Rethinking Your Insurance Around Environmental, Social and Governance Policies

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Now more than ever, people care that the businesses they support and work with have strong ESG principles. Well planned ESG policies set your company up for success and the insurance industry is key to helping implement these changes.

So, this may be controversial, but insurers are increasingly scrutinizing companies' Environmental, Social and Governance (ESG) policies and performance, often to improve the transparency of risks not captured by conventional financial metrics. Issues such as climate change, environmental degradation, pollution, human rights, diversity and inclusion and corporate conduct have been receiving greater public attention, resulting in more litigation.

People want to feel good about their investments and purchases and are increasingly applying these non-financial factors when looking at a company's behaviours. ESG analysis can provide a more holistic overview of a company and give insight into its leadership and culture.

78% of insurers believe the COVID experience is accelerating their focus on ESG.

(Source: BlackRock Global Insurance Report 2020)

What is ESG?

ESG refers to the three central factors in measuring the sustainability and societal impact of a company or business, with each item supporting a self-aware and transparent ethos for conducting business responsibly and prosperously. In a business world guided by ESG principles, "responsibly" and "prosperously" are now entwined when determining success.

The three criteria when evaluating a company's ESG policies are:

Environmental

The environmental component refers to factors that determine a company's impact on the earth or how it performs as a steward of the environment, in both positive and negative ways. This pillar of ESG is often the easiest to target and analyze, and insurers have started to focus specifically on this space. Environmental policies can involve:

- Usage of renewable energy including wind and solar
- Carbon footprint and carbon intensity (pollution and emissions)
- Greenhouse gas emissions goals
- Climate change policies, plans and disclosures
- Recycling and safe disposal practices
- Water-related issues and goals
- Natural resource conservation
- Use of raw materials

Social

The social component of ESG consists of people-related elements like company culture and issues that impact employees, customers, consumers, suppliers and communities – both within the company and in greater society. Social parameters include:

- Mission or higher purpose of the business
- Ethical supply chain sourcing
- Employee treatment, benefits, and perks
- Diversity and inclusion (or equity) in hiring, pay and in advancement opportunities
- Compliance with labour laws
- Employee safety policies including sexual harassment prevention
- Public stance on social justice issues, as well as lobbying efforts

Governance

The governance component relates to corporate governance and behavior, such as board quality and effectiveness. Some key governance topics are:

- Compensation tied to metrics that drive long-term business value, not short-term share price targets
- Diversity of the board of directors and management team
- Whether a company has a classified board of directors
- Whether chairman and CEO roles are separate
- Transparency in communicating with shareholders, and history of lawsuits brought by shareholders
- Executive compensation, bonuses and perks
- Cyber and data security
- Risk management and oversight

The Role of Insurance

Increasingly, insurance companies are being viewed as agents for imposing positive ESG change on entities such as their policyholders and vendors, as well as implementing change in their own operations.

In essence, the insurance industry is being targeted because many stakeholders believe it can affect change by increasing costs of insurance or not insuring companies that harm the environment, engage in anti-competitive practices, or lack diversity in the management ranks (or companywide). This has resulted in underwriters examining a company's ESG policies to assess a company's liability risk and potential exposures very closely and to rethink their approach to underwriting coverage entirely in some cases.

- Zurich Insurance Group has committed to terminating its relationship with companies that generate more than 30 percent of their revenue from mining, generate more than 30 per cent of their electricity from thermal coal, oil sands, oil shale, extract more than 20 million tons of thermal coal or continue to invest in coal mining and infrastructure.
- Aviva has stopped insuring companies generating more than 5 per cent of revenues from thermal coal or unconventional fossil fuels as of the end of 2021. They will make some exceptions for companies serious about transitioning out of high carbon fuels and those that have already "committed to clear science-based targets aligned to the Paris Agreement target of limiting temperature rises to 1.5 degrees."
- Allianz, on April 29, 2022, stated it would stop investing in or underwriting new single-site and stand-alone oil and gas selected risks as of 1, 2023, and would not renew existing contracts after July 2023. The exclusions will apply to exploration and development of new oil and gas fields, including oil sands and extra-heavy oil, amongst other segments in the same space.
- AIG announced on March 1, 2022, that it has "committed to no longer invest in or provide insurance for construction of any new coal-fired power plants, thermal coal mines or oil sands."
- Aspen Insurance (a Lloyds of London syndicate) stated on April 21, 2022, that it would cut ties with Trans Mountain, following Munich Re, Zurich Insurance Group, Argo Group and others in the face of public pressure.

> Globally, the insurance industry is in a unique position when it comes to climate risk as insurers are exposed on both sides of the balance sheet: their investments face climate risk on the asset side of the balance sheet and they face underwriting risk, particularly in the property and casualty line, on the liability side.
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> (Source: H. Ross, S&P Global)

ESG and Underwriting

A lot of focus has landed on insurer underwriting activities and the process of underwriting is actively changing very quickly. The analysis of risk is expanding from traditional elements – such as the types of operations/activities or geographical characteristics – to qualitative analyses in relation to ESG criteria.

This may include examination of employment/employee practices, to audits of supply companies, to reviews of water and land environmental impact and sustainability reports. Insurers also are considering the consequences of disclosure requirements imposed on companies by various regulatory bodies. Increased use of artificial intelligence and scoring systems are being formulated and deployed as part of an integrated underwriting process. Underwriting applications and

questionnaires are also being updated, and early dialog regarding ESG risks is being incorporated into the underwriting process. This is especially true when it comes to the various lines of casualty or liability products.

And this is not just impacting large corporations or companies; ESG based underwriting is also being applied to mid-size and small businesses based on industry segmentation (such as healthcare, transportation/trucking, technology, hospitality, manufacturing/distribution, etc.).

Policyholders that actively address sustainability issues could also benefit from this change in the underwriting process. For example, opportunities could arise in pricing, policy terms and coverages, and program structuring, including lower deductibles. Companies could be given incentives to change their processes and contribute to compliance with sustainability and climate targets.

How ESG Will Impact You

ESG concepts and methodologies are being applied to underwriting processes in relation to your business, whether large or small. It's meant to be a comprehensive framework, a 360-degree view of a business and its behaviors and impacts that show how they can continue to grow and evolve with the times.

Developing strong policies that focus on ESG can present you with an overview of your company's risks and exposures and allow you to adapt and adjust.

The insurance industry (brokers and insurers) has insurance and risk management products that are useful to policyholders and clients in managing risks and addressing ESG issues; we have expertise and capabilities in risk assessment, management, response and loss control that could benefit you. Unquestionably, insurers must be cognizant of the ESG practices and risks of policyholders as these issues are rife for litigation, claims and loss activities.

On the flip side, corporations and companies that have strong ESG policies have tremendous opportunities since better ESG track records generate better investment returns, reflect better financial performance and reduce risk. Put another way, the world is watching – and that world includes investors, insurers, supply chain partners, entire communities, customers and employees. And these stakeholder's care about how the companies they support conduct themselves.

It's easy to feel overwhelmed when you begin to navigate this new landscape since it can be a big shift in thinking. However, developing robust ESG practices will have a positive impact on the society around you – whether it is reducing your carbon footprint, creating an inclusive and diverse work environment or being more transparent with stakeholders and employees.

You don't have to navigate this alone. Contact us today to speak to one of our experienced commercial brokers and learn more about how you can develop ESG-focused policies and practices.

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