often find themselves playing catch-up as they strive to keep pace with ever more exacting stakeholder expectations. A 2022 PwC survey found that nearly eight out of ten institutional investors plan to increase their allocations to ESG products over the next two years. More than seven in ten assess their asset managers' ESG investment strategies before deciding where to allocate funds. A 2021 PwC global investor survey found that 79% believe that how a company manages ESG risks is an important factor in investment decision making. Even more believe that companies should show how ESG affects their business model (84%) and how ESG is embedded directly into their core strategy (82%). The growing importance of ESG and tax transparency reporting is therefore going to be a critical factor in how your business is rated and valued.

Forces driving change

To help make sense of all this new regulation and its implications, it's therefore helpful to look at the background to this gathering wave of ESG regulation. What's driving the changes, what they seek to achieve and the common threads between them.

Five key regulatory aims

1	Embed ESG and accelerate green transition in line with the **European Green** Deal and EU **Action Plans on Financing Sustainable Growth** (e.g. SFDR, Taxonomy and CSRD)
2	Strengthen understanding about exposures to physical climate risks and green transition risks (e.g. TCFD, TNFD and CSRD)
3	Strengthen disclosure of strategy and performance on social and environmental issues (e.g. CSRD, tax transparency reporting)
4	Bring the preparation and disclosure of non-financial reporting up to the assured standards of financial reporting (e.g. ESRS, ISSB and SEC proposals)
5	Define what activities and investments are considered sustainable and apply greater uniformity in how they are marketed and reported on (e.g. SFDR and EU Taxonomy)

Today's regulatory shake-up reflects growing recognition of the social, environmental and economic impacts of unchecked climate change.

The EU has set the highest level of ambition by initiating the European Green Deal, Action Plans on Financing Sustainable Growth and resulting legislation. To help get companies behind climate action, the EU is introducing a strengthened sustainability disclosure directive, the CSRD.

Through the CSRD and parallel SFDR and Taxonomy, the EU also wants to define what activities are considered sustainable and what information should be presented to policyholders. However, it's notable that while the CSRD covers the insurance value chain, it does not focus on the positive impacts of insurance within the green transition. In turn, the Taxonomy only looks at climate change adaptation within insurance policies, rather than all the environmental objectives in which insurers' contribution could be so critical. As we highlighted in Chapter 1 and develop further in Chapter 3, the onus will be on your business to pursue such opportunities and present the results to stakeholders.

Other key EU-driven developments include the inclusion of policyholders' ESG preferences in the updated Insurance Distribution Directive (IDD) and building climate change into the updated Solvency II system of governance, own risk and solvency assessment (ORSA) and stress testing.

Globally, the G20 Financial Stability Board (FSB) has developed the Task Force on Climate-Related Financial Disclosures (TCFD) to make sure that a company's climate risks are appropriately disclosed, and hence allow for informed and efficient investment decisions.

Following on from UN Climate Change Conference 26 (COP 26), COP 27 has provided further impetus for change with a particular focus on accountability and implementation of the commitments made in previous conferences. The prevention of climate change is closely connected to the protection and restoration of biodiversity and ecosystems. For example, wetlands and forests provide natural carbon storages. In December, the COP15 on biological diversity will take place in Montreal with the aim of agreement on a Global Biodiversity Framework setting binding biodiversity targets. The financial sector could be assigned a similarly important role as in the Paris Agreement. Draft objectives include adding nature-positive criteria to all financing instruments and increasing finance for nature-positive incentives by at least 200 billion USD annually while reducing contrary incentives by at least 500 billion USD annually. Mirroring climate-related initiatives, several biodiversity-related initiatives are currently emerging. The Taskforce on Nature-related Financial Disclosures (TNFD) is currently working on disclosure recommendations for nature and biodiversity-related risks and opportunities. Furthermore, Science Based Targets Initiative for Nature offers support in the setting of nature-based objectives and the Partnership for Biodiversity Accounting Financials (PBAF) is providing guidance on biodiversity impact assessments, in particular biodiversity footprints.

One of the most crucial developments emanating from the G20 and COP work is the IFRS Foundation's launch of the ISSB at the end of 2021. The ISSB aims to develop a comprehensive global baseline for sustainability disclosure to meet investors' information needs. The ISSB is seeking to align its standards with EFRAG's ESRS, the TCFD and voluntary frameworks such as the Global Reporting Initiative (GRI). The G20 has also agreed that the CSRD should be aligned with the ISSB sustainability disclosure as far as possible. There are also some similarities between the ISSB's initial proposals on sustainability reporting and those put forward by the US Securities and Exchange Commission (SEC). The result will be heightened global scrutiny of ESG strategy and performance. The problem is that despite the headline commitments to harmonisation, there are markedly different approaches to the evaluation of core KPIs. In particular, the CSRD is built around double materiality, but the ISSB and SEC only focus on single materiality at this stage (the impact on investors). In a further example of divergence, the Taxonomy's main priority is the level of sustainability alignment, while the ISSB focuses on the carbon footprint of assets and insurance policies.

Standing up to scrutiny

If we look at what's coming up, the CSRD stands out as the hardest regulatory development to implement, especially in combination with the Taxonomy. The CSRD is also set to have the most decisive impact on the strategy and operations of your business. But with the challenges come opportunities. Once a large proportion of participants in the economy are forced to report on their ESG strategy and performance, the visibility will drive innovation and change and provide appropriate revenue and shareholder value rewards for the organisations out in front.

At a time when sustainability disclosures are coming to match financial reporting in the levels of expectation and scrutiny by investors, policyholders and NGOs, the implementation effort needed for CSRD reporting could be compared to IFRS 17. The CSRD also calls for a financial reporting mindset and investor-grade set of controls. And, arguably, the CSRD goes further by requiring a rethink of business models and objectives, rather than just implementing a single regulation.

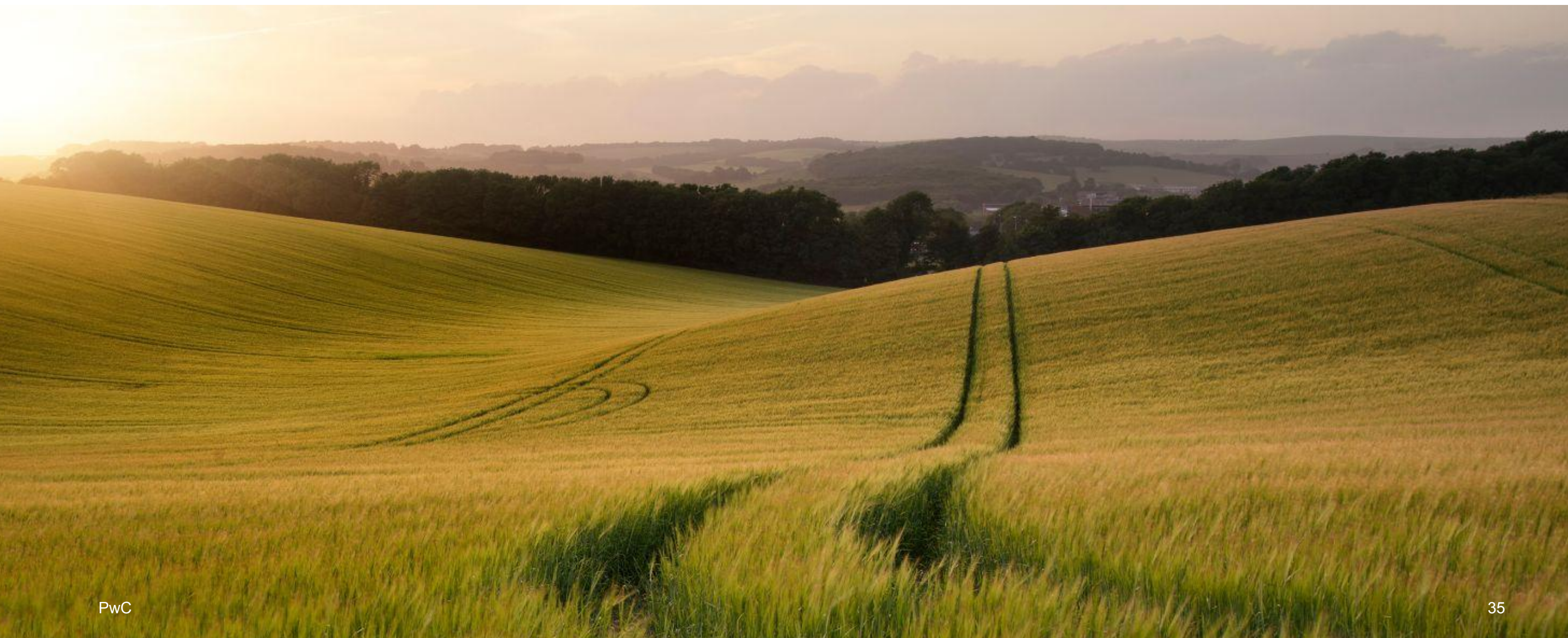
With the rating, valuation and credibility of your business at stake, it's important to be able to communicate a clear strategy and relevant KPIs backed up by firm evidence. Strategies would need to be aligned with front office processes to demonstrate to stakeholders that ESG is a genuine priority and you're delivering on your commitments. This is an opportunity to articulate your ambitions for ESG and gain credit for progress. The big dangers are a tick-the-box approach to compliance or sugar-coated disclosures. Both would put your business at risk of reputational damage. You could also lose business to competitors with more compelling and credible ESG strategies and reporting.

The scale of the challenge is heightened by your reliance on other companies to feed you information. This might be the asset managers looking after your investment portfolio. It might also be your corporate insurance clients or major divisions within your business such as home and motor cover. They too have to get up to speed on data gathering, measurement and verification. And with the CSRD due to come into effect for financial year 2024, the time to prepare is short and the resulting risk of reputationally damaging reporting errors is significant.

Double materiality drives strategic rethink

These reputational risks underline the extent to which new ESG regulation is far more than just a compliance challenge, as significant as this is (we look at how to get reporting and data management up to speed in Chapters 4 and 5).

From a strategic perspective, the game-changer is the concept of 'double materiality'. Under the CSRD and GRI, you would not only be expected to develop strategies for and report on the outside-in impact of all ESG issues including climate change on your business, but also your inside-out and outside-in impact on climate change through your insurance and investment portfolios. Given the insurance industry's pivotal place within society and the economy, both these material impacts are considerable. It's important to ask yourself whether your ESG strategy stands up to scrutiny and is sufficiently embedded and operationalised across your business to be delivered. If you're not convinced, why should anyone else be? The big dangers are headline strategies and policy statements that aren't reflected in decisions and operations on the ground.



Time to apply a strategic lens

So how do you get to grips with this wave of regulatory change? A bottom-up approach to implementation would assign separate working groups to deal with each regulation and the various details within them. But with so much at stake strategically and reputationally, it's also important to look top-down. So before tackling all the minutiae of these new regulations, the initial priority is to assess what's coming through a strategic lens.

The implications of double materiality provide a good starting point for this strategic assessment. From the outside-in perspective, it's important to ask how vulnerable are your asset holdings, loss reserves and financial performance to the effects of climate change under different temperature rise scenarios? What changes and new capabilities are needed to manage and mitigate these risks within your portfolios?

From the inside-out perspective, it's important to ask what more could and should you be doing to help curb climate change and mitigate its impact on society and the economy. As we discussed in the previous chapter, you may want to be a leading force, spearheading and facilitating the green transition and taking a place at the heart of the new economy. But ambitions need to be realisable, and performance measured, tracked and prepared to an auditable standard. You also need to demonstrate that you are living up to your promises, while practising what you preach in your own operations in areas such as energy usage and diversity and inclusion.

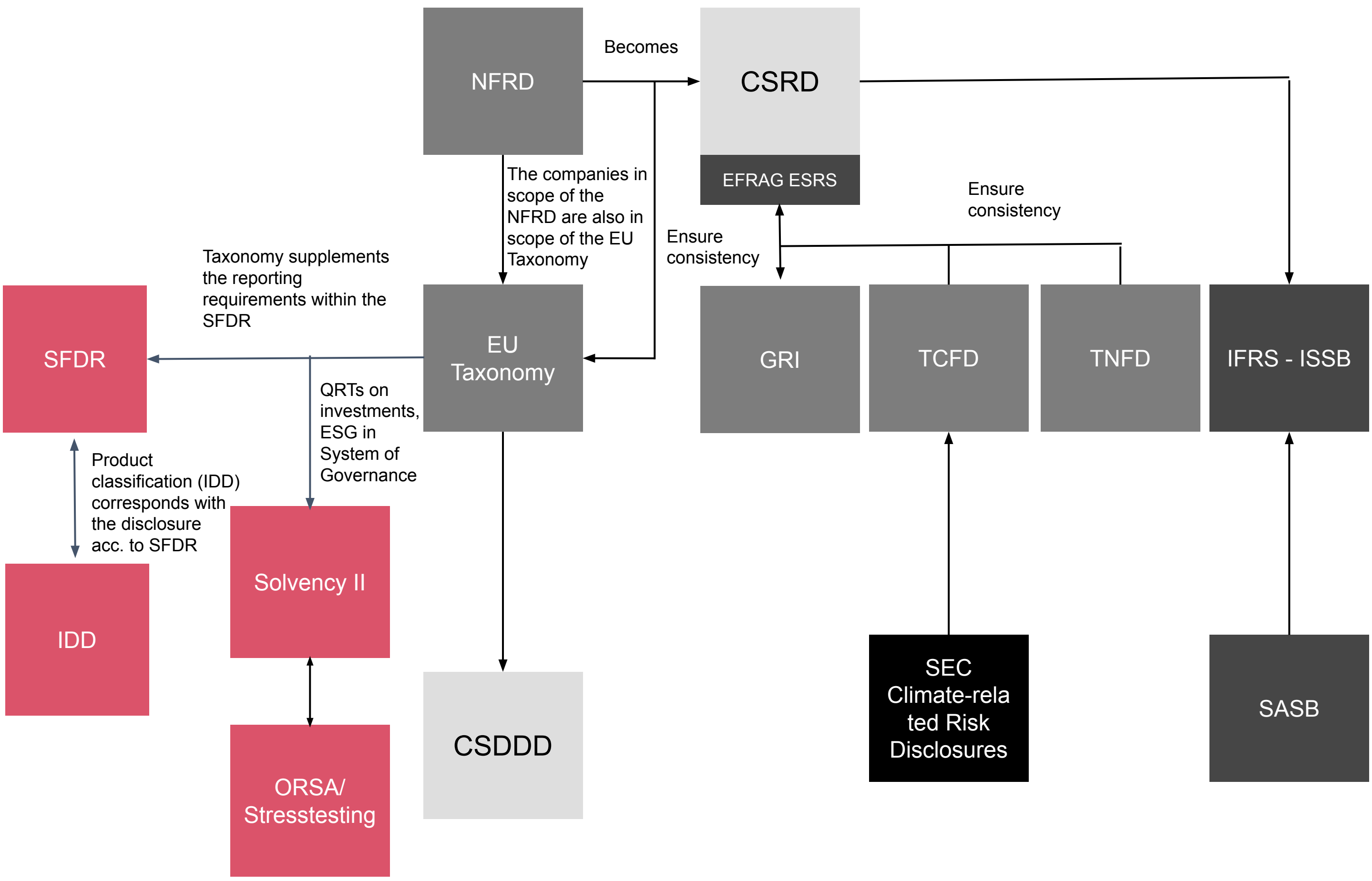
These strategic considerations demand active direction from the board and full buy-in and accountability from business teams. ESG regulation can't be left to risk, compliance, tax and reporting teams to tackle on their own. Key priorities include defining your goals and aligning this with day-to-day underwriting and investment decisions. You also need to define the metrics you will be using to assess materiality and inform business decisions, track progress and communicate performance.

The related considerations are how to put across your message most effectively and judging how it will be received. Qualitative explanation will be just as important as quantitative data in conveying what you want to achieve on ESG and your rationale for this. You may also need to explain why targets aren't being met and how you intend to address this. Other important qualitative disclosures would centre on how you interpret and apply any grey areas of regulation and the assumptions behind your numbers and product designations. Placing sustainability at the centre of your management report will put it in the spotlight of your corporate reporting. But it's also an opportunity to make your case on ESG in a compelling and convincing way.

The existing landscape of ESG frameworks and standards is very diverse, even more looking from a cross country perspective. There are many different regulations and standards that are interconnected and need to be applied, as can be seen in Exhibit 6.

Exhibit 6

The existing ESG landscape and its interrelationships



NFRD=Non-Financial Reporting Directive
CSDDD=Corporate Sustainability Due Diligence Directive
CSRD=Corporate Sustainability Reporting Directive
GRI=Global Reporting Initiative
IDD=Insurance Distribution Directive
ORSA=Own Risk and Solvency Assessment
SEC=U.S Securities and Exchange Commission
SFDR=Sustainable Finance Disclosure Regulation
TCFD=Task Force on Climated-related Financial Disclosures
TNFD=Taskforce on Nature-related Financial Disclosures
ISSB=International Sustainability Standards Board
SASB=Sustainability Accounting Standards Board

Source: PwC

Spotlight on regulation: TCFD

The G20-sponsored TCFD is the master blueprint for the new generation of carbon-related reporting worldwide. The EU, SEC and ISSB have used the guidance as their starting point.

So far, the UK is the only major economy to build the TCFD directly into mandatory reporting. But others may soon follow, either directly (e.g. Switzerland) or by using the TCFD as a baseline for further development (e.g. CSRD and ISSB).

One of the main reasons why the TCFD is so significant is that it requires you to evaluate and report on the future impact of the physical and transitional risks. This would include a discussion of the potential impact of a range of global warming scenarios on your strategy and financial performance, along with the metrics used to inform these judgements. The TCFD also enables you to set out the opportunities for your business opened up by green transition and how you intend to capitalise.

The other big departure is the level of board involvement and oversight required. This includes explaining your methodologies and governance practices for these assessments.

The introduction of mandatory TCFD in the UK highlighted the importance of allowing time to develop sufficiently thorough and credible scenario analysis. It's also important to move early in aligning corporate objectives with reporting requirements on ESG and developing a standardised governance framework to track KPI progress.

Why it's significant	Who it applies to	When	Parallel regulations
Would put sustainability disclosure on a common and statutory basis, albeit only at a baseline level	Listed companies and financial services organisations in the UK. Organisations that have adopted the Principles for Responsible Investing (PRI) also partly report on a TCFD basis	Required in UK since April 2022. Other markets may follow	CSRD and ISSB

Spotlight on regulation: International Sustainability Standards Board (ISSB) reporting framework

In November 2021, the IFRS Foundation announced the formation of the ISSB to develop a single set of high quality, understandable, enforceable and globally accepted sustainability standards based upon clearly articulated principles.

The aim is to create a common baseline for standards worldwide. The standards could either be used on a standalone basis, or linked into other regulatory requirements.

In practice, however, the potential mismatch between ISSB proposals and the EU's own steps need to be settled. There is certainly room for duplication of effort, if not divergence of outcomes. This has been a key focus of the response to recent consultations. Any misalignment could also impair any moves towards regulatory 'equivalence' for insurers reporting outside the EU.

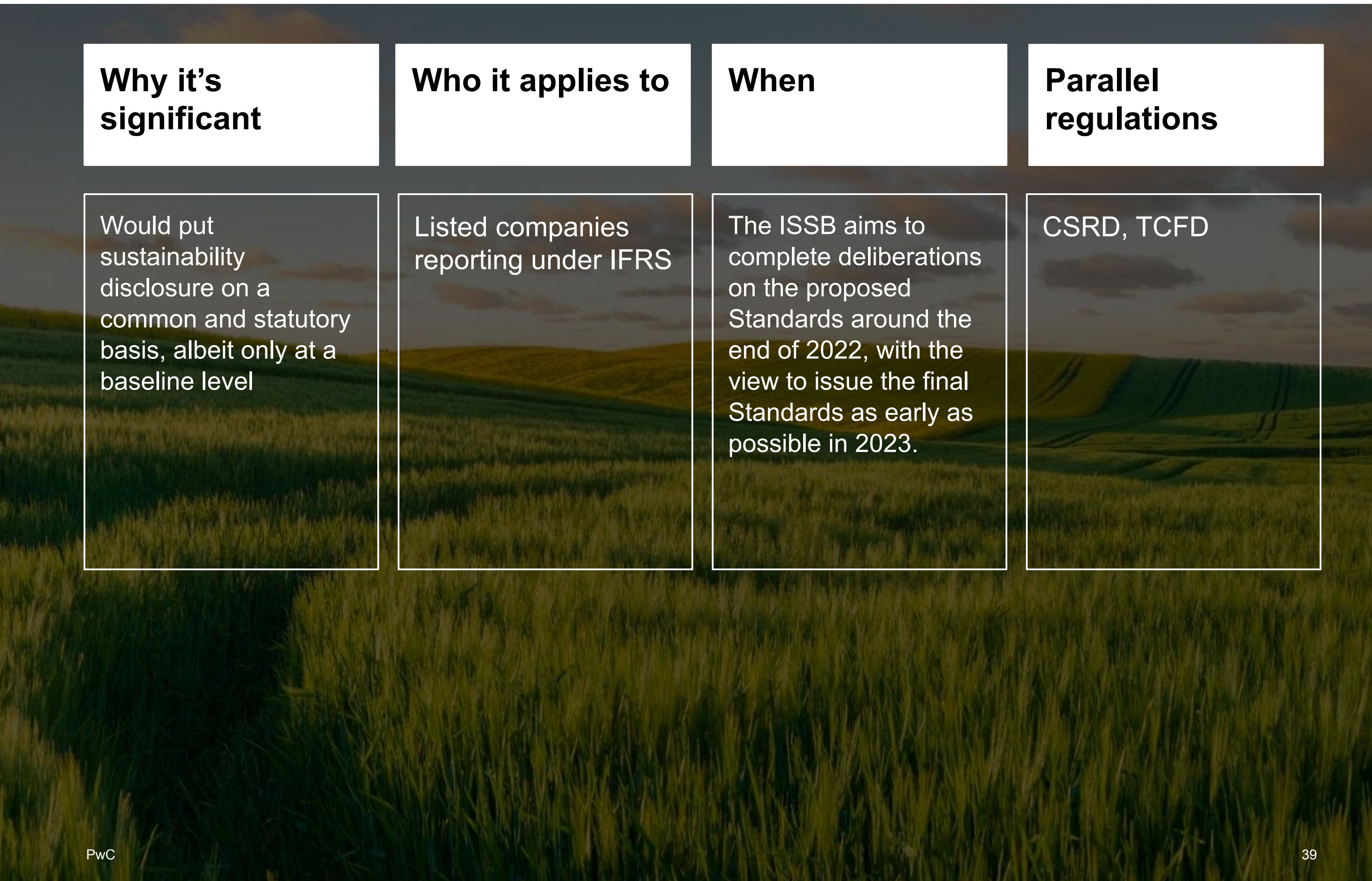
The updated proposals announced in October 2022 would require company disclosures on Scope 1, Scope 2 and Scope 3 GHG emissions, applying the current version of the GHG Protocol Corporate Standard.

The ISSB has confirmed that its requirements will focus on meeting the information needs of investors. However, it has decided to modify some of the language in earlier proposals. This includes removing the term 'enterprise value' from the objective and the assessment of materiality and removing the term 'significant' to describe which sustainability risks and opportunities to disclose.

The ISSB has also confirmed it will use the same definition of material as is used in IFRS Accounting Standards and will discuss at a future meeting the need for further guidance on how to determine what is material information.

Once approved by the ISSB, the proposed standards will be considered by the International Organization of Securities Commissions (IOSCO)and, if appropriate, endorsed by IOSCO's Board. IOSCO will thus act as a bridge into the regulatory world.

Alongside the investor-focused ISSB framework, TCFD and the GRI standards could form the basis for multi-stakeholder disclosures as part of the ISSB/GSSB memorandum of understanding.



Why it's significant	Who it applies to	When	Parallel regulations
Would put sustainability disclosure on a common and statutory basis, albeit only at a baseline level	Listed companies reporting under IFRS	The ISSB aims to complete deliberations on the proposed Standards around the end of 2022, with the view to issue the final Standards as early as possible in 2023.	CSRD, TCFD

Spotlight on regulation: CSRD

The EU is replacing its existing Non-Financial Reporting Directive (NFRD) with the much more rigorous and comprehensive CSRD.

In keeping with the principle of double materiality, the CSRD would require detailed disclosures about how sustainability issues affect your business, as well as the impact of your business' activities on people and the environment. This includes information necessary to understand:

- Your company's impact on sustainability matters, including environmental, social, and employee matters, respect for human rights, anti-corruption and bribery matters, and governance
- How sustainability matters affect your business development, performance, and position (an 'outside-in' perspective).

Examples of KPIs include:

Environmental: e.g. consumption of non-renewable energy
Social: e.g. number of employees with disabilities
Governance: e.g. number and nature of confirmed incidents of corruption or bribery

In practice, you would need to consider each materiality perspective in its own right. This approach to materiality acknowledges the needs of stakeholders beyond investors and other capital providers.

This contrasts with the SEC's and ISSB's narrower concepts of materiality, which are based on information that is material to investors. The CSRD's required disclosures are also broader, covering the entire spectrum of sustainability topics (e.g. climate change, biodiversity and ecosystems, working conditions, human rights and business ethics). These disclosure requirements will be detailed in the new ESRS being developed by EFRAG.

The proposed climate disclosure requirements in the ESRS exposure draft are based on the pillars of the TCFD framework, and so some elements mirror proposed SEC and ISSB disclosures. However, the proposed ESRS disclosures would be more robust. For example, the SEC requires disclosure of emission reduction targets if the company has made them. The ESRS, on the other hand, would require you to have an emissions reduction target for specific years and to disclose overall progress towards the target, and whether the progress is in line with what was initially planned. Other proposed disclosure requirements in the ESRS climate exposure draft include:

1. An analysis of the resiliency of your strategy and business model in response to climate-related risks
2. A scenario analysis to identify physical and transition risks over the short, medium, and long term
3. Your policies and action plans for climate change mitigation (i.e. limiting the increase in global average temperature as laid out in the Paris Agreement) and adaptation (adjusting to actual and expected climate change and its impacts)
4. Performance measures, including Scope 1, Scope 2 and Scope 3 emissions
5. Reconciliations of amounts used to calculate metrics to amounts included in the financial statements

Value chain disclosures may be some of the most challenging areas of reporting, given the both the scope and the reliance on information from parties not controlled by your company. The proposed disclosure requirements include key features of the value chain in the context of sustainability. For example, value chain disclosures would include:

1. How your company considers its value chain in the assessment of material sustainability risks
2. Details about value chain- related greenhouse gases removed from the atmosphere
3. A description of workers in the value chain
4. Communities affected by the value chain
5. How direct customers and those further down the chain use your products and services In turn, the CSRD focuses on the role of the board in setting and delivering these goals and any adverse impacts connected to your company.

Crucially, CSRD would require you to include sustainability disclosures within your management report. The qualitative and quantitative disclosures would require limited assurance at first but would most likely need to reach reasonable standards of assurance in the coming years.

The development of the CSRD acknowledges the significant variations in the preparation and presentation of sustainability disclosures. The proposals therefore seek to bring greater consistency and comparability to sustainability reporting within the EU and tie down some of the grey areas. This includes setting out the basis for the presentation of sustainability reporting within the management report in accordance with the CSRD. In turn, the proposed 'characteristics of information quality' explain the requirements of comparability, verifiability and understandability. They also provide definitions of forward-looking and retrospective information. Further stipulations cover the presentation of information about your workforce.

The CSRD presents an immense challenge for business and reporting teams in relation to data availability, sourcing, analysis and presentation. As IFRS 17 has shown, developing, agreeing and applying a common reporting framework to a complex sector like insurance can be especially challenging.

After a public consultation, EFRAG submitted the final first set of sector-agnostic ESRS to the European Commission in November 2022. The delegated act by the European Commission is expected in June 2023. The second set of ESRS will be developed by EFRAG in 2023 and will include sector-specific standards. The delegated act by the European Commission for the second set of ESRS is expected by June 2024.

Why it's significant

Increases spotlight on strategy

Double materiality

Limited assurance initially in 2025 (financial year 2024) for companies that are already required to report according to NFRD and in 2026 (fiscal year 2025) for large companies according to CSRD Para. 19a (1).

The European Commission will review the need for reasonable assurance in 2028.

Your business would need to develop the appropriate processes and controls to accumulate the necessary data and support its reliability. This may be particularly challenging if reporting will be required for the first time at a sub-consolidation or subsidiary level

Your board would need to review, sign-off and be accountable for the sustainability disclosures in the same way as financial reporting

Who it applies to

The CSRD brings many more companies into the net than the current NFRD. To be in scope, two of the following three criteria would need to apply:

- more than 250 employees on average during the financial year
- a balance sheet total in excess of €20 million
- a net turnover in excess of €40 million

When

FY 2024 for companies already subject to the NFRD (large public-interest companies)

FY 2025 for EU large undertakings (according to the Accounting Directive) not subject to NFRD

FY 2026 for listed SMEs, small and non-complex credit institutions and captive insurance undertakings. Important to note, listed SMEs can choose an opt-out from the new regime until 2028

FY 2028 for third country undertakings generating a net turnover of more than €150 million in the EU and which have at least one large or listed EU subsidiary or a EU branch generating a net turnover of more than €40 million

Parallel regulations

ISSB, SFDR and EU Taxonomy

Spotlight on regulation: SFDR

The EU SFDR requires financial services organisations to classify products and provide product- and company-related information to help customers gauge the sustainability and wider ESG-orientation of the policies on offer.

The EU believes that investors and policyholders will gravitate to products with an ESG label. This will therefore encourage financial services organisations to modify existing products and promote green investment. While often presented as primarily a matter for asset managers, the SFDR has significant bearing on life and pensions policies.

The SFDR divides policies into three main categories, based on their underlying assets:

SFDR product categories:

Article 6

No specific sustainability objectives

Article 8

Promoting environmental or social characteristics

Article 9

Explicit sustainable finance objective

Up to now, the kind of strategies and investments that classify a policy as ESG-orientated and what delineates a light green Article 8 and dark green Article 9 policy have been far from clear.

The EU is therefore seeking to provide greater clarification and consistency through a proposed update of its regulatory technical standards (Level 2). But it's important to note that the SFDR is only a reporting directive. The classification of insurance products is made within the IDD. The SFDR only introduces obligations for the disclosure of products. In turn, the Taxonomy supplements the reporting requirements within the SFDR.

Nonetheless, the SFDR is already having a strong impact on policyholder demand and hence provides a foretaste of the impact of other regulations to come. In particular, the ESG credentials of your life and pensions policies or lack of them are now highly visible thanks to the SFDR.

It's also important to note that even though SFDR Article 6 doesn't require ESG objectives or screening, it isn't a 'get out' clause. You would still need to disclose the impact of sustainability risks on the policy and why they aren't relevant in this case.

Why it's significant	Who it applies to	When	Parallel regulations
Requires you to rate the ESG credentials of your life and pensions policies	Investment products including life and pensions policies	Gradual entry into force since 2021, but the EU continues to update the regulatory technical standards. Will also be affected by the designation of green investments and activities under the EU Taxonomy	IDD and EU Taxonomy

Spotlight on regulation: CSDDD

The Corporate Sustainability Due Diligence Directive (CSDDD) takes the demands on own operations to a new level. This includes monitoring actual and potential human rights violations and respect for environmental standards in your own operations and your value chain. The directive also brings the risks of civil liability and heightened NGO scrutiny into play.

In practice, the CSDDD therefore requires a step-up in risk analysis, management, prevention and remediation. This in turn enhances the need for relevant staff, processes and guidelines required for effective management and oversight. If it's just the upstream supply chain that's in scope, the appropriateness of your measures would need to be evaluated in a different way from companies you invest in and underwrite. This might include exclusion criteria, due diligence measures and internal pricing models for human rights issues.

Why it's significant

If the current legislative proposal is passed, you would need to develop processes to fulfil your duty to prevent, mitigate and manage related risks and violations in your value chain and report on them. You would also need to take steps to prevent or minimise adverse impacts by companies you underwrite or invest in, possibly including termination of the relationship in case no preventive measures are taken by the company.

Who it applies to

EU and third country companies, each divided into two groups. Here we focus only on EU companies:

Group1: EU-Companies with

- More than 500 employees on average and
- A net turnover of more than 150 million in the last financial year for which annual financial statements have been prepared

Group 2: EU-Companies with

- More than 250 employees on average and
- A net turnover of more than 40 million in the last financial year for which annual financial statements have been prepared
- At least 50% of this net turnover generated in one or more "high risk sectors" (e.g. manufacturing of textiles, agriculture, forest

When

The European Commission's legislative proposal was published in February 2022. After a public consultation period, the proposal is currently being reviewed by the European Parliament. A final agreement could be reached by end of 2023 or in 2024, Member states will then have two years to transpose the Directive into national law. The Directive will start to apply to the first group of companies two years later (expected 2026)) and respectively four years later for the 2nd group of companies (expected 2028).

Parallel regulations

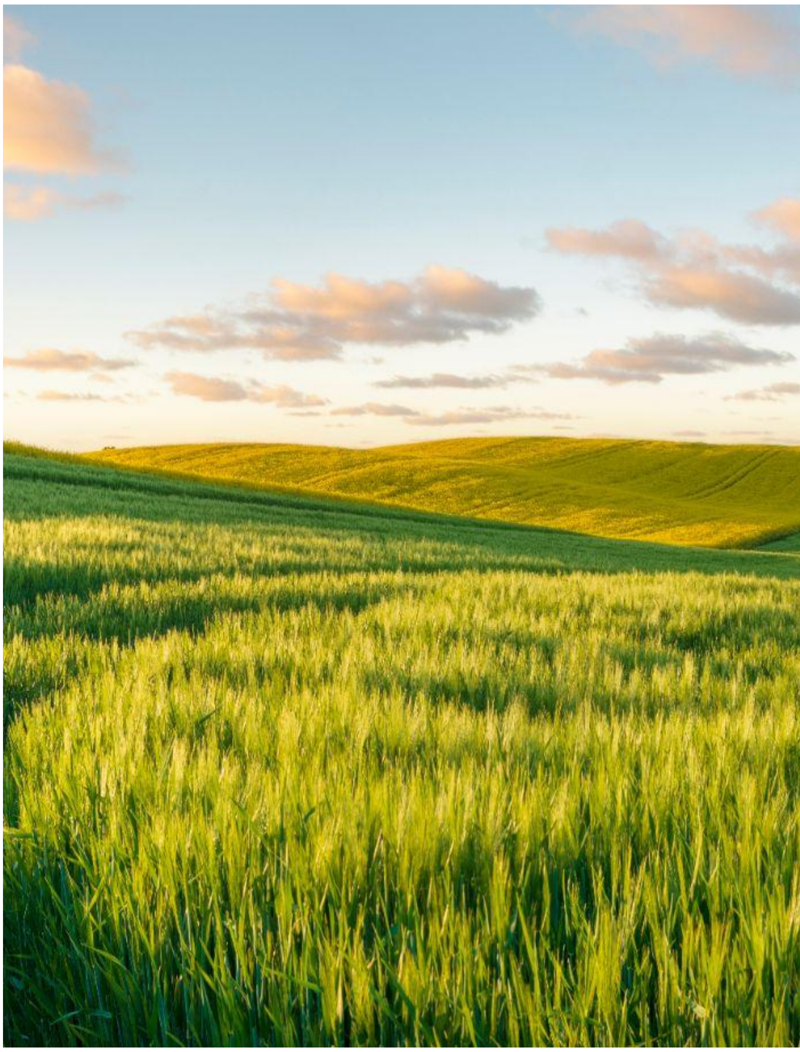
CSRD, SFDR, Taxonomy

Spotlight on regulation: EU Taxonomy

The Taxonomy aims to support the classification of ‘green’ investments and non-life (re)insurance products and limit the risk of unverifiable statements and mislabelling. In the first step, this includes defining what activities and investments are considered as economic activity within the Taxonomy and reporting on these (“Taxonomy eligibility”). In next steps, the Taxonomy also sets out provisions on how to screen (technical screening criteria) for the “Taxonomy alignment” and report on these green activities and investments.

In practice, however, interpretation and implementation are challenging. This includes uncertainty over the alignment of certain products such as health insurance. There is also uncertainty over the determination of insured risks and what is designated as ‘climate-induced’. Further questions centre on the technical screening criteria with high room for interpretation as the guidance is largely qualitative and lacking in concrete examples (e.g. modelling, product design, etc.). For example, many insurers are asking “at what point is the threshold of the technical evaluation criterion reached?” Other areas of uncertainty include the determination of premium share (total premium versus premiums related to climate-induced hazards).

Other practical challenges centre on the granularity of assessment and the data availability for assessing the ‘do no significant harm’ (DNSH) criteria. Related questions centre on what data basis to use (e.g. Solvency II versus IFRS) and the application level of DNSH and minimum social criteria (value chain of the company versus consideration of the insured object). The compliance of the minimum social criteria considers four core topics regarding inadequate or non-existent corporate due diligence processes: human rights, including labour rights, bribery, taxation, and fair competition. Final liability of companies in respect for breaches of any of these topics as a sign of noncompliance with the minimum social criteria.



As an insurer, you would need to publish information on how and to what extent your investments and insurance business qualify as sustainable (‘sustainability alignment), albeit only on a single materiality basis. Insurance itself only qualifies as sustainable in relation to its ability to help communities and businesses adapt to the impact of climate change.

KPIs to be assessed and published include the proportion of premiums coming from sustainable activities and what percentage is derived from non-sustainable ones. This could be an especially scrutinised metric and source of comparison within the insurance marketplace.

Implementation hurdles include embedding definitions into product design and management. Related challenges centre on the definition of internal and external data requirements and development of an appropriate systems infrastructure.

Why it’s significant	Who it applies to	When	Parallel regulations
Should help to define what is and isn’t sustainable, though developments and uncertainty over the regulations remain Puts you under the spotlight by requiring you to disclose what proportions of your premiums (non-life and reinsurance) and investments (all insurers) come from sustainable activities and what percentages don’t	Same as CSRD	Taxonomy eligibility reporting is due from 2022 (financial year 2021) and alignment from 2024 (financial year 2023).	CSRD, SFDR and IDD

Spotlight on regulation: Updated Insurance Distribution Directive (IDD)

The IDD sets common minimum standards for transparency and consumer protection – and therefore conduct as well – across the EU. It includes stipulations on the disclosure of product features, costs and charges (insurance product information document).

Conduct – the treatment of and outcomes for customers – is in the sights of regulators worldwide. Do customers understand the product? Does it meet their needs and preferences? The need to reflect a customer’s sustainability preferences on ESG brings ESG and conduct onto the same page, with significant implications for sales and product design.

Sustainability preferences are defined as whether and to what extent the policyholder wants their funds to be invested in sustainable investments. As part of the advisory and sales process, you would need to ask policyholders and potential customers about their sustainability preferences. You would then seek to match the product with these preferences. The products are divided into three groups (see Exhibit 7). The products are differentiated by the set criteria. Compared to the SFDR the IDD introduces an additional product distinction.

Exhibit 7

IDD product categories and its corresponding to the SFDR and Taxonomy

IDD

A	B	C
Insurance investment products with a minimum share in environmental sustainable investments within the meaning of Art. 2 (1) Taxonomy (Taxonomy aligned investments)	Insurance investment products with a minimum share in sustainable investments within the meaning of Art. 2 (17) SFDR	Insurance investment products that take into account key adverse impacts on sustainability factors

SFDR

Art. 9 products

Financial products that pursue specific sustainable investment objectives

- Fulfillment of the investment objective must be demonstrated, which requires very granular data and its management
- Greater regulatory uncertainty

Art. 8 products

Financial products that take into account environmental or social features (according to SFDR).

- Since no specific objective is pursued, the fulfillment of which must be proven
- For the fulfillment of sustainability preferences, the IDD distinguishes:
  - Products for which sustainable investment is the objective among others
  - Products for which adverse impacts are taken into account (e.g. GHG emissions, lack of human rights policy)

Source: PwC

In practice, you would need to explain the sustainability features and risks of a particular product so that the policyholder can decide whether it meets their stated preferences. You also need to run a suitability test.

After the target market assessment, the customer should be asked about their individual sustainability preferences. For existing customers, the sustainability preferences can be queried during the next regular update of the suitability assessment. If no insurance investment products can be recommended to the customer on the basis of their sustainability preferences, the customer should have the option of adjusting their sustainability preferences.

Based on this definition of 'sustainability preferences' in the suitability test, you would need to determine whether the customer also wishes the integration of products in accordance with Article 8 and 9 disclosure regulations. The customer can also be presented with the product that most closely meets the sustainability preferences.

To comply, you would need to provide documented justification to show how the product meets the suitability preferences. It's also necessary to justify the extent to which the recommendation fits the customers sustainability preferences and document any subsequent change in preferences. During the lifecycle of the product, you would need to continuously monitor it, check whether and how the customer's sustainability preferences may have changed and whether they still meet these preferences. If this is not the case, the policyholder has to be informed about the changes.

Why it’s significant	Who it applies to	When	Parallel regulations
Major change to product design, sales and distribution Need to integrate sustainability factors, risks and preferences into your investment advice, conduct of business rules and product governance Big call on justification and documentation, which needs to be built into systems and staff training Product categories differ from the sustainability designations in the SFDR, which will heighten the complexity of the product landscape	All insurers and intermediaries, who are distributing life and pension products	Since August 2022	SFDR, Taxonomy and Solvency II

Spotlight on regulation: Solvency II Review

The review of the Solvency II prudential regulations aims to build sustainability more closely into your system of governance, risk assessments, capital evaluations and quantitative reporting templates (QRTs).

Under EIOPA’s definition, sustainability risks can arise from environmental, social or governance factors. Environmental risks include climate change, pollution or the unsustainable use or lack of protection of water and marine resources, biodiversity and ecosystems. Social and governance risks include social and labour risks, respect for human rights, anti-corruption and anti-bribery.

New requirements include applying climate change stress scenarios to your balance sheet as part of your ORSA.

The new quantitative reporting template (QRT) framework would include information on the proportion of investments exposed to transitional and physical risks associated with climate change. As an indication of the level of detail required, you would need to include geographical data within your asset disclosures.

You may apply your own methodologies in assessing risk, including the use of reasonable approximations and assumptions with reference to available analyses.

While the technical reporting and capital evaluation demands are significant, there are currently discussions over possible capital relief to encourage more socially and environmentally conscious investment (e.g. sustainable qualified infrastructure). On the flip side, environmentally or socially harmful investments could incur additional capital charges.

Solvency II aims to strengthen stability by matching risk and required capital. While sustainability is not the main objective, it could have significant impacts on the risk profile and the valuation of assets and liabilities.

Why it’s significant	Who it applies to	When	Parallel regulations
Aligns risk and capital management more closely with ESG	EU insurers with premiums in excess of €5 million	From 2023	Taxonomy, CSRD and IDD

Are you ESG-ready?

- The influx of new ESG regulation and the policy goals that sit behind it are placing a whole new set of expectations on your business, with significant implications for your strategy, reputation and market valuation, as well as your compliance and tax capabilities.
- Does your strategy and performance on ESG stand up to stakeholder scrutiny and regulatory and tax compliance?
- Are your governance and due diligence processes ready to identify emerging gaps?
- Are your measurements and disclosures credible?
- How does double materiality affect the way you assess and manage your business?
- How do you plan to deal with the uncertainties, anomalies and conflicts in ESG reporting worldwide?
- How can you turn the regulatory shake-up into an opportunity?

Chapter 3

Be part of the solution

Embedding sustainability in your products, assets and own operations

Be part of the solution

Embedding sustainability in your products, assets and own operations

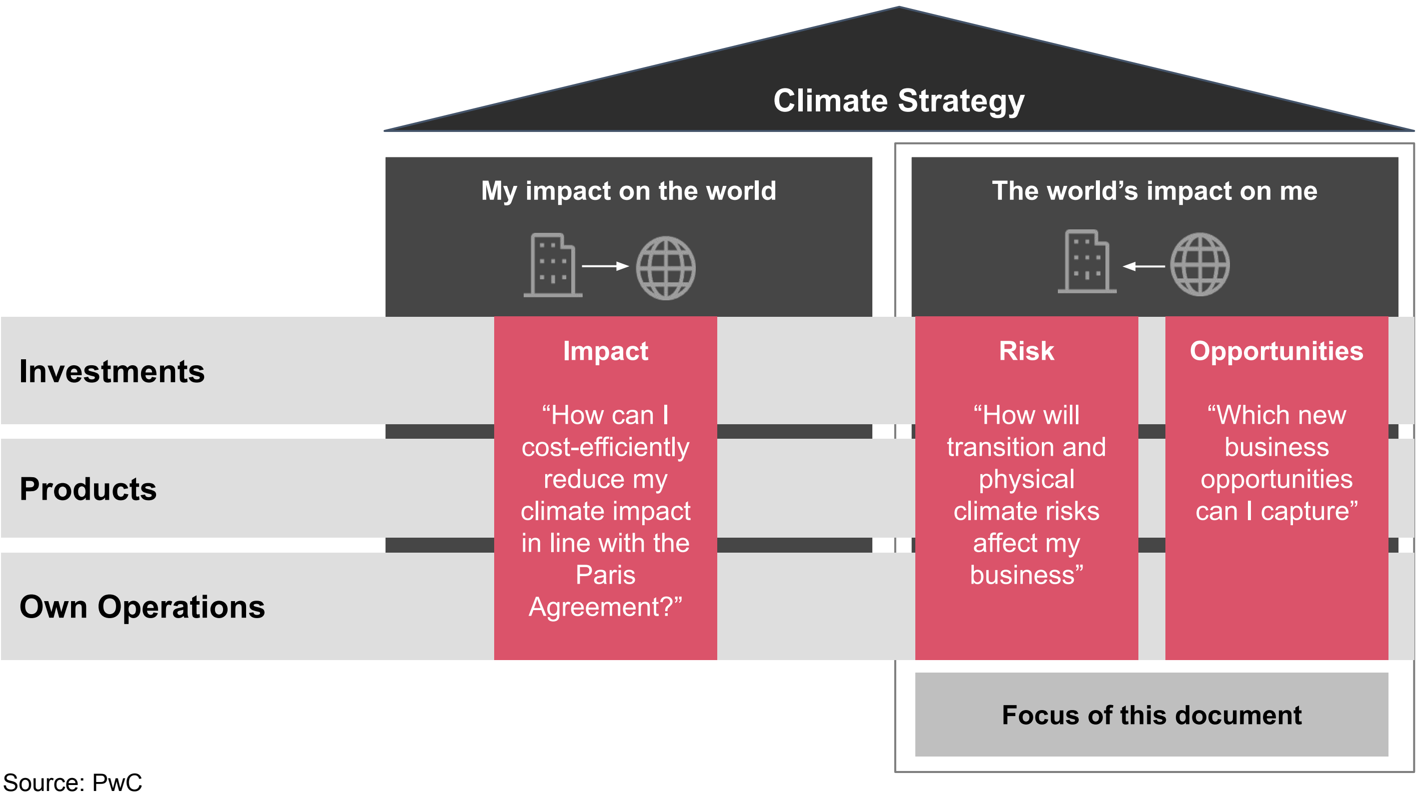
Having established your strategic ambitions for ESG and how these fit into your wider purpose as an organisation, the next and in many ways most far-reaching challenge is how to apply these priorities in practice.

Our Global Insurance ESG Survey highlights the difficulties of turning intention into action. It's especially telling that insurers rate products and services as the area where the most progress is needed to meet their environmental ambitions.

In this chapter, we therefore focus on the practical steps needed to bring your product offering and asset strategy into line with your overall ESG ambitions. We also look at how to match sustainability of your investment and underwriting strategies with the own operations of your business. As Exhibit 8 highlights, these are the building blocks for delivering ESG and driving future value.

Exhibit 8

The foundations to delivering your climate ambitions



Source: PwC

ESG is strategically fundamental. Accelerating progress on ESG is an opportunity to boost innovation and growth, secure customer and employee loyalty and change perceptions of the industry as a whole. On the flip-side, there is a real risk of acting too late, which will likely lead to lasting commercial and reputational damage. There is also a risk of overpromising and under delivering, which can pave the way for greenwashing.

When determining how to respond to these opportunities and risks, what comes through strongly is the need for a rethink of objectives across all areas of your business. Just as important is a cultural leap as you look to secure buy-in and build relevance and credibility among clients, investors and other key stakeholders.

Embedding sustainability in your products

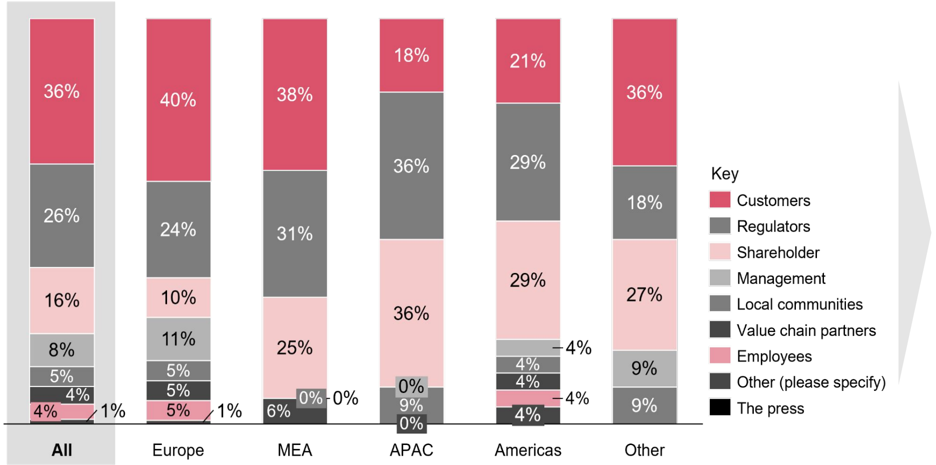
Rethinking product offerings

When we asked insurers who is their most important stakeholder for ESG, it's highly significant that they chose customers rather than regulators (see Exhibit 9). This highlights the extent to which both the attitudes and risk protection needs within the client base are changing.

Exhibit 9

Most important stakeholders for ESG

% of respondents who ranked these as their #1 priority
Total responses to the question - 191



Key insights

- **Customers, regulators and shareholders** together make for **~80% of insurer's priority** when considering an ESG strategy
- Insurer responses show **regional disparities** in stakeholder priority**:**
  - **Regulators and shareholders** are of much more importance to **insurers in APAC** vs other regions due to regulatory pressure gradually rising in APAC
  - **Insurers in EMEA highlight customers** as their rank #1 priority much more than other regions

Source: PwC Global Insurance ESG Survey 2022

From a product perspective, the sustainability dynamics differ between life and non-life. On the life side, the SFDR provides a baseline for judging how products and their management would need to change. But the way forward for non-life insurers is only now beginning to crystallize hence the primary focus of this product offering section. As a non-life insurer, while there are some reference points such as the EU Taxonomy regulation and guidance from the UNEP FI Principles for Sustainable Insurance (PSI) Initiative and NZIA, there is a need, or perhaps a strategic opportunity, for you to take initiative and develop your own approach to embed sustainability into your product offering.

So how can you embed sustainability into your product design and insurance cover? Two priorities stand out: Developing an understanding of the changing ecosystem as a basis for portfolio steering and new product development.

The starting point is defining the most strategically material sustainability topics affecting your business model and developing an actionable understanding of how the commercial and risk ecosystems are changing around those sustainability topics. What are the risks, the opportunities and perhaps most importantly, the risks within the opportunities that could present the potential for an innovative insurance offering? Ideally, this exercise is a cross functional effort that leverages internal capabilities and knowledge with data and expertise available externally to build up a comprehensive view. However, on a smaller scale and perhaps an immediate step is engaging underwriters that have the risk and market knowledge to begin building the risk landscape around your company's strategic sustainability topics on the ground level. One of the most important topics is likely to be climate change due to its societal magnitude and the relevance to the insurance business model.

Therefore, we will use climate change as a thread throughout this section. Resulting questions include: What is your role as an insurer in helping businesses and consumers deal with the increasing risks associated with climate change? How can you help them to make the green transition achievable? How can you build sustainability into a new business-as-usual?

The first step is to focus on the risks associated with climate change. When it comes to dealing with the increasing physical risks, insurance products form a potentially important tool in climate adaptation. As there is an expected, or even already observed, increase in frequency and severity of major weather events, insurance companies expect loss patterns to change and this may reflect in where and how coverage is offered. There are already many areas where the private insurance market is unable to offer satisfactory solutions for flood risk for example. How are your underwriting guidelines and risk appetite likely to be impacted by this evolution? You may not find it economically viable to offer cover with traditional insurance protection. However, you may be able to find other innovative solutions to add value to the climate adaptation effort, such as a workable parametric solution, public-private partnerships or making your risk data and analytical tools available to public and private institutions to use as part of their risk management. As an insurer and for the industry as a whole, it's important to recognise the value of your capabilities and be open to deploying them in novel ways.

In relation to climate change mitigation, your business is likely to find a complex ecosystem as both companies and consumers evolve to lower their carbon footprint as part of the energy transition. A clear case in point is the electrification of transport. This will trigger a whole new set of client demands within the new sustainable ecosystem, including readily available and affordable high-volume cover in areas such as electric vehicle fleets. The changing demands also include the more specialist risk understanding and underwriting needed to support the development and application of next generation technologies in areas such as biotech, new materials and artificial intelligence-enabled connectivity.

Case study
Hydrogen demonstrates both the potential and risks of green transition

The growing use of hydrogen as a sustainable alternative to fossil fuels highlights how the risk environment and client demands are changing.

Hydrogen has the potential to be the 'green oil' of the 21st century, providing a clean and abundant source of energy for uses ranging from travel to steel production. But hydrogen comes with inherent risks, from gas release and flammability to the embrittlement of metals used in machinery and piping.

Through risk advice and protection, insurers can play a key role in realising the hydrogen potential on the one side and creating openings for new product development and revenue growth within their businesses on the other.

This new ecosystem is bringing both you and your clients into uncharted territory (see Chapter 5 on data and systems). There may be little or no historical data to help assess the risks from emerging technologies and production techniques. It's therefore important to invest in modelling and monitoring and also perhaps in underwriting specifically defined new and emerging risks within strictly controlled parameters to enable your underwriters to really practically learn about the intricacies of the risk while minimizing the potential downside. It's also important to seek out new data sources, collaborate as an industry and work with people developing new green technologies to strengthen risk understanding.

This lack of risk data and claims experience are clearly challenging. But the industry has overcome comparable hurdles before. Catastrophe risk and, more recently, COVID-19 vaccine indemnity, are clear cases in point. One of the keys is strengthening learning capacity by working as an industry as well as across industries to share knowledge on new and emerging risks. This is going to be especially important in supporting smaller insurers who may not have the necessary funding and capacity to drive progress as larger counterparts. Beyond the challenge of developing a sufficient understanding of risk, it's also important to consider the types of products available and the way in which they will be distributed. This is clearly an opportunity to work closely with manufacturers to develop a diverse array of products such as embedded insurance, parametric insurance based on developments such as extended warranties and Internet of Things (IoT) connectivity.

Aside from understanding technological advancements, your business will be grappling with how transition risks will impact your customers and potentially insurance coverage. These risks may include the risk of stranded assets, outdated business models, loss of licence to operate and liability risks from failing to act as required to meet the challenge of climate change.

Setting portfolio targets and timelines aligned to sustainability goals

After developing an understanding of how sustainability-linked ecosystems are likely to evolve, it's important to incentivize and enable the organization to utilize this improved risk awareness and understanding by developing clear environmental targets for your underwriting portfolio.

One such portfolio might be reducing carbon emissions,and work is already underway in providing the right tools and methodologies to enable this. Bringing together some of the world's leading insurers, the Net-Zero Insurance Alliance (NZIA) is helping to develop science-based targets to reduce emissions and associated measurement to track and report on progress. The first priority is establishing a baseline and attributing emissions in a credible way.

The parallel priority is governance and accountability. This includes making sure your business takes concerted action to meet these targets and reports progress in a transparent and verifiable way. Effective measurement is a critical part of this, but not enough on its own. It's also important to make sure that underwriting and other frontline teams understand the targets, buy-in to the underlying strategy and are clear about their role in delivering it. But the complexity of setting and achieving these targets cannot be underestimated. The NZIA has therefore collaborated with the Partnership for Carbon Accounting Financials (PCAF) who are focusing on commercial lines and personal motor lines business as a starting point, have recently provided guidance on the methodology to measure and disclose insurance-associated emissions and a framework to assess data quality. This is an excellent example of industry collaboration on a complex topic and hopefully the outcome is an aligned and comparable methodology that can be adopted by large and small insurers alike. However, the most forward-looking insurers didn't necessarily want to wait for the NZIA to be convened to start experimenting with such methodologies and likely this innovative and entrepreneurial early work has been an accelerator for the NZIA. This spirit of experimentation and ultimate collaboration must be applauded and encouraged as companies move beyond climate change to tackling other issues.

Moving your portfolio in the right direction

With the foundations of understanding the ecosystems and the associated risk, as well as having strategically aligned targets for progress, in place, we have identified three levers you can pull to move your portfolio in the right direction and strengthen collaboration with clients.

Lever one: Bringing your influence to bear

Whether commercial lines or personal lines, insurance companies have many opportunities to engage with customers. Historically, this has been at the point of binding new business, a renewal or in the event of claim. However, more and more insurance companies are seeking ways to have a continuing dialogue with their customers.

In commercial insurance, customers often seek advice from insurers on sustainability topics especially in relation to climate change. There is also increased knowledge exchange, which strengthens the competence of both parties.

Digital customer engagement presents an opportunity for more frequent and targeted communication than was previously possible when contact was restricted to annual renewal and claims. Leading insurers are using these capabilities to build sustainability into a more interactive and intuitive always-on relationship. It can also lead to an exchange of data whereby the customer receives additional information, granularity or analysis on the risks related to sustainability and the insurance company receives additional customer data to enhance the overall quality of their assessment of sustainability related risks.

Examples of risk advice may include providing energy saving tips and offers on equipment such as solar panels as part of your homes and contents policies. You could also offer lower cost insurance for homes that meet emissions and waste targets or build on pay-as-you-go vehicle insurance cover to reward policyholders who cut down on their road usage.

We advocate a strategic approach to engaging with your customers on sustainability topics and creating a clear link to your targets. This includes segmenting your customers to make sure that you target the right customers with the right approach for maximum impact.

Lever two: Using portfolio steering tools

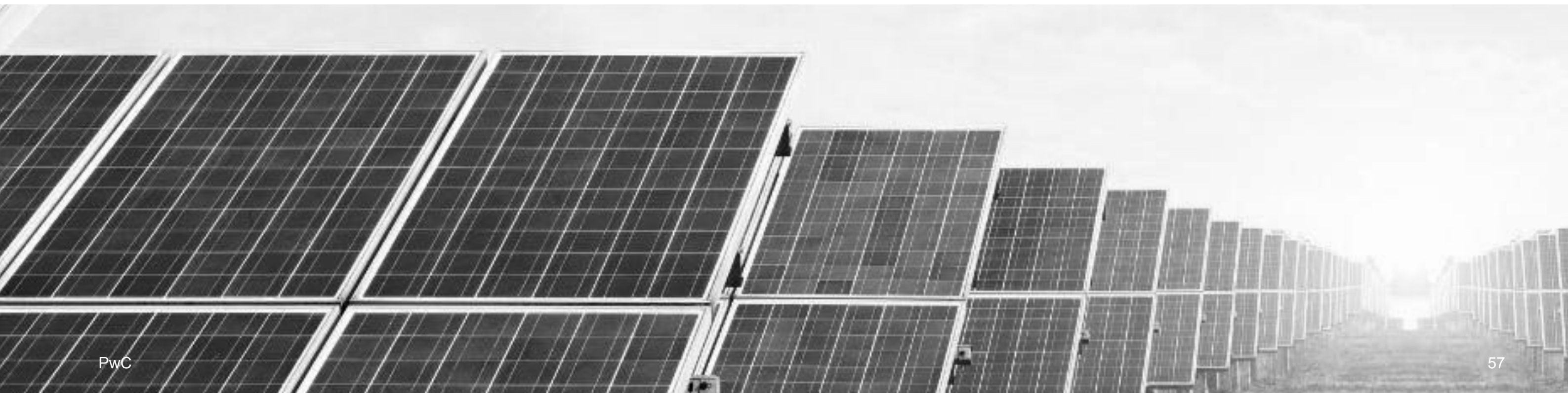
In line with your sustainability targets and reputational and underwriting risk assessment, you may need to revise your risk appetite, pricing and available capacity for coverage of certain types of businesses, production techniques and technologies. For commercial cover, these limits would be communicated to brokers and potentially aligned with distribution commissions as an additional tool to either encourage or discourage these different types of business depending on how they support you achieving your targets.

In regards to moving towards exclusion of certain risks due to sustainability considerations, for example high carbon intensity,the first priority for portfolio companies should be guidance, influence and positive incentives to make progress on defined sustainability goals. This would be included in your customer engagement strategy. The priority should be nudging clients in the right direction rather than a final decision to exclude business from the portfolio. But if a carbon-intensive and/or high emissions business is transitioning at a slower pace than previously communicated without credible reasoning, you may need to withdraw cover to remain on track to fulfil your sustainability obligations. Setting a clear timeline for expectations and progress can safeguard your reputation and provide an incentive for the customer to act as most of the high-quality coverage is moving in the same direction. The clearest example of this is thermal coal generation. Several large insurance companies have now placed significant limits on the placements that they are willing to underwrite in this market segment and have executed exclusions where necessary.It is important to continue to engage with customers and brokers to ensure that the impact of such policies is as intended from a holistic ESG perspective.

Lever three: Bringing sustainability to the centre of your product innovation process

Embedding ESG is an opportunity to target new risks and drive product innovation and differentiation. These opportunities should become more apparent as you work to understand the ecosystems around your chosen sustainability focus topics.

In the example of climate change we have already seen several developments for covers aimed at assisting the transition. If we look at commercial property insurance, for example, developments include so called ‘green buildings insurance’. This usually takes the form of a policy endorsement to cover what may be the higher cost of using sustainable materials in damage repair and replacement, which may go as far as achieving or protecting green certifications. Further examples seen in the market include the provision of energy efficiency insurance to guarantee the financial performance of energy-saving projects and long—term coverage that guarantee solar and wind generation performance. Policyholders gain both the incentive and assurance to invest in improvements. As an insurer, you could take this further by pairing the energy efficiency insurance with carbon emissions assessments and ongoing tracking.



New data sources are coming on stream all the time to make up for the lack of historic information on sustainability (e.g. databases for buildings' energy efficiency, emissions). Where we have not yet seen significant movement from insurers is in using a similar model to the banking sector where corporate green loans tie interest rates to performance against predefined sustainability targets. This type of arrangement may be particularly interesting in directors and officers (D&O) insurance, in which there is a potential link between achievement of publicly disclosed targets and loss.

Further opportunities for innovation include the development of parametric insurance for severe flooding and other extreme weather events, with a particular focus on underinsured or hard to insure locations and risks. Openings ahead include building on developments in insurance-linked securities (ILS) to create a new generation of climate-focused resilience bonds and index-based solutions. The results can help to boost resilience by enabling affected communities to quickly rebuild homes and restore livelihoods. It therefore provides a valuable contribution to delivering on social as well as environmental commitments.

The starting point for capitalising on these opportunities is putting sustainability at the heart of your product development process. This may take the form of posing specific challenges either internally to your underwriters or externally to insurtech providers that you may be willing to work with. Or it could be including a question on how specifically a newly developed product impacts on your sustainability goals as a filtering mechanism for investment in new products. You can also work with clients and brokers to understand underinsured risks and issues they would like you to tackle, while raising awareness of new innovations and solutions.

Case study
Parametric cover helps protect against reputational damage

With ESG policies and performance coming under ever more intense scrutiny, a failure of governance or board oversight in this area could significantly harm a company's reputation and value. In response, a leading insurance intermediary and risk advisor has developed innovative parametric solutions to indemnify companies against such damaging losses.

The solutions are based on a synthetic index of reputational value. Drawing on a seven-million-event experience base, the company calculates the value(s) of the one or more parametric trigger(s) best matching the client's choices. Estimates are stratified by commercial sector, market capitalisation, compliance authority and index volatility. The policy pays when the insured's index value dips below a trigger value for 20-weeks following a publicly recognised adverse ESG event.

In a typical indemnification scenario, an insured company sustains an operational failure in one or more areas felt to be the duty of senior management and the board to oversee, such as ethics, innovation, quality, safety, sustainability or security. The failure sparks a media storm and stakeholder outrage.

Within 90 days, the reputational value metric (parameter) falls below the first Loss Gate. Two weeks later the parameter drops below the second Loss Gate. Twenty weeks later, the parameter has consistently remained below the second Loss Gate, thereby meeting the parametric condition for indemnification at the second Loss Gate that typically pays 40% of limits.

Qualification for these parametric solutions begins with a review of a company's quantitative measures of reputational health. According to the insurance intermediary providing the cover, around 30% of public companies would qualify for coverage purely on an analysis of reputation health and risk implied by these quantitative measures.

Electric vehicle cover provides catalyst for innovation and growth

As the full electric and hybrid vehicle market grows, so do the openings for insurance innovation.

Battery technology illustrates how insurers can support both the development of electric vehicle (EV) manufacturing and take-up by commercial fleet owners. Recent strides in battery development are helping to improve efficiency, reduce vehicle prices and encourage more businesses to switch their fleets to electric. But as with any technological development, there is a risk. Uncertainties about the reliability and long-term performance of the newly developed batteries are still a major barrier to widespread acceptance. Creating confidence in the reliability of the technology could therefore help to accelerate the electric transition.

By offering innovative warranty cover for manufacturers and fleet owners, a large German (re)insurer is helping to mitigate the risks and overcome the uncertainty. This includes cover to protect the warranty promises of the manufacturer towards their customers. In turn, fleet owners can take out cover to protect against the insolvency of the manufacturer by extending the benefits of the manufacturer cover to them directly.

Mitigating the long-term battery technology can help to encourage more fleet owners to make the switch to electric.

Pioneering index on risk from ecosystem collapse

Countries around the world depend on a range of vital natural services – known as biodiversity and ecosystem services (BES) – to help maintain the health and stability of their communities and economies. These include water provision, food security and air quality.

As a PwC/WWF study on biodiversity risks highlights, all sectors are dependent on nature to a certain extent, while 50% are moderately or highly dependent. However, a study by Swiss Re Institute revealed a serious decline in biodiversity and ecosystem services, affecting both developing and advanced economies.

As insurers, understanding the extent and impact of this decline and the associated risks is key to minimising further damage. For example, trees protect coastal areas and riversides from erosion. In areas where forests disappear, floods and landslides are more frequent, causing higher property losses. Conversely, measures to preserve biodiversity, such as reforestation, reduce the risk of damage.

Maintaining a healthy balance between humans and nature will remain a key issue. For this reason, a leading reinsurer has developed a BES index to enable businesses and governments to account for biodiversity and ecosystem issues into their decision-making. The index can also be used by insurers to develop insurance solutions for communities at risk of biodiversity loss and ecosystem collapse.

The BES index aggregates local data in areas ranging from soil fertility and food provision to habitat intactness, coastal protection and water and air quality. The information can be used for local, regional, or country-level analysis of biodiversity and ecosystem services.

Building sustainability and climate risk into your asset strategy

How sustainable are your investments? How are you managing climate risks within your asset portfolio? How can you help drive the development of green finance and accelerate green transition through your investment strategy and influence as a shareholder? How to mitigate any adverse financial impacts for the reallocation of your asset portfolio to a “greener” investment strategy?

Given the size and reach of the insurance industry’s asset holdings, mounting pressure to address these questions is coming from clients, the media and regulators including EIOPA. But this is also an opportunity to capitalise on fast growth markets in areas such as the development of sustainable infrastructure. The latter has the advantage of aligning with the long-term investment and return horizons of pension policies.

The challenges are both strategic and operational. It’s important to ensure that your business has the necessary skills, data and models to manage the climate risks and wider ESG issues within your investments. It’s also important to ensure coherence and consistency on both sides of the balance sheet.

Assessing the risks

The value of long-term insurance investments is not only affected by climate risks and resulting claims, but also by transition risk. In particular, new taxes and regulations, technologies or shifts in consumer preferences could erode asset values. At the extreme end of this risk are so-called ‘stranded assets’ – businesses or production facilities that can no longer operate as a result of regulatory curbs or consumer pressure.

The distinct challenge for you as an insurer is the need to assess climate risk in a way that links your underwriting and investment portfolios. For example, if you’re basing both your life insurance claims’ forecasts and non-life repricing around a 1.5-degree scenario, is this consistent with the scale of the transition risk implied in your investment strategy?

Beyond the impact of physical and transition risk on investment performance, some insurers are also looking at litigation risk. This relates to either claims for past negligence or for breaches of current environmental legislation. High profile cases include the recent settlement of a claim against a $57 billion Australian Retail Employees Superannuation Trust. A member accused the Trust of failing to act in his best interests by not properly considering the impact of the climate risks within its investment portfolio. Estimates suggest that there could be up to a thousand climate-related class action lawsuits now underway across 25 countries.

Tax risks also need to be considered. Tax is an important element for the investment strategy of an insurance company. Investing in green bonds and other green assets needs to be evaluated from an after-tax-return point of view and tax incentives need to be taken into consideration. Insurance companies must evaluate how close their tax function is to the investment decisions and whether there is a need to involve the tax function any further. Additionally, insurance companies may be able to claim R&D credits in case they invest in technology that indirectly supports the environmental and social aspects of ESG.

Step-up in regulatory demands

Financial services regulators and supervisors expect you to identify, assess and manage the physical, transition and litigation risks arising from climate change. You would also need to incorporate those risks into your risk management framework (see Chapter 4).

The EU Taxonomy and insurers' key role as investors in green transition are set to have a significant impact on the direction of asset management. Together, new taxes and regulations, technical standards and guidance are seeking to provide a common standard for what can be classified as green (see Chapter 2).

The EU Taxonomy requires the disclosure of indicators on sustainability, with a specific eye on the extent to which the insurer or reinsurer carries out Taxonomy-relevant activities. Specifically, EIOPA has proposed two KPI disclosures that could become compulsory:

- The proportion of insurer's 'assets' – in relation to 'total assets' – that are directed at funding, or are associated with, economic activities that qualify as environmentally sustainable under the Taxonomy
- The proportion of the non-life 'gross premiums written' or non-life 'revenue from insurance contracts issued' corresponding to insurance activities identified as Taxonomy-aligned

Elements of the Taxonomy have inevitably proved controversial. This includes the classification of natural gas, forestry and nuclear power as green investments. The underlying question within the continuing debate is the extent to which the Taxonomy will affect access to capital markets for certain industries.

Crucially, however, there is as yet no sign of regulators requiring minimum alignment with the EU Taxonomy or any other international equivalent. The focus of regulation is on risk management and transparency. The most likely step would be increased capital buffers for high ESG risks. The European Central Bank (ECB) may introduce such requirements following the thematic review and the climate stress test. Similar discussions are running at European level for the insurance regulation.

The big issue is client expectations

Indeed, the most important pressure for a shift in asset strategies is coming from clients rather than regulators. Given the public focus on sustainability and ESG more generally, the social licence to operate could be just as hard to maintain as the regulatory licence. Related threats include a backlash against investments in carbon-intensive industries or being exposed for greenwashing. It's telling that investigations into potentially misleading claims have triggered sharp falls in share values.

The importance of ESG in meeting client expectations has been reinforced by indications that ESG products offered a greater level of resilience, a lower level of risk contagion and higher inflows during the COVID-19 pandemic. The previous perception of a trade-off between financial and ESG performance may therefore be diminishing.

In the EU, the already intense client scrutiny on ESG will be heightened still further by the incoming regulation. For example, increasing reporting requirements to policyholders and pressure to increase sustainable investments options through SFDR or pressure during the sales cycle through adjusted IDD regulation (see Chapter 2). This requires you and your distributors to integrate sustainability factors, risks and preferences into product oversight and governance. You would also need to build these factors into your conduct of business rules and investment advice for insurance-based investment products. Meeting these demands calls for a major redesign of business and distribution processes. But it also creates significant opportunities for new and differentiated products that reflect changing client demands on ESG.

Given the client and regulatory pressures, your business faces two key questions. First, how important is your purpose and reputation on ESG to your business model? And second, how important will the Taxonomy-aligned disclosures be to your ESG reputation? In other words, will customers, employees, shareholders and supervisors want to steer clear of insurers that benchmark poorly against their peers on these KPIs?

If you decide that ESG is critical, there are a number of steps you can take to bring asset evaluation and risk management up to speed. The starting point is to map the risks against your investment strategy.

As in any time of transition and change, there will be difficult decisions. For example, you may come under pressure to withdraw investment from businesses seen as environmentally damaging. But divestment should be the last resort. By planning for the long-term, you can help portfolio businesses to make the necessary changes. If you explain what you're doing and why, you could make the difference and take stakeholders with you.

Moreover, while this isn't about excluding whole sets of industries and activities, you would need to understand the risks, the associated reporting demands and how your business will come across as a result. New tools can help to embed climate scenarios into your risk management (e.g. PwC Climate Excellence Tool).

In addition to bringing ESG expertise into your business and updating your risk and performance evaluation models, partnership will be important as you look to reshape your portfolio. This includes working closely with asset managers, distributors and data providers.

Overcoming the barriers to green investment

Among the key considerations within the ongoing review of Solvency II is how insurers should integrate climate developments in the valuation of assets and liabilities, investment and underwriting practices and catastrophe risk.

The use of climate scenarios in the own risk and solvency assessment (ORSA) is now firmly on the agenda. This will put the fitness of the risk management frameworks and adequacy of capital requirements related to climate risk firmly in the spotlight.

On the plus side, the review may provide further incentives for insurance investment in assets with ESG characteristics as a result of lower capital charges for longer-term business. Life insurers in particular are well-placed to invest in longer-term assets – such as environmentally sustainable infrastructure and renewable energy projects – given their long-term investment horizon. But they're currently constrained by what they view as unduly high capital requirements.

In an important development, the review of Solvency II may reduce the 'risk margins' you need to hold against certain long-term business and lower the capital charges for equities that are treated as 'long-term'. You and your policyholders could also benefit from the higher returns that may be available on longer-term, but often illiquid, assets.

Alongside capital requirements, another key enabler for ESG investment is clear and consistent disclosure requirements. PwC has been working with more than 20 of the world's leading insurers as part of the PSI of the UN Environment Programme. The initiative seeks to find practical ways to implement the recommendations of the TCFD. This includes developing consistent and transparent analytical scenarios that can help identify, assess and disclose climate-related risks. The results will strengthen transparency, accountability and public trust.

Strengthening the sustainability of your own operations

As an insurer, you would be expected to practise what you preach. The ESG strategy, transparency and performance within your own operations, along with those of your suppliers and outsource partners, are critical to the integrity of your brand and your credibility when engaging with clients and regulators.

The focus on your own operations has been heightened by new reporting requirements such as the Corporate Sustainability Reporting Directive (CSRD) and the standards published by the International Sustainability Standards Board (ISSB). This requires you to set out your targets and performance within your sustainability reporting.

In turn, the first draft of the Corporate Sustainability Due Diligence Directive (CSDDD) puts the onus on you to identify, prevent and mitigate environmental damage and human rights breaches in your own operations and value chain, while it is still under discussion if your investees, policyholders and investors are to be considered. However, you could face civil liability claims and reputational damage if you fall short.

Ultimately, your workforce needs to live and breathe sustainability from top to bottom. And, more than ever, you need reliable and credible data to support this performance.

Determining how your business is judged

Sustainability disclosures are fast becoming as important as financial reporting in how you're judged by investors. The growing alignment between financial and sustainability reporting is reflected in the formation of the ISSB by the IFRS foundation. The ISSB aims to establish a global baseline of sustainability disclosure standards.

What this all means in practice is that the same rigour that's expected in the preparation of financial reporting should be applied to sustainability. It's also important to focus on your social impact in areas such as diversity and inclusion. This is a critical factor in your ability to attract and retain talent. It also affects environmental decisions. Real sustainability comes from a breadth of perspective, which can only be achieved through a diverse leadership.

So, what are the practical issues you would need to address? The main challenges within your own operations are ensuring the supply and reliability of Scope 1 'direct', Scope 2 'purchased' and Scope 3 'upstream' emissions data. To a large extent, your business is dependent on data coming from third-parties. You are in turn responsible for the information you supply to other parties including your clients and investors.

Judging materiality

A good starting point is materiality. The ESRS will require a holistic materiality analysis. However a first look on emissions of insurers shows that Scope 1, Scope 2 and Scope 3 (cat 1, 5, 6, 7) emissions are not all that material compared to your Scope 3 cat 15 (investments) impact. However, target setting standards such as SBTI, CSRD and TCFD require you to set targets on Scopes 1, 2 and 3 also to be in line with the Paris Agreements.

Given the workload and demands on finite resources, it's important to look at the balance between Scopes 1, 2, and 3 and how much attention you focus on each. Data for Scopes 1 and 2 tends to be easier to source and manage than Scope 3. Scope 3 emissions are hard to govern as they are reliant on other parties and complex calculation and estimation methods. The risk is an excess organisational effort on the easier Scopes 1 and 2 goals at the expense of Scope 3. NGOs however tend to focus more on Scope 3 than Scopes 1 and 2 regarding financial institutions as their main environmental impact comes from there.

Where to focus

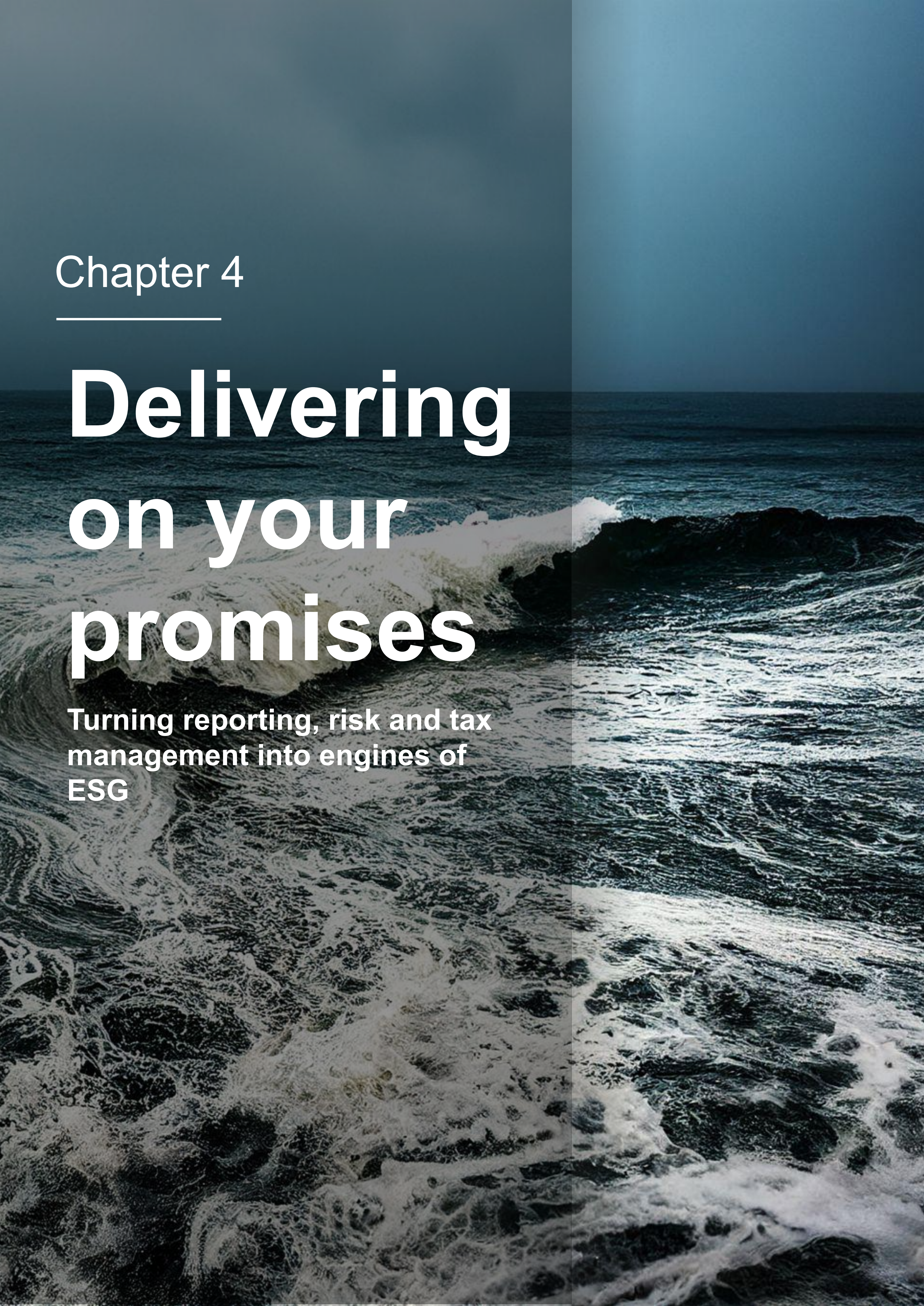
Depending on the results of your materiality analysis, carbon emissions are a central part of Scopes 1 and 2, along with Scope 3 cat 15. For the TCFD, the key focus should be management of climate risks, in which field stakeholders would expect insurers to be frontrunners, given their core business activity of evaluating and dealing with all kinds of risks.

Internal controls are useful here. Some insurers are taking this further through internal risk pricing. They are also putting robust verification and documentation in place. This includes recording the justification for assumptions and estimation methods used as proxies for missing data points.

On the social side of ESG specifically, the expectations tend to be less prescriptive than the climate and sustainability aspects. But data on your workforce should be included in areas such as diversity. It's also important to gauge awareness of sustainability within your workforce and how it affects their work and decisions.

Are you ESG-ready?

- Product development, asset management and the management of your own operations are the building blocks for turning your ESG ambitions into concrete actions. Getting on the front foot offers huge opportunities to drive innovation and develop new business models.
- How are client demands changing and what opportunities does this open up?
- How can you bring sustainability to the centre of your product design process?
- How can you put ESG at the centre of your investment strategies?
- How can you bring the sustainability, inclusion and ethical policies within your own business and its value chain up to the standards you expect from clients and portfolio companies?
- What data, systems and skills do you need to get up to speed?
- How your current tax strategy could support the ESG-readiness in terms of product development, asset management and the management of your own operations?



Chapter 4

Delivering on your promises

Turning reporting, risk and tax management into engines of ESG

Delivering on your promises

Turning reporting, risk and tax management into engines of ESG

Growing stakeholder demands for ESG disclosure are an opportunity to convey your ESG ambitions, build stakeholder trust and attract new business. But regulatory, sustainability and tax reporting remains fragmented, in parts inconsistent and challenging to use. Many of the implementation timelines are also tight, heightening the risks of reporting errors and being called out for greenwashing. These challenges underline the need for a candid and pragmatic approach to disclosure built around what is available, reliable and verifiably true.

As we outlined Chapter 2, your business faces a flurry of new and more demanding reporting requirements.

In theory, this should be welcomed. Stakeholder trust is going to be hard-earned as you seek to overcome widespread public cynicism over corporate greenwashing. Clearer, more relevant and reliable information on sustainability can help you to boost transparency and hence strengthen trust.

Internally, more accurate, actionable and in-depth data will provide a more informed basis for ESG decision making and help you to target your strategies and investment where they can have the greatest impact – what gets measured gets done.

Stretching your capabilities

In practice, deep challenges remain. Chief among these is a tangled web of diverging and even at times conflicting reporting standards worldwide (see Exhibit 10). The other big headache is how much there is to do to prepare and how little time there is to do it. In particular, the first round of disclosures for the EU CSRD, which is in many ways the biggest step-up in reporting demands, is due from 1 January 2025 for financial year 2024.

Exhibit 10

Fragmented reporting landscape

International

- **ISSB*** is developing a **global baseline for investor-focused** sustainable disclosure
- **ISSB exposure drafts on General Sustainability and Climate-related Disclosure requirements published** (build on TCFD, SASB/ IIRC, WEF)
- **SEC** proposed new rules for climate change disclosure

Americas	EMEA – EU	EMEA – UK	Switzerland	APAC
USA • Surveys by each state; mostly qualitative with variable data needs • **Group TCFD report currently sufficient; in future supplemental disclosure expected** • SEC announcement **Latin America / Canada:** No current/ expected regulations	• Most advanced & ambitious regulatory landscape with urgent need for action • **EU Taxonomy** (Taxonomy Eligibility for Taxonomy Eligibility for FY 2021 and FY 2022: FY 2023 onwards Taxonomy alignment and **CSRD** (2025 for FY 2024); no group exemption for listed subsidiaries • Comprehensive ESRS published and will further extend requirements from CSRD	• Several legal acts effective, partly met by reference to Group reporting (UK modern slavery act) • UK tends to "copy" EU regulation - UK Green Taxonomy applicable earliest in 2023 for FY 2022, TCFD earliest by 2024 • Uncertainty: Group exemption option unclear	• Disclosure requirements as of 2024 for FY 2023: – **RBI counterproposal** (aligned with NFRD) – Climate-related financial risk disclosures regulation **(TCFD)** – Disclosure on **Group level sufficient** • FINMA follows NGFS recommendation on climate-related risk and also stress testing exercise • Influence of CSRD and EU Taxonomy on Swiss regulation will become clearer in the future	• Several initiatives, mainly in Singapore (SG), New Zealand (NZ), Malaysia (MY); aim for adopting TCFD • **Uncertainties:** local add-ons; group exemption unclear • ASEAN taxonomy in development; not mandatory • Federal acts in place in Australia and new regulation in China

* ISSB: International Sustainability Standards Board ** ESRS: European Sustainability Reporting Standards

The necessary data gathering and measurement are likely to require a revamp of reporting infrastructures and coordinated input from across your organisation. The immediate priority is how to get over the regulatory line for initial disclosures. Along with generating the numbers, you need the verification and oversight to make sure that the information going out into the market meets auditable standards.

The challenges are compounded by the fact that there are so many audiences for your disclosures, ranging from regulators and rating agencies to clients, business partners and NGOs, each with a distinctive perspective and set of demands.

Grappling with complexity and inconsistency

From an implementation perspective, our work with clients highlights a number of tricky hurdles, which will need to be tackled along the path to implementation.

First and foremost, this is a complex and dynamic environment. A lot of the rules are still being finalised. But the timelines mean that you can't wait until everything is agreed before getting implementation underway. This puts obvious strains on project teams and systems capacity.

As insurers scramble to meet the deadlines in the face of what are in parts unclear requirements, we're likely to see a lot of hurried and varied interpretations of the rules. This can only heighten inconsistencies in the initial disclosures, though we hope that some level of consensus and comparability will emerge over time. While the CSRD is only subject to limited assurance at first, this will still put further pressure on an already demanding implementation schedule.

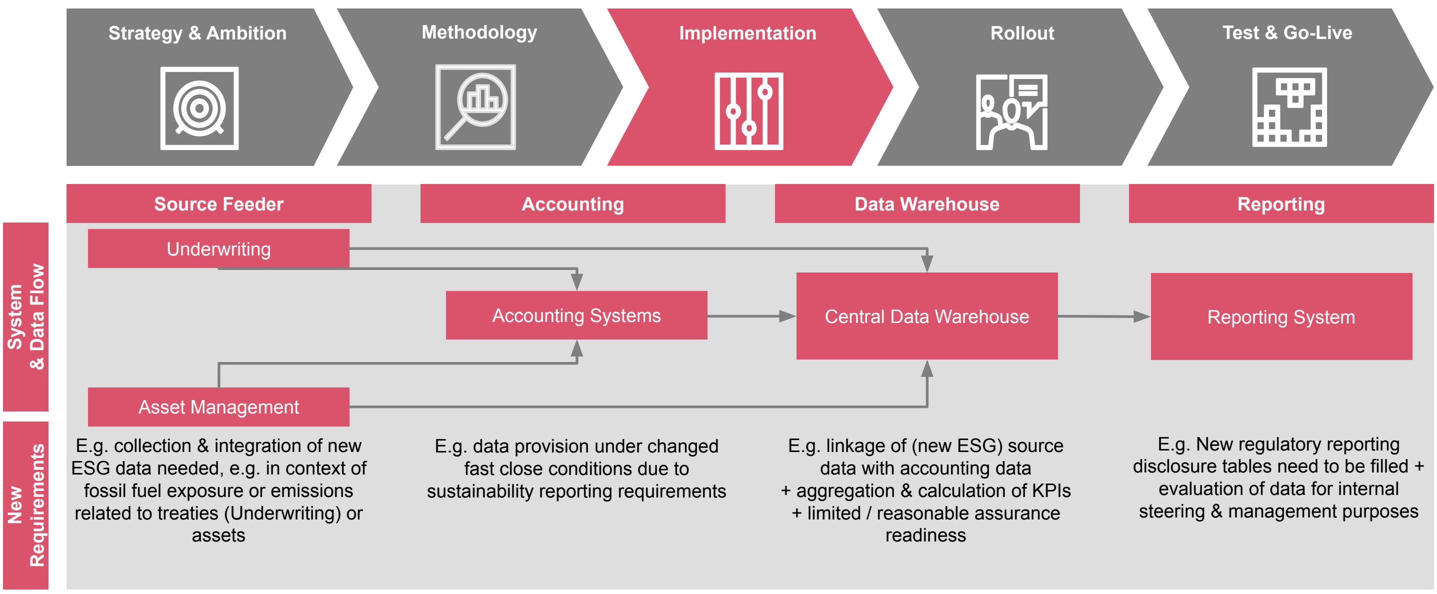
Further challenges centre on the difficulties in ensuring consistency and interoperability between the CSRD and the parallel disclosure frameworks being developed by the SEC and ISSB (e.g. effective dates for first applications, materiality definitions). Even within the EU regulations there are inconsistencies between the KPIs and how they are measured. The onus will be on your business to limit inconsistencies within your disclosures and explain any anomalies and variations.

Getting implementation on track

So how do you get implementation on track? It's important to define a project set-up that responds to the complexity of incoming and future reporting (see illustrated implementation approach in Exhibit 11). The cornerstone is organisational accountability and buy-in. The project should be built around active board-level direction and engage all the back office and frontline operating divisions that will be affected. This will help provide the basis for the enterprise-wise understanding, resources and collaboration needed to comply on time. It will also help to alleviate the risks of inconsistencies.

Exhibit 11

Implementation Approach



Source PwC

Overhauling your operating model

What also comes through strongly from working with clients is the need for major adaptation and possible overhaul of operating models to deal with both the increased importance of sustainability reporting and the required levels of data capture, oversight and organisation-wide mobilisation needed to deliver the new requirements. This includes defining new responsibilities, processes and ownership.

We focus on data in the next chapter. What's important to stress here from a project perspective is the need for partnership with systems teams and proper governance over all external commitments and communications to ensure compliance and reduce reputational risk.

Timing requires compromise

Deadlines are approaching. You'll therefore need to accelerate data gathering and reporting preparation through expedients such as fast/hard close. In the first instance, it's important to determine ways to deliver data that isn't currently available or incomplete. Initially, this will include approximations, while allowing time to ensure appropriate validation.

You'll also have to rely on third-parties including portfolio companies. This underlines the need for effective upfront verification and assurance rather than leaving this until all the quantitative and qualitative disclosures are prepared.

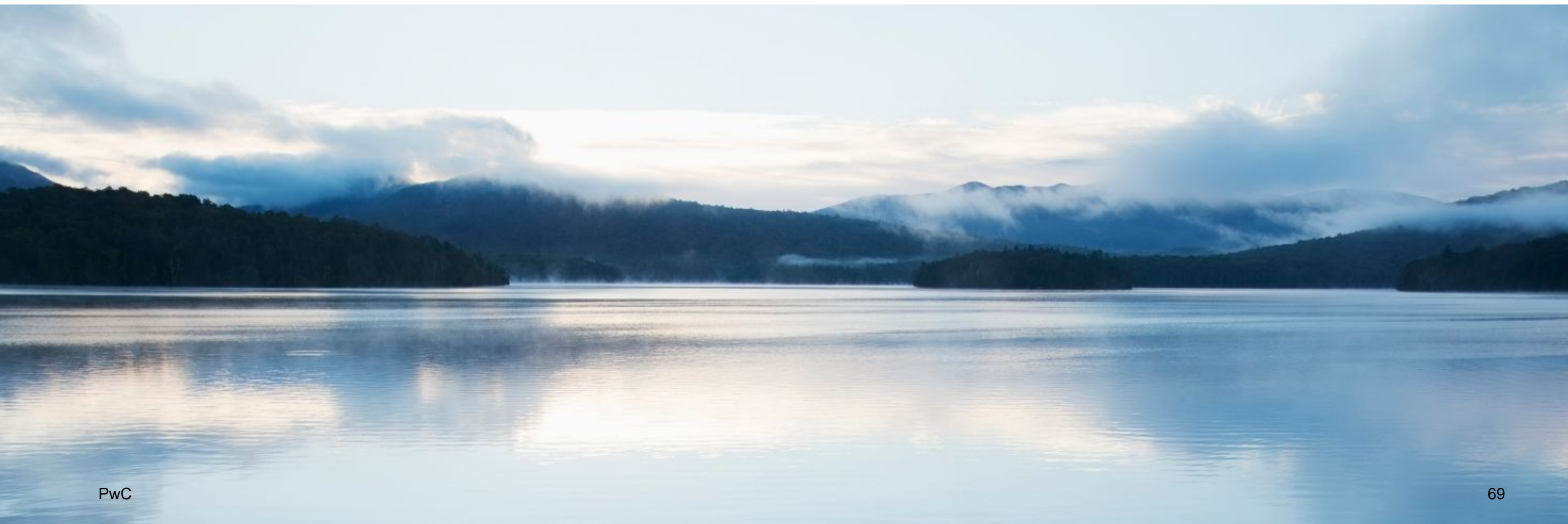
Further hoops to get through include the need to consolidate data and information from local subsidiaries and branches worldwide. Their ESG knowledge may not be as advanced as that of group teams at this stage. Within the time available, it's therefore important to bridge potential knowledge gaps by upskilling local teams and monitoring initial outputs.

Attributes for success

There is no getting around the amount of effort needed to comply with the incoming reporting demand. But some insurers are making faster and more effective progress than others. The front-runners are marked out by a number of common approaches and attributes:

1. Be clear about the ask

The key to cutting through the regulatory knot is an in-depth understanding of what regulation, commitments and ratings you will need to comply with and how to align the disclosure demands with your ESG strategy. Commitments should be regularly monitored to ensure they remain aligned with the overall strategy, which could mean some initiatives being postponed or shelved. Looking at the requirements line-by-line may actually cloud the waters if this is the first thing that you do. What's needed as a starting point is an assessment of your inside-out and outside-in impact so you can focus your efforts on the areas of your business that are most material and subject to scrutiny.



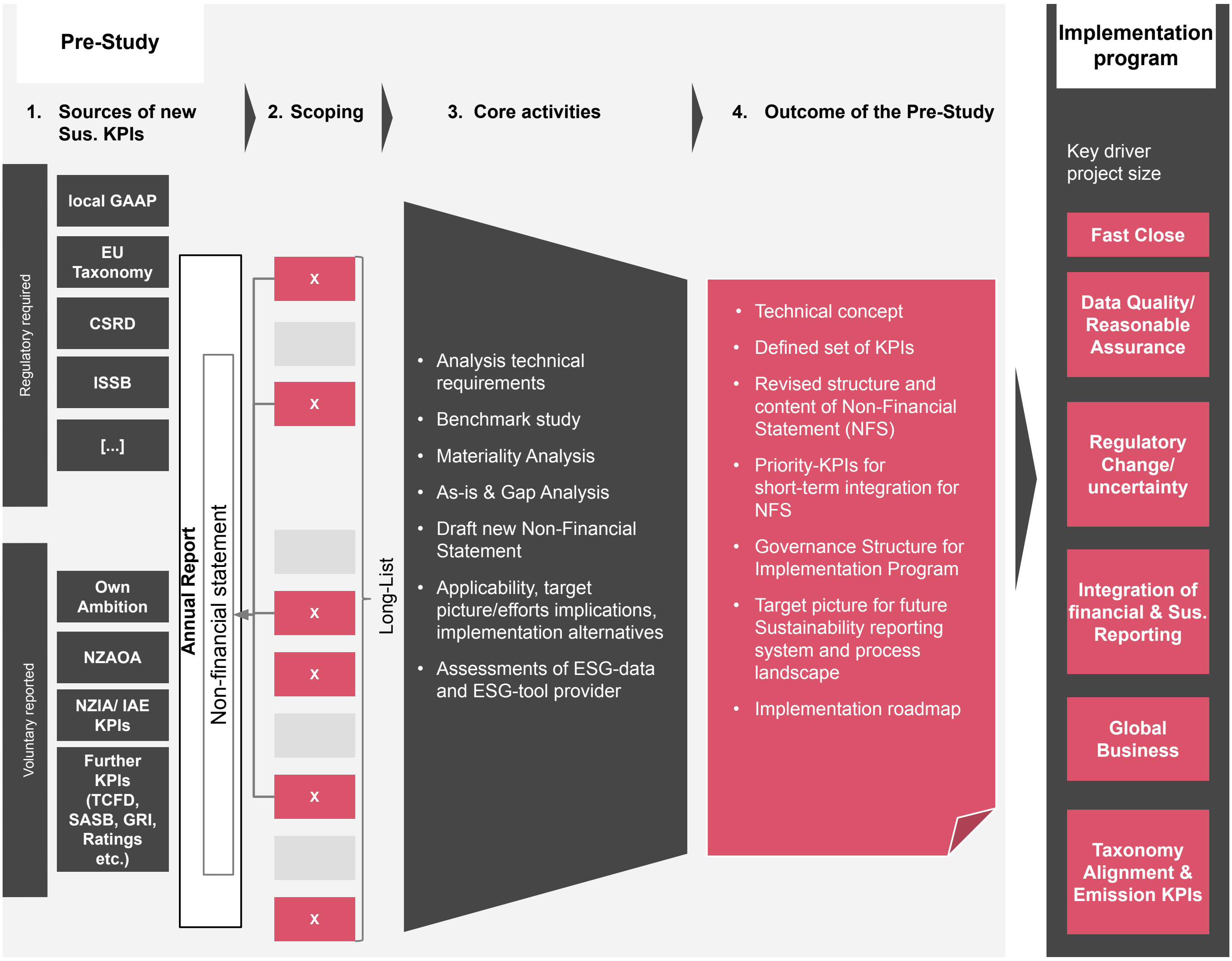
2. Close the gaps

The compliance assessment will help you to identify a list of requirements. You can then carry out gap analysis to compare your 'as-is' current reporting capabilities, metrics and KPIs with what you need to have in place. We strongly recommend a pre-study to be carried out as soon as possible for that and to use the materiality assessment requested on the CSRD (following double materiality) for the scoping exercise.The analysis should look at the potential data gaps within individual KPIs.

The gap analysis will enable you to identify priorities, assess required resources and draw up a roadmap for implementation in areas such as bridging data gaps and upgrading systems. As Exhibit 12 highlights, it's important to be realistic by identifying and prioritising the critical data points from a compliance perspective. It's also important to consider what more may be needed to convey your ESG strategy and progress against it over and above what the regulatory and other reporting specifications dictate.

Exhibit 12

Pragmatic approach to closing the data gaps



Source: PwC

The gap analysis will also help you to determine the most effective operational approach depending on reporting lines and available tech and talent. Key questions include whether to put a central team in charge of KPI generation or adopt a decentralised approach. Given that sustainability information will be audited, it's also important to ensure that the data feeding into your consolidated report is appropriately governed and assurance-ready.

3. Tell it as it is

There may be a temptation to put a positive gloss on your ESG performance. But selective disclosure or exaggerated claims could undermine credibility and trust. They would also be difficult to substantiate from an audit perspective.

Rather than simply promoting stand-out strengths, reporting should be clear and candid in setting out attainable objectives, plans to get there and progress over time. It’s also important to explain the reasons behind the numbers, including any disparities between the results for similar KPIs in different reporting regulations.

Your business may be wary of drawing attention to its shortcomings. Yet even if you’re behind the curve in some aspects of ESG, there are opportunities to get on the front foot by acknowledging that there are areas you need to focus on and setting out how you intend to accelerate progress. Such openness and resolve can make a favourable public impression.

4. Make the most of qualitative disclosure

The current deficiencies and inconsistencies in quantitative data reinforce the importance of setting out a clear vision and reporting on progress against it within enriched qualitative disclosures. Fuller explanation doesn't just help to bridge any gaps in the numbers, but also justify strategies whose positive objectives. A clear case in point is explaining why finance and/or insurance cover is still going to companies with high emissions now and how you are helping them to move onto a sustainable footing.

Promoting insight and harmonisation

Disclosures need to be comparable across the industry to have weight and meaning. With little consistency in the regulatory frameworks, you may need to look to alternative options. This is the thinking behind the creation of the Partnership for Carbon Accounting Financials (PCAF). The PCAF is a global partnership of financial institutions that work together to develop and implement a harmonised approach to assess and disclose the greenhouse gas emissions associated with their loans and investments. The PCAF is now working with the UN-convened Net-Zero Insurance Alliance (NZIA) to develop a specific standard to measure insurance emissions. PCAF launched the Global GHG Accounting and Reporting Standard for Insurance-Associated Emissions in mid-November 2022 to support harmonisation within the insurance industry on emission reporting.

The joint initiative aims to provide deeper insights into the greenhouse gas emissions in insurance portfolios, help create comparability for stakeholders and stimulate innovative approaches to decarbonisation. It also aims to help insurers develop a better understanding of the climate impact of their underwriting decisions and promote concrete actions that have real-world impact through emissions reduction in the real economy.

Risk management: Making a difference

ESG strategy and risk management need to be aligned and cover regulatory requirements. You won't be able to deliver your strategic and regulatory commitments if the risks are managed as a tick-the-box exercise. Both risk and business teams should therefore be driving discussions on sustainability within business teams and make an impactful difference on ESG, while managing the complex array of threats and liabilities it presents.

ESG brings a whole new dimension to the risk landscape and the challenges of managing it.

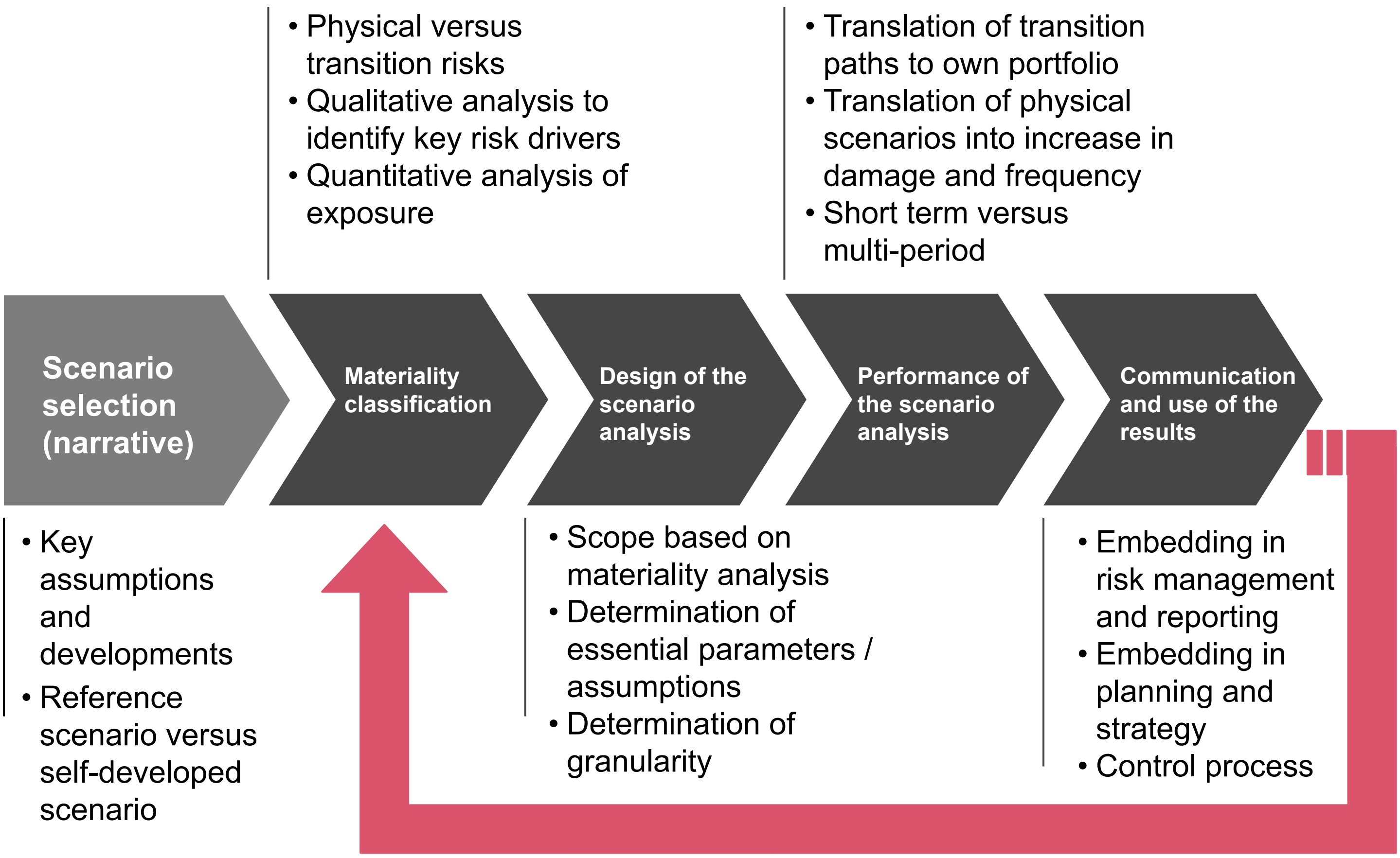
From a financial risk perspective, a lot of the focus is centred on the physical risks, chiefly climate-related insurance losses in areas such as floods and wildfires. But just as important are the transitional risks. These range from investment assets that might become obsolete or stranded as a result of green transition, to the uncertainties and potential losses for clients in overhauling production techniques and deploying unfamiliar technologies. How can you develop the right tools and techniques to understand and manage these risks?

Beyond the financial risks are a raft of equally material non-financial risks. The previous section highlighted the reputational risk of being called out for greenwashing. It's also important to guard against the conduct risks of false claims and mislabelling relating to the ESG credentials of the products you market and the investment and underwriting strategies that underpin this.

The risk implications of climate change and wider ESG are attracting regulatory attention. These include the planned inclusion of long-term climate risk scenarios within a revised Solvency II Own Risk and Solvency Assessment (see Exhibit 13).

Exhibit 13

ORSA scenario modelling



Source: PwC

Time to step-up

Compared to the immense future reporting requirements, concrete measures and actions for actuaries and risk managers are limited, but regulation still forces them to rethink objectives and operations.

On the non-life side, the lack of urgency can be compounded by limited time horizons. The narrow focus on the risk of loss within a one-year policy fails to take account of the slow burn impact of threats such as temperature rises and environmental degradation, which can take decades to materialise.

As a result, there may be a tendency to view ESG risk as largely a compliance exercise. What's often missing, but is now essential nonetheless, is a real debate about how ESG has transformed the risk landscape and how to build ESG risk insight into strategic management. For risk actuarial and risk teams to deliver on their purpose and potential, they should also be thinking about how to harness their expertise to make a positive material impact in areas such as facilitating green transition and bridging the protection gap for underinsured communities.

Cross-functional impact

As you look to create an informed basis for decision-making and execution, the key question isn't just how your risk function needs to adapt, but also how to engage and mobilise the wider business. Exhibit 14 highlights the enterprise-wide impact of ESG risk in areas ranging from underwriting to product development and marketing. There are also likely to be a lot of moving parts and knock-on impacts within these risk assessments. For example, to build ESG into your risk appetite, you may need to set and monitor underwriting limits on carbon-intensive businesses and align actuarial risk of loss evaluations with the impact on your Scope 3 emissions and disclosures.

Exhibit 14

ESG risk impact on the wider business

- In contrast to the usual expectation of short-term, mid-term and long-term time horizons in the ORSA, time horizons from a climate change perspective tend to be considerably longer
- For most climate change risk analyses currently done in the ORSA, the time period considered was 1-5 years or not specified
- However, different insurance activities require different time horizons

Motivation to undertake climate change analysis	Time horizon	Example of firm functions impacted
Disclosure: TCFD related	Long	Corporate and Social Responsibility, Finance and Risk, Finance, Actuariat, Sales, Marketing, Exposure Management
Disclosure: Public reporting (e.g. shareholders)	Medium, Long	Finance, Actuarial, Exposure Management, and Risk
Disclosure: Public policy advocacy	Long	Corporate and Social Responsibility, Finance, and Risk
Business decision: Underwriting and pricing	Short	Sales, Marketing, Underwriting, Finance, Exposure Management, and Risk
Business decision: Capital	Short	Claims, Finance, Actuarial, Exposure Managemen, and Risk
Business decision: Outwards risk transfer (e.g. reinsurance purchase)	Short	Underwriting, Finance, Actuarial, Exposure Management, and Risk
Business decision: Product development	Medium, Long	Sales, Marketing, Underwriting, Claims, Finance, Actuarial, Exposure Management, and Risk
Business decision: Business Plan	Medium	Sales, Marketing, Underwriting, Finance, Actuarial, Exposure Management, and Risk
Business decision: Risk management, including risk appetite setting	Medium, Long	Underwriting, Finance, Actuarial, Exposure Management, and Risk

Source: PwC

Resetting the risk agenda

So what are the key considerations for risk functions and wider business teams in this evolving risk landscape?

The role of the CRO

ESG demands purpose, commitment and leadership. Therefore, a good starting point for rethinking and reconfiguring risk management is to consider what kind of role your CRO should play in delivering and aligning with your ESG ambitions.

As a CRO, are you the translator explaining the risk implications, the facilitator for addressing them, the communicator mobilising the business or the strategic influencer helping to drive action and change? The guiding priority in addressing these questions is how you and your team can genuinely make a difference on ESG.

When evaluating your impact as a business, it's important to look beyond regulation to the principles and objectives that underscore it. Does your company comply with the Paris Agreements' targets and, if not, what more should you do, for example? How can you use your influence and risk expertise to help achieve these goals? Are you capitalising on the opportunities this opens up?

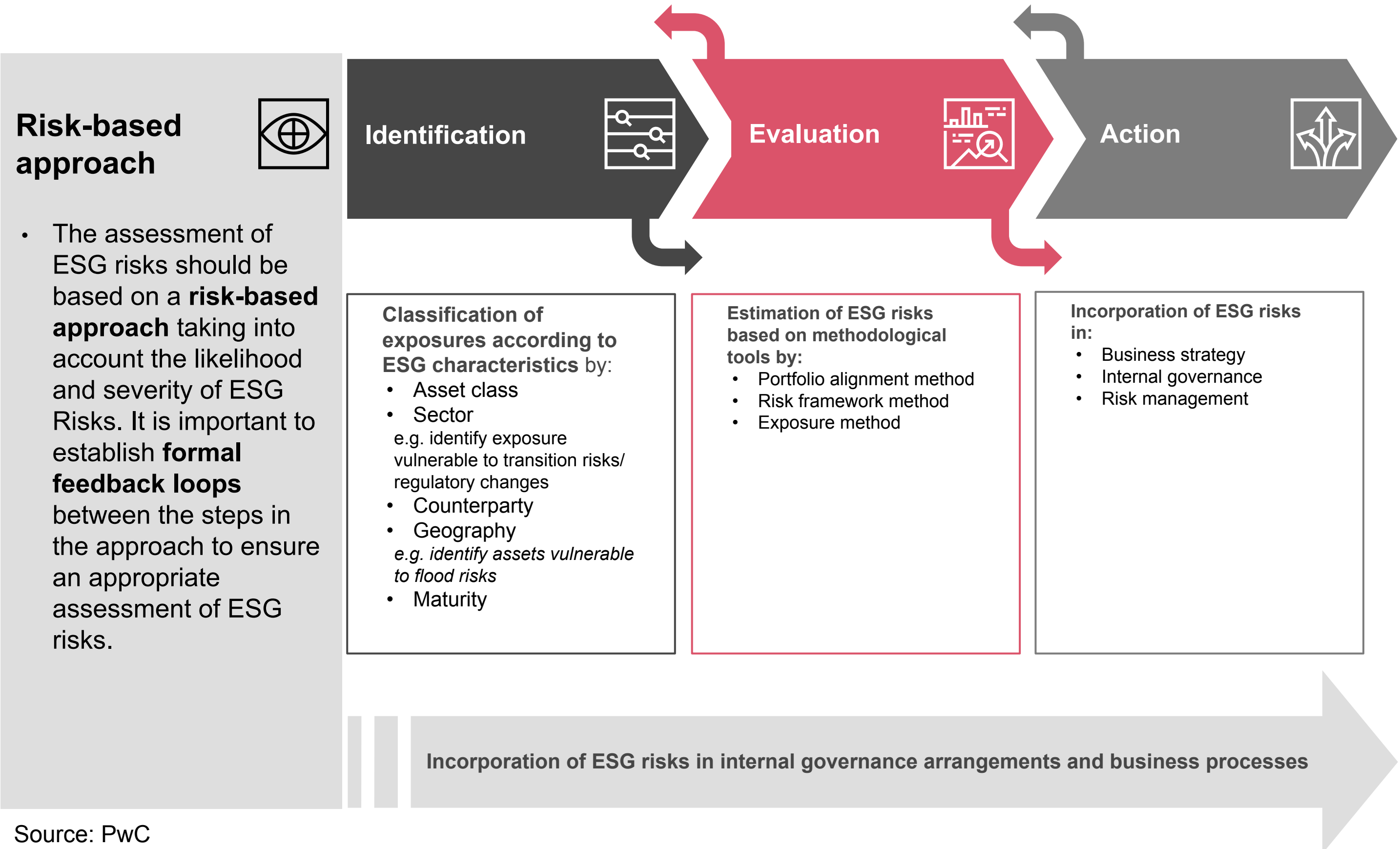
Gauging materiality

The parallel priority is a clear and comprehensive assessment of your organisation's ESG risks and how you can help clients understand and respond to the risks they face.

Exhibit 15 outlines an actionable approach to risk assessment that seeks to identify the specific risks you face, gauge their likelihood and severity, and build potential responses into your strategy and governance.

Exhibit 15

Comprehensive approach for the assessment of ESG risks



Source: PwC

A useful framework for making the links between the likelihood/severity of a specific risk, the actions in response and who needs to be involved are the heat maps developed by the UNEP FI PSI Initiative.

In line with the double materiality principle, it's not only necessary to assess the outside-in risks impacting your business, but also your impact looking inside-out. This requires a shift in perception.

Data may be limited and difficult to interpret (see Chapter 5). Further hurdles include making sure you have the experience and expertise to evaluate new and unfamiliar risks. At present, gaps in knowledge of the risks are leading to insufficient identification, mitigation and reporting. Translating ESG issues and scientific climate data into risks and impacts that will be understood within the business requires new skill sets, both in relation to climate risk and engagement.

Making ESG manageable

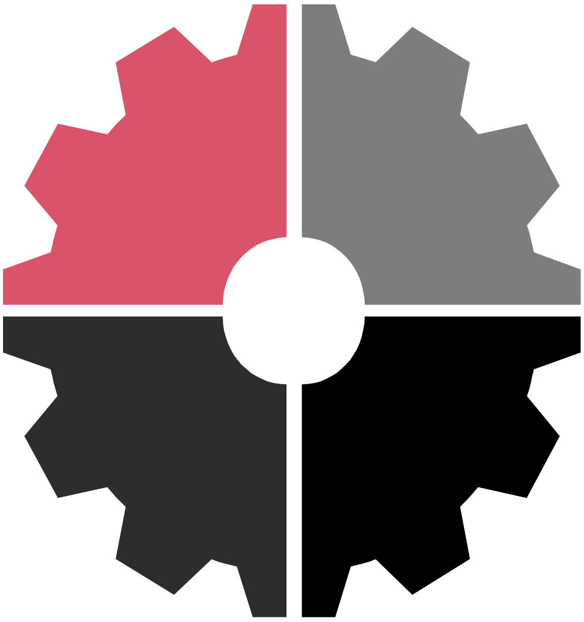
From a change management perspective, it's important to break the immensity of the risk down into manageable and understandable pieces.

The materiality assessment can provide the foundations for building awareness of the impact of the different risks and for prioritising actions. The next step is integrating these risks into your wider enterprise risk management (ERM) and business decision making frameworks, drawing on the methods and processes already in place as far as possible.

Exhibit 16 highlights the key priorities for ERM integration as you move from setting your risk appetite and tolerances through to translating these into relevant and actionable metrics for decision making, monitoring and tracking.

Exhibit 16

Incorporating ESG risks in the Risk Management Framework



Risk appetite

- Description of the **risk appetite**, **tolerance levels**, **thresholds** and **limits** set for the identified material risks
- Description **how the risk indicators and limits are allocated** within the group, business lines, branches
- Management of ESG risks **as drivers of prudential risks** within their current risk management frameworks, in a consistent manner with the risk appetite and as reflected in the ORSA

Data and methodology

- **Collection** of necessary **information and data** related to ESG risks associated with the counterparties (e.g. through a targeted due diligence assessment)
- **Review** and **update** this information throughout the lifecycle of the transaction, where needed
- Establish **appropriate policies** and **procedures** as well as criteria

Stress testing for climate risk

- Gradually developing **methodologies** and **approaches** to a **climate risk stress test**
- Information on the **resilience** of insurer's own **business model** and **investment strategies** with a milder focus on capital implications
- Use of **stress test results** to determine the effectiveness of new and existing business strategies from an ESG risks perspective and the possible impact from transition and physical risk.

Risk monitoring and mitigation

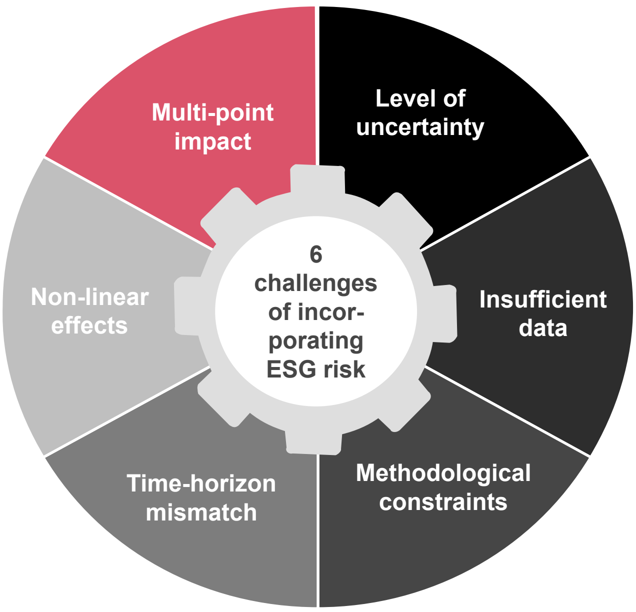
- Development of **risk monitoring metrics** at exposure, counterparty and portfolio-level
- Categorisation of these metrics by their ESG characteristics and risk associated with these, subject to their size and complexity

Source: PwC

Some of the challenges centre on integration. Some relate to data, processes and expertise as outlined before. But there are also cultural and mindset changes in areas such as the need to consider long-term time horizons and the possibility of 'green swan' events which, while rare, can be both unexpected and devastating.

Exhibit 17

Challenges for the integration of ESG risks in the insurer's management



ESG risks can drive different (existing) prudential risk categories
e.g. credit risk, market risk, capital and liquidity adequacy, etc.

Timing and impact of physical and transition risks, social risks and governance risks are hard to predict
A range of scenarios with very different economic and social implications is conceivable.

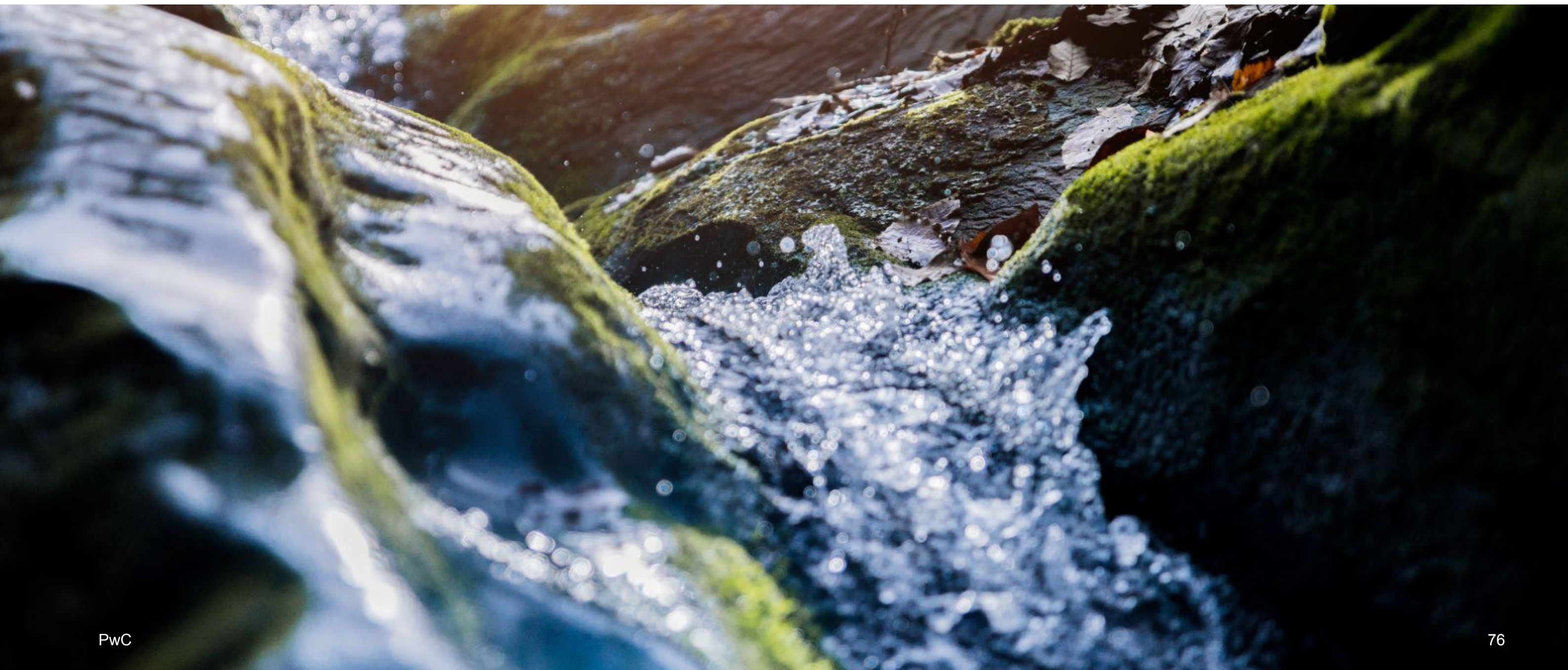
Lack of relevant, comparable, reliable and user-friendly data
Even where data is available (esp. large corporates), it remains challenging to translate ESG factors into expectations for financial performance.
Lacking reliability and comparability also complicates ESG disclosure.

Methodologies have not been established
Historical data is not useful for analysis of future risks as e.g. climate change is not reflected in historical data.
Understanding and translating ESG risks into prudential risks remains difficult.

Mismatch between "traditional" management tools and materialisation time of ESG risks
Especially environmental factors develop impact over decades.
Strategic planning horizons of risk management frameworks are shorter than climate pathways.

When events occur, their impact may be greater in relation to the instantaneous magnitude of the event itself
e.g. (Black/Brown/Green) Swan Events

Source: PwC



Tax: Managing tax through an ESG lens

Tax is coming under an increasing ESG spotlight, both in how much you contribute as a business and as an incentive for sustainable strategies and investments. In response, it's important to look at the tax implications of your strategy upfront, rather than vetting at the end.

Tax makes up a significant part of your contribution to society. In turn, these contributions add to the public revenues of the countries and support financing the efforts towards delivering the UN's Sustainable Development Goals. That in itself should bring it to the centre of the ESG agenda. Our own integrated framework for Total Impact Measurement and Management here at PwC includes tax impact alongside a company's social, environmental and economic impact.

ESG considerations are increasingly affecting all business functions and activities – from human resources, finance and treasury, operations and supply chain, products and sales to analytics, tax and legal. There is a growing awareness of the fact that companies have a more attractive and fit-for purpose business model for the future and can achieve higher returns if they take ESG criteria into account. They are better positioned to cope with tighter and emerging regulations and legislations such as carbon taxes. Regulators are also paying attention to financial institutions and large institutional investors, as they can channel money flows into more sustainable sectors and technologies.

Public tax transparency as a contributor to sustainability

Insurers are required to disclose financial and tax data in accordance with internationally accepted financial reporting standards. But public tax transparency goes beyond such requirements (please see Exhibit 18 on developing a tax transparency strategy).

Exhibit 18

Tax Transparency Journey

Public Tax Transparency journey:

- Develop a **Public Tax Transparency document** based on the current tax landscape.
- Evaluate the different Public Tax Transparency **options** as a corporate as well as an investor.
- Compare **value and risk** of increased tax disclosures.
- Compare Public Tax Transparency strategy to **sustainability standards or other initiatives** and perform **benchmark analysis**
- **Perform gap analysis** between **current and target/desired** states and develop an **actionable roadmap.**
- **Engage with internal and external stakeholders to avoid any surprises.**

3 Pillars of the Public Tax Transparency report benchmarking:

- **Peers** – define best practice of the industry competitors and assess their approach and report.
- **Broader market practice** – define the leaders in the field of Public Tax Transparency disclosure and assess their approach and report.
- **Frameworks** – define which of the frameworks and regulations follows:
  - – GRI
  - – DJSI
  - – MSCI
  - – IBC WEF
  - – EU public CbCR
  - – Any many others

Source: PwC

It is about the additional tax-related, non-financial information that companies report in relation to their tax governance framework, such as their tax strategy, their tax-paying behaviour, their tax risk management and how they contribute to the sustainability agenda of their organisation. It is about their commitments to comply with the letter as well as with the spirit of the tax laws and regulations in the jurisdictions in which they operate, not to transfer value created to low or nil tax jurisdictions, etc.

Further, quantitative data, such as country-by-country reporting and total tax and other economic contributions are also part of their public tax transparency. Public tax transparency is a means of communication to inform internal and external stakeholders of the contribution the business makes to public revenues and of what it undertakes regarding ESG principles and initiatives – based on the understanding that tax does not only have a financial impact, but also an impact on society and climate, and that it supports governments achieving their SDGs (please see Exhibit 19 on the considerations for developing a tax transparency report efficiently).

The advantages of pro-actively publishing a public tax transparency report are manyfold. Tax is part of sustainability, and public tax transparency is part of sustainability reporting. It creates additional value for the organisation and is an opportunity to build up trust – not only with shareholders, but also with other external and internal stakeholders. It is a way to show that the company delivers sustainably on the bottom line and to build up a clear ESG reputation. Institutional investors are looking for fit-for-purpose tax governance frameworks that allow the tax functions to govern their tax affairs rigorously and with manageable risk positions.

Important to note, it is not a matter of form, but a matter of substance; insurance tax functions should have a fit-for-purpose tax governance frameworks and make sure to live with it every day. However, as positive as these developments are, challenges remain. In the growing field of information on sustainability, there are still too many different standards. There are no coherent requirements but an abundance of non-standardised metrics. To make ESG reporting meaningful and turn it into a useful tool for investors and the public alike, unified standards must be developed and established on a global scale. There is definitely room for improvement –in terms of reliable measures, as well as in companies' adoption of a tax transparency mindset.

Although in the EMEA region several insurers or reinsurers are already publishing tax transparency reports, there still many (re)insurers that have not published or published very little. The inconsistency amongst the existing reports does not offer to the readers any comparability options. Further, the data extraction, data collection and data aggregation processes are relatively complex especially when many different systems are involved. Finally, several insurer or reinsurer have their tax transparency reports reviewed by independent third parties.

As governments are looking to reduce public sector deficits, there is likely to be greater scrutiny on the contribution companies make to public finances due to the demand for greater transparency. Furthermore, the climate change debate, and commitments to net zero, will influence future tax policy with a focus on taxes other than profit taxes. Total tax contribution data can help to highlight the broad contribution in taxes and provide data to inform policy discussions.

The spotlight of scrutiny has been intensified by new regulation, including the need to publicly disclose the country-by-country reporting to meet the requirements of the EU Directive 2021/2101 that amending the Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches. As an insurer you also have to consider the tax policies of the companies within your investment and underwriting portfolios.

Exhibit 19

Public Tax Transparency Report

Source: PwC

Public Tax Transparency report:

- Define the format and content of the Public Tax Transparency report and assess which typeof reporting is suitable by identifying and analyzing different options.
- Engage with internal stakeholders to **ensure alignment** of the Public Tax Transparency report with other ESG reports.
- Conclude on the **relevant qualitative and quantitative data** to be included in the Public Tax Transparency report to avoid any **misinterpretation risks** as well as **any inappropriate disclosures**.
- Set up data extraction, data collection and aggregation processes and controls as well as harmonize **data for Total Tax Contribution numbers**.
- Industrialize the data collection process to achieve **operational efficiencies** through **automation** and taking account of recent development.

Open to scrutiny

New legislation and regulation underline the importance of building a clear plan to manage tax reporting and transparency in a way that builds trust with key stakeholders. Tax transparency could also help boost your sustainability index rating.

Further impetus comes from voluntary disclosures such as the GRI section on tax. This is an opportunity to set out your fair and transparent approach to tax. But it comes with the same risks of 'washing' that applies to other aspects of ESG.

Incentives and penalties

Alongside tax paid, the tax implications of ESG include tax incentives for green practices and penalties for harmful ones.

The incentives include tax breaks for investment in areas such as sustainable infrastructure. Some 70% of companies in PwC's EU Green Deal Survey Report that have undertaken environmental improvements have tapped incentives, grants and tax credits to do so.

The penalties include taxes on energy, pollution and carbon emissions. The EU is taking this further through a proposed Carbon Border Adjustment Mechanism (CBAM). This is designed to prevent so-called carbon leakage by discouraging firms from importing carbon intensive materials such as steel and cement from outside the EU to circumvent environmental taxes and controls within it.

The CBAM could have a significant impact on the supply chains of the companies within your investment and underwriting portfolio. It could also have financial and reputational implications for them and, indirectly, on you. How are you monitoring carbon leakage and other harmful practices within your portfolio? How can you influence this? How can you make sure that the incentives and penalties are considered with your investment management and product development (see Chapter 3)?

Dealing with the ESG implications of tax

So how do you integrate tax management into ESG strategy, governance and execution?

Get involved

Your tax team will need to proactively engage with colleagues across your organisation and be closely and promptly involved in a range of ESG-related areas including impact assessment of environmental taxes, carbon footprint, ESG reporting and tax transparency.

Get the data

Building ESG into strategy and governance demands an enlarged and, in key areas, more frequently updated database. Priorities include working with portfolio companies to secure information on their tax planning and approach. Further, the data extraction, the data collection and the data aggregation for the purposes of the tax transparency is rarely readily available. Therefore, it is important to develop certain processes, identify the related risks and introduce the controls needed to manage such risks.

Get it right

Your tax policies and total contributions need to be fully transparent. The same goes for the tax considerations within your portfolios. If a product is designated as ESG, tax should be closely considered and scrutinised within the overall screening and due diligence.

Are you ESG-ready?

?

- The mechanics of reporting, risk and tax management will define how effectively you manage the volatility, uncertainty, complexity and ambiguity (VUCA) at the heart of ESG and the associated threats and opportunities for your business. The data demands and technical intricacies are clearly sizeable. But just as important is the embedding of these engines of ESG into the running of your business?
- What data, skill sets and technical understanding do you need to report credibly and informatively to both boards and external stakeholders?
- What tactical measures do you need to meet initial reporting deadlines, while putting measurement and disclosure on a durable footing for the future?
- What new and emerging risks does ESG open up and what role does your CRO play in managing them?
- How can you go beyond tick-the-box compliance by building ESG into your wider enterprise risk framework?
- How can you ensure the governance, oversight and alignment between front office and reporting, risk and tax teams needed to protect your business and deliver on its promises?
- Is your tax team closely and proactively involved in embedding the tax strategy within the ESG strategy and vice versa?

Chapter 5

From data to actionable insights

How a data rethink can sharpen insight, innovation and credibility

From data to actionable insights

How a data rethink can sharpen insight, innovation and credibility

The already significant ESG data demands are likely to be heightened still further as insurance shifts from being an 'absorber' of climate shocks to an 'enabler' for the net zero economy. But questions over what data is needed and where it comes from shouldn't just centre on reporting. As important and demanding sustainability disclosures are, only focusing will not provide the data you need to meet your ESG ambitions and make the most of related opportunities for innovation and growth. So, what kind of ESG data is needed to act and how does an effective data strategy look like for your business to deliver?

In this report, we have explored the impact of ESG on critical aspects of your business ranging from investment strategy and product innovation to risk, reporting and regulation. Your ability to meet these changing priorities comes down to credible, timely and comparable data.

What makes ESG data different from financial or 'normal' data:

1. ESG data is often not under your control or in-house
2. ESG data is by nature more complex due to the material themes
3. ESG data is often a best-estimate or proxy
4. ESG data encompasses a large amount of new data points
5. ESG data has a lower maturity due to the lack of controls in the data-gathering process
6. There is a lack of clarity on what kind of ESG data is most helpful for compliance and decision-making due to the dynamic development of the multiple stakeholder demands

A big part of the challenge is pulling together the vast array of new and enriched data needed to meet regulatory reporting requirements. As previous chapters have highlighted, this is no easy task. The CSRD alone will introduce an enormous number of new data points, with even more sub-data points with estimates over > 10.000 data points. But as ESG pushes back the frontiers of strategic possibility and stakeholder expectations, it's also important to think about what data you need to deliver actionable business insights and innovative solutions.

More than 50% of our environmental data comes from space. This data is available in various public databases. Adding to this is the data available within your client, product, investment portfolios. While we often hear about gaps, when all these multiple sources are brought together, we actually have more than enough data to actively address the environmental challenges we face. But to make the most of what's available, your business would need to integrate all this data into your core processes, your strategy and material topics. Reporting should primarily reflect the progress made against objectives and allow your stakeholders to act accordingly. So reporting should not drive your strategy, but helps in structuring the data needs for actionable insights.

Aiming higher, let your strategy rule your data needs

What's raising the bar for data demands? Why is it so important to step up to the mark?

Introducing sustainability criteria in claims offers a telling illustration of how data sourcing, management and modelling would need to evolve. Following a flood, for example, the new generation of sustainable insurance cover might include provisions to replace damaged materials with greener alternatives or fit sensors and other protective equipment to help prevent future losses. In line with circular economy priorities, you might also want to recommend repair rather than replacement where possible and keep a database of local trades people for this.

There is a receptive market for this kind of environmentally conscious insurance. But realising the potential demands new forms of data, the ability to cut across functional silos and closer integration between sustainability, pricing and claims models. Without this, what could be a winning opportunity is likely to remain stuck in the innovation lab.

This opens-up the discussion of which skills and capabilities are needed to set-up the data governance. This means leveraging existing experience, e.g. from IFRS 17, and approaching the opportunities with new skills. These capabilities and skills can be categorised as:

Exhibit 20

Six key cascading capabilities to realize the ESG transformation with data & tech

Maturity of solutions in reverse order

Capability	Abilities
Develop a data-driven strategy	• Ability to steer on material ESG topics relying on **robust, timely data** • Ability to incorporate **quantitative ESG insights** into risk management • Ability to **continuously improve and revise** the ESG data strategy
Generate key ESG insights	• Ability to generate **real-time ESG insights** to inform strategic decisions • Ability to **interpret ESG insights** and revise analyses where necessary • Ability to **forecast ESG data** and corresponding risks and opportunities
Choose ESG tech solutions	• Ability to clearly **map the ESG tech solution landscape** • Ability to **integrate ESG data architecture** with existing systems • Ability to identify needs for **niche tools** based on operating context
Report on ESG performance	• Ability to **annually report externally** on ESG performance • Ability to **fulfill regulatory requirements** (e.g. CSRD, EU Taxonomy) • Ability to meet **stakeholder demands** for quality and quantity of data
Implement ESG governance	• Ability to clearly designate a **data structure across the organization** • Ability to set clear **ESG targets** and corresponding incentives • Ability to create **ownership throughout the whole organization**
Source correct ESG data	• Ability to **identify material ESG topics** and an **determine data needs** to measure performance on these topics • Ability to differentiate between **quality of data sources/ vendors** • Ability to integrate/ implement the data in core processes

- To move up the maturity cascade, ESG data goes from a separate niche topic reported on once per year to an **integrated part of the strategy supported by a robust data & tech infrastructure**
- Companies are **pushed up this maturity cascade** by regulatory pressure, market competition, consumer demand, and investor needs
- To go up the cascade, mere tooling is not enough - these capabilities are to be **supported by a robust knowledge base** and buy-in across every level.

Source: PwC

Being ready for the new realities requires credible data

A clear example of the evolution of data relates to the insurance needed to help accelerate the development and application of climate tech. The security of insurance can help to boost investment in new innovations and their take-up by businesses and consumers. But as many of these developments are so new, there is little more than cursory claims data against which to price the potential risks. Historic models no longer make any sense in this case. The risk, underwriting and product expertise needed to make up for some of data deficiencies are also more scattered than ever.

But one way or another, your underwriters need to find ways to understand and price these climate tech risks. Yes, there will be trepidation, but comparable challenges in areas such as cyber risk have been tackled. And overcoming these data hurdles is not only critical in delivering on your ESG purpose and ambition, but also offers immense commercial potential. The frontrunners will be able to call on the data they need to make sharp strategic decisions and position themselves in a changing marketplace. They will also be able to comply with upcoming legislation in an agile and proactive way, while strengthening risk management and lowering compliance costs.

In order to act, you need to find, enhance and use the data. The objective here is to experiment and use these insights to develop the actionable insights in addressing legislation and the strategic ambition of your organization.

Exhibit 21

Phases of the data journey

	Find & create data		Increase maturity and reliability			Reflect, use data
Key ESG Data Phases	**Understand which data we need for which purpose**	**Operationalize data collection**	**Integrate ESG data in companies (existing) data architecture**	**Have data quality and data integrity checks in place**	**Ensure data governance**	**Ensure action**
Key challenges	Where do I want to use my ESG data for? (strategy, risk management and reporting & regulatory compliance)	How to source all ESG data? What is the best approach? Will the efforts outweigh the benefits?	Do we store the ESG data in current data warehouses or in a centralized ESG data warehouse?	How do I ensure my data has the right quality along several DAMA DQ dimensions?	How to ensure I have roles & responsibilities set out to foster strong ESG data management?	Is the data digestible to directly impact performance, and growth, both on board level, and department level
	Which are the relevant departments using the data? (HR, Finance, Facilities, Legal, Other)	Which are the relevant departments holding the data (HR, Finance, Facilities, Legal, Other)?	How to build our ESG data pipelines to integrate with legacy systems?	How can I enhance my DQ framework to reflect the ESG data quality score?	Who are my ESG data owens,users, stewards	Is the process from updating roadmaps and making required changes present?
	How to deal with changing ESG definitions due to evolving ESG (regulatory) standards / frameworks?	How to deal with missing / low coverage ESG data?	How can I streamline data collection, to reduce workflow friction and answer the data needs?	How to set-up DQ issue management to prevent making to same mistakes?	Maturity differs across 1) the "E", "S" and "G" dimension and 2) ambition level: Compliance, Opportunity/Risk, Strategic, Impact Investing	

Source: PwC

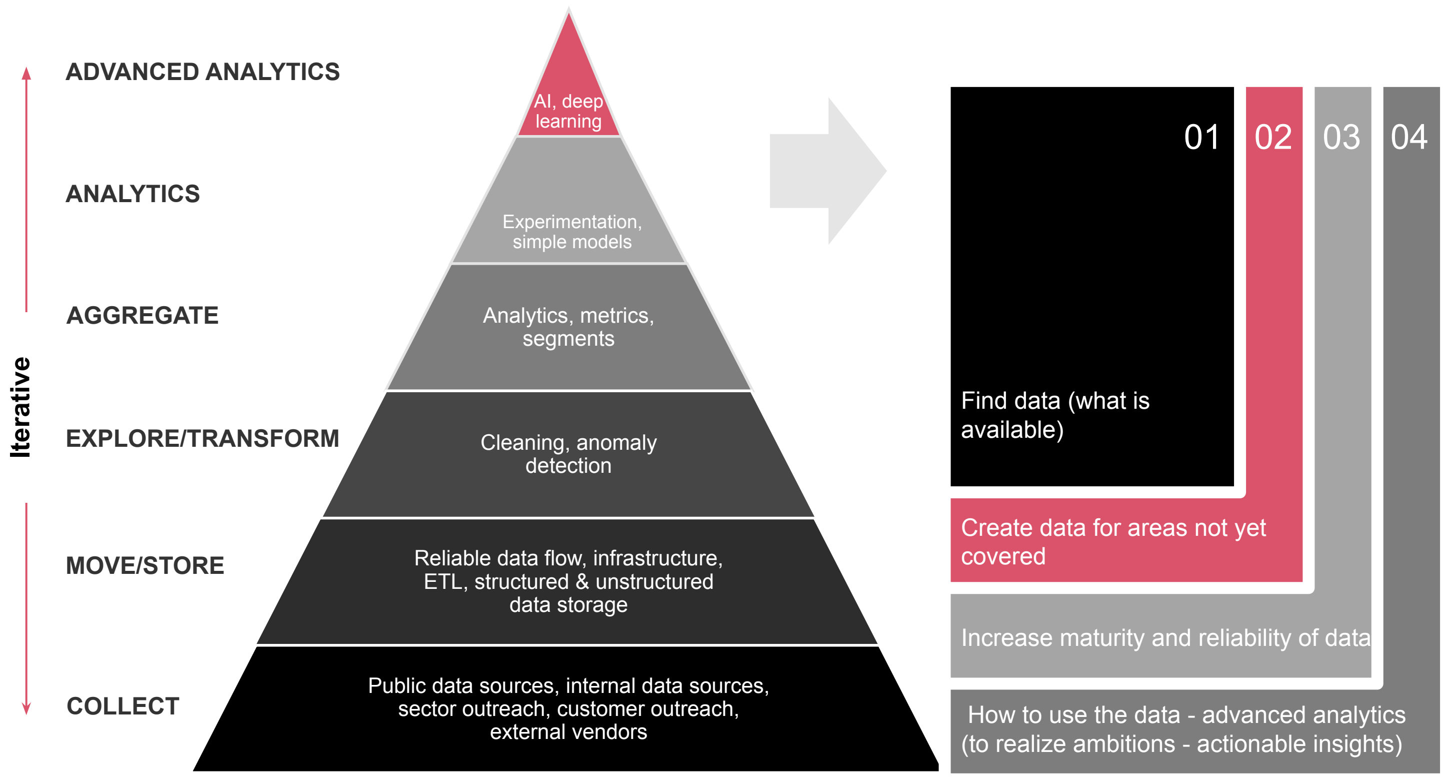
Barriers remain, but are not impossible

So how far have insurers come in this data transformation and what barriers still need to be overcome? The stark fact is that all industries are struggling to bring ESG data up to scratch and insurance is no exception. The challenges are heightened by the fact that much of the data is new. For example, data on Scope 1 and 2 greenhouse gas (GHG) emissions would need to include the type and usage of electricity, heating and cooling across offices. In turn, Scope 3 requires data across a range of different categories, including business travel, commuting, purchased goods, investments and waste. Some of this data is generated and measured internally. But a large proportion on the sourcing relies on information from suppliers and partners. The findings from the 2022 PwC CEO Survey highlight the scale of the task. More than half of the organisations that have yet to set decarbonisation commitments cite an inability to measure their GHG emissions as a major reason why. This is despite the fact that more than half of CEOs are very concerned that climate change will inhibit their ability to sell their products and services over the next 12 months.

It's especially telling that data gaps are still prevalent along the E in ESG despite this generally being seen as the most mature in terms of data availability and quality. Tackling data gaps in relation to the impact dimension of S and the G are going to be all the harder. There is not only less impact data in these areas, but many issues such as human rights are hard to quantify and are likely to require a primarily qualitative approach.

Exhibit 22

Solid ESG data management is an enabler for being effective with ESG strategy, reporting and insights and transformation



Source: PwC

Specific hurdles for insurers

As an insurer, you face the additional challenges of integrating ESG data into your products, pricing, underwriting, customer selection and investment decisions. An area that can prove especially problematic is positioning sustainable products in a rapidly changing environment. The most straightforward example is the impact of climate risk on your underwriting portfolio. The long-term viability of a significant portion of your portfolio would be dramatically impacted by changes in climate scenarios. A quantitative analysis in line with TCFD recommendations therefore requires both internal and external data on the exposure of products to increasing climate tail risk. This is not just a technical hurdle but also a strategic question. Previous underwriting assumptions might no longer be valid. Some businesses and risks might even become uninsurable.

If we look at insurance as an enabler for economic change, the data issues are proving to be equally problematic. The hurdles were highlighted in Insuring the net zero transition: Evolving thinking and practices, a recent report by the Net Zero Insurance Alliance (NZIA). Looking specifically at reducing GHG emissions in underwriting portfolios, the NZIA noted "limited progress" to date, citing "lack of suitable data" as one of the main reasons".

So, how can your business overcome these hurdles and get the actionable data your business needs to deliver your ESG ambitions and help accelerate green transition?

data on track?

With so much of the data and how you use it likely to be new and unfamiliar, addressing this question not only calls for a rethink of data supply, but the culture, approach and ownership that underpins this.

Data management is more than tooling

In ESG data management we see three levels i) the data part, ii) ESG assets, tools, solutions & dashboards and iii) platforms. The primary reaction of most institutions is to search for data outside the organisations with third party data vendors and rates. Another reaction is to build patch solutions via dashboarding, 'tools' and other visualisations in an attempt to cope with the amount of data covered. Although promising, the hard work of integrating ESG elements into the core processes requires a rethink of your data strategy and architecture. What is key in the discussion is that you have the capabilities, skills and knowledge to know where to look for your specific product offerings, investments and risk modelling. Otherwise the data jungle will become even bigger. As such, a one size tool does not exist as of today to cope with the complexity of the data challenges faced. Key takeaways for those in the process of defining and/or maturing their ESG data architecture are:

1. Define a future-proof and actionable data strategy, thereby considering that the pace, granularity & credibility of data needs is evolving fast.
2. Put in place a robust and centralized ESG data architecture and corresponding governance to cope between front, mid and back offices. All have different roles in owning, using or stewarding the data flows within your organisation.
3. Set data gathering priorities to the use of specific metrics, methodologies and monitor data collection efforts, thereby considering metrics stipulated by EU Regulations as mentioned in chapter 2.
4. Apply multiple preventive & detective controls to enhance the data quality. Especially by using the nature of ESG data being present in external, public data sources,
5. Identify your ESG data needs and subsequently conduct an ESG data gap analysis, thereby considering the (i) CSRD and other regulations ii) internal reporting needs to meet strategy progress, risk management & compliance measures (iii) industry, business & committed objectives.

6. Intensify ESG data collection by i) tracking data gaps ii) define ESG data sources iii) prepare & embed client questionnaires iv) assess and integrate third-party providers, and v) establish internal procedures and infrastructure solutions to ensure that all ESG-related data, whether sourced internally or externally, are available and assigned.
7. Only engage with third-party data providers able and willing to educate you on their data lineage, so you prevent their data sourcing remains a black box to you which you are not able to explain in sufficient detail to auditors, supervisors or competent authorities.
8. Start.

Judging data demands

In evaluating data needs, the multiple data points within the CSRD can provide a good starting point. You can then build on this core data pool to assess what data is needed to meet your broader ESG ambitions and changing role within the economy.

In judging these data demands, it's not only important to list what's required but also who uses it, how and why. Other practical considerations include where it's sourced from, where it's stored and how it's governed.

Get the data

With your data demands clarified, you can look at what you have, what you need to gain access to and how. Do your homework – we've found that there is often a lot more data available in-house than many companies realise. You can also tap into external sources in areas such as property emissions, the supply of which is increasing all the time.

But even with this trawl, a lot of the data you need won't be readily available. You therefore have to be innovative in developing new and augmented information streams. If we take climate tech risk as an example again, you can partner with tech developers and the companies deploying the new systems to evaluate the risks. You can then work with your modelling teams to build these evaluations into pricing and risk selection.

Move from commitment to accountability

Given the scale and complexity of the data demands, business teams have to step up rather than leaving this to risk and reporting This includes taking responsibility for assessing the data they need to deliver ESG strategy and ownership of delivering it and integrating it into underwriting models. Business teams should also be devising and driving the data-enabled use cases and innovations needed to manage climate risks and accelerate green transition.

Be pragmatic

Initially at least, some of the data you use may not meet full completeness, accuracy and quality thresholds. But it can still be used as long as decision makers are aware of the limitations and impact of the assumptions needed to overcome them. Similarly, some information feeds and reporting may need to rely on qualitative rather than quantitative data, especially with regard to gauging the ESG impact. Again, this is acceptable, as long as there is sufficient explanation, and any claims are backed up by clear evidence.

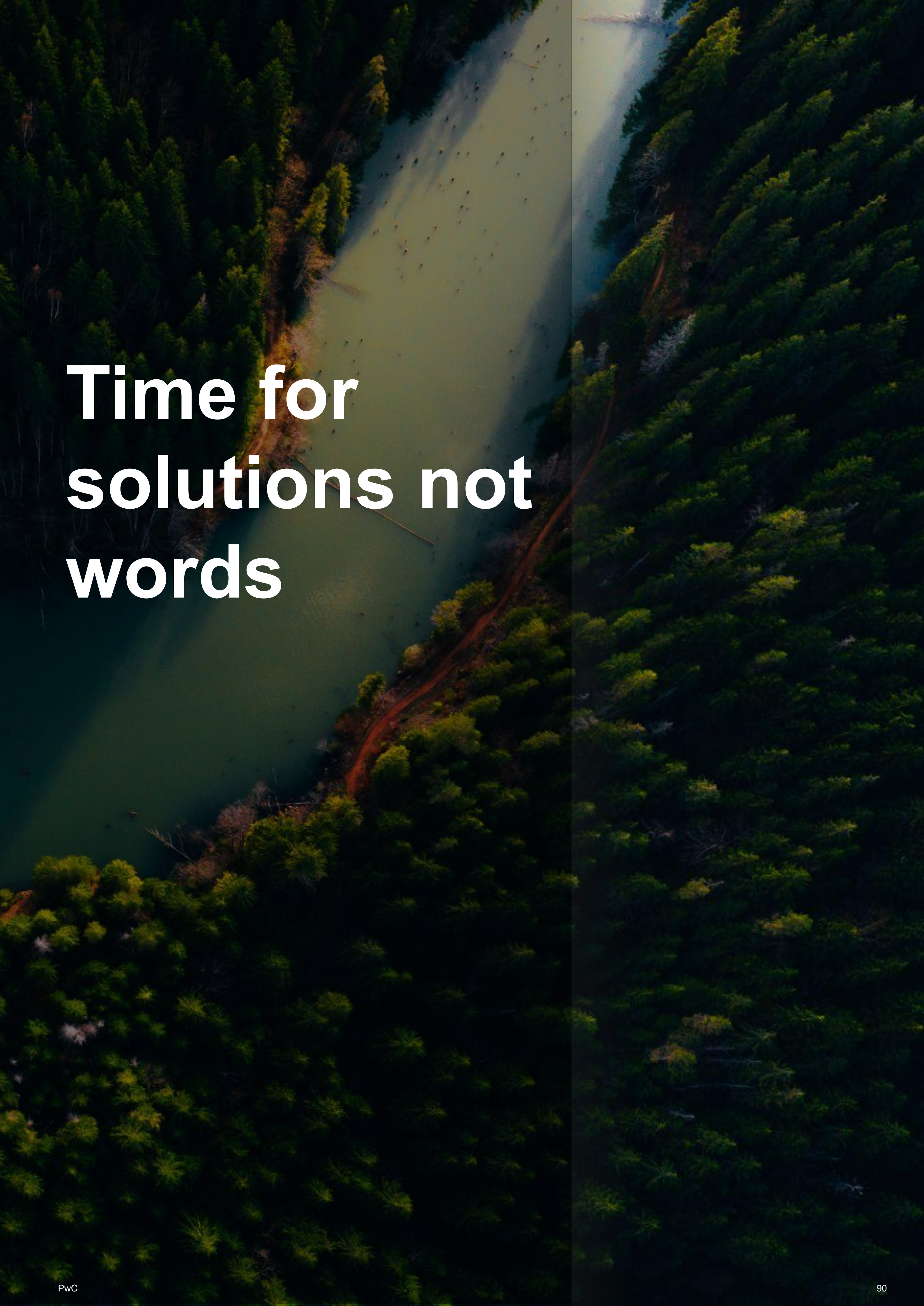
Strengthen quality control and assurance

The same rigour that's expected in the preparation of financial reporting should now be applied to sustainability and other non-financial disclosures. Similarly, boards and business teams need to be able to make decisions with confidence. What processes and controls exist to support your non-financial information and disclosures? Are they of similar robustness to your financial data? Would they stand up to an independent party auditing them and providing an assurance opinion? If not, how can you start improving your data and processes?

Are you ESG-ready?

- Your ability to realise your ESG ambitions depends on data. The main challenge isn't the lack of data – it's largely there if you can find it – but how to embed it into decision making and performance reporting in a way that turns information into insights and intentions into actions.
- What specific data do you need to deliver your ESG ambitions?
- How and where can this data be gathered, enriched and validated?
- How can you iron out inconsistencies and create a single version of the truth?
- How can this data be integrated into your company's data architecture and decision-making?
- How should data and analysis be governed and who is responsible?

Time for solutions not words



COP 27 ended with excitement and disappointment. The discussion on damage from climate change, the need for accountability performed via actions illustrated the pivotal role insurers need to play today and in the coming years.

The climate crisis and wider focus on ESG are changing what society and your clients want from insurance and insurers. Sustaining relevance and delivering your purpose requires you to become an enabler for green transition and the sustainable economy of the future.

This is neither a straightforward nor linear challenge, with the scale of the task amplified by the uncertainty, ambiguity and inconsistency surrounding it. But with the will, there is a way. In this report, we have sought to cut through the immensity of ESG to provide a structured approach to turning ambition into action. This starts with the strategic and regulatory imperatives, before moving on to what this means for the fundamentals of your business and how to gear up your organisation to deliver.

What cuts through this is the need to determine what a green and sustainable future looks like, what your clients need to transition and what you can do to support this. The answers and solutions are an opportunity to unleash the full power of innovation and risk expertise within your business and emerge as a leader in a sustainable new economy.

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Let's live ESG together.