Addressing sustainability is more than complying with ESG reporting; it’s now essential for insurers’ survival to address risk holistically. Insurance CIOs can use this trend analysis to build the technology capabilities needed to expand sustainability across the investment value chain.

Overview

Opportunities

- Create long-term stakeholder value by incorporating sustainability and environmental, social, and governance (ESG) considerations, with two primary objectives in the strategic and tactical investment decision process:
  - Manage investment risk more effectively.
  - Help the firm and customers invest with greater transparency.

- Create sustainability transparency as a competitive advantage by embedding sustainability into investment decisions and reporting, rather than using an ad hoc approach.

- Rally enterprise support for an ESG data strategy that delivers data and insight across the investment workflow.

Recommendations

Insurance CIOs who are responsible for financial services digital business strategy and innovation should:
What You Need to Know

In the insurance industry, and in the wider financial and business communities, the concepts of sustainability and ESG are becoming increasingly important. While they are often discussed together, ESG and sustainability are not the same and cannot be used interchangeably. ESG is a measure of performance used to measure robustness of insurers’ governance mechanisms. Sustainability is about creating long-term stakeholder value by guiding strategic and operational decision making while considering the environmental, social and governmental impact of those choices.

ESG is the measure and sustainability is the overall outcome.

Gartner research defines the terms in greater detail in Harness ESG Exuberance, and outlines steps to communicate the difference to stakeholders. Recognizing the differences is essential to a coherent and effective strategy. What’s more, a regulatory compliance-driven ESG initiative is not enough; getting ESG practices wrong can trigger a reputational or even a legal crisis.

Embedding sustainability more broadly across the investment and insurance value chain is easier said than done. There are practical challenges and barriers (see Figure 1). Many insurers cite access to reliable, standardized data as the primary hindrance to ESG implementation. However, other challenges include a disconnect between ESG reporting and financial information and lack of forward-looking disclosures, at a minimum.
Insurance firms can influence investment decisions and processes, and some are starting to impact the broader investment ecosystem by embedding sustainability (particularly climate change) within the investment decision process for both proprietary and actively managed investments. Insurers are also pushing their third-party investment managers to comply.

Global ESG assets are on track to exceed $53 trillion by 2025, according to Bloomberg Intelligence,\(^3\) representing more than a third of the $140.5 trillion in projected total assets under management. In this research, we explain the importance of understanding the role of, and extent to which, sustainability can affect investment decisions, and identify steps that insurance CIOs should take to expand sustainability in the investment value chain.

**Embedding Sustainability and ESG in Insurance Investment Decisions**

*Description:*
Insurers are increasingly incorporating sustainability and ESG considerations in their investment decisions, not only to ensure regulatory compliance, but to build (or preserve) brand reputation and avoid potential legal risks from policyholders, shareholders and other stakeholders.

**Why Trending:**

In the insurance industry, and in the wider financial and business communities, the concept of sustainability is evolving. The 2021 Goldman Sachs Insurance Asset Management Survey\(^1\) found that insurers’ consideration of ESG in the investment process has grown. Today, 83% of global insurers evaluate ESG in their investment processes, compared with only 32% in 2017.

The survey also revealed that global insurers consider current/future regulation as the primary driver for implementing (or considering implementing) ESG strategies, versus the previous year. In that survey, risk mitigation was the main driver (survey respondents ranked risk mitigation second this year). Current and future regulation was the primary motivator in Europe and the Americas, while consistent with 2020, Asian insurers reported shareholder, creditor and customer considerations as the dominant implementation drivers.

In addition to ESG, climate change is beginning to factor into insurance investment decisions. More than half of the 101 global institutional investors participating in a PGIM study\(^2\) say climate change is already affecting their portfolios by creating new risks and presenting new opportunities. Insurance asset managers are helping the industry broaden the perspective of how issues impact investment portfolios, but also how insurance and investment portfolios impact the environment and society.

**Implications:**

As pointed out earlier in this note, ESG and sustainability are not the same thing. We often hear ESG factors being conflated with sustainability, or the terms being used interchangeably. We also hear ESG practices referred to as simply external reporting and investor relations — in other words, keeping the investor and regulator community happy. Distinguishing the difference between sustainability and ESG is essential to a coherent and effective strategy. Getting this wrong creates especially high risk and leads to:

- ESG washing, which promotes a false impression or provides misleading information about the enterprise’s ESG strengths
- Exposing the company to litigation risk
- Sacrificing competitive advantages that can come from providing ESG data transparency to the right audience in the most compelling and decision-useful way
- Missing out on the opportunity to secure resources for efficient ESG processes, systems, governance and reporting
- Working with fragmented, duplicate ESG data, combined with manual workarounds that inflate cost; and as sustainability becomes an important part of investment decisioning, fragmentation will potentially lead to technology debt

**Actions:**

- **Research and learn about the true scope of sustainability in investment decisions.** Identify steps CIOs can take to help the chief investment officer, as well as compliance and risk teams, to expand sustainability in the investment value chain.
Once they identify the scope, CIOs can use the analysis to:

- **Use Principles of Responsible Investing (PRI) to Scope Sustainability** — PRI is an independent agency set up to encourage investors to use responsible investment to enhance returns and better manage risks. The agency engages with global policymakers but is not associated with any government; it is supported by, but not part of, the United Nations. PRI’s six principles for responsible investment are a menu of possible actions for incorporating sustainability issues into investment practice. We use the six principles to understand the true scope of sustainability.

  - **Principle 1** — Signatories must commit to incorporating ESG issues into all investment analysis and decision-making processes. This is what asset owners aspire to — creating strategies that are responsible by design. In reality, firms most commonly use negative screening and avoidance tools to be the most common ESG consideration across insurer portfolios.

  - **Principle 2** — Signatories commit to being active owners and to engaging in related policies and practices.

  - **Principle 3** — Signatories will seek appropriate disclosure on ESG issues by the entities in which they invest. Data availability (particularly across asset classes) and standardization are the biggest challenges. The EU’s March 2021 Sustainable Finance Disclosure Regulation (SFDR) is reverberating globally as investors demand more disclosure. Gartner’s *Market Guide for Corporate ESG Ratings* can help with an understanding of the market dynamics of data providers.

  - **Principles 4 and 5** — These principles involve collaborating with other investors to improve practice, and also to promote the principles in the marketplace. Against this changing regulatory backdrop, reliable and quality ESG data and the analysis that supports it play a pivotal role. While still lacking overarching standards for data and disclosure, in 2020, the industry rallied together with government and regulators pushing for broad adoption of standards such as Sustainability Accounting Standards Board (SASB) standards.

  - **Principle 6** — Signatories will report back to PRI on their activities and progress toward implementing the six principles. Most insurers have figured out the regulatory reporting. The focus now is to reduce reporting complexity and cost, and this is directly linked to managing data.
- Develop the technology aspects of the sustainability and ESG strategy to ensure alignment with business goals and growth.

- Discover and implement new technologies that yield competitive advantage by identifying potential leading-edge tools and capabilities (including fintech/insurtechs) to meet current challenges and opportunities.

- Develop analytic tools, leverage unstructured data, and deploy end-user interfaces using visualization and other core technologies.

- Develop and monitor key metrics to assess sustainability goals.
Create an ESG Data Strategy — Critical success factors for insurers who want to expand their sustainability offerings include a robust process combining data and tools, augmented by human insight and built with a transparent methodology customized to suit insurance firms’ internal policies. Instead of focusing efforts on ensuring that strategies are aligned, methodologies are understood and data operations are seamless, insurance asset managers are also deciding to partner with data providers and technology vendors within the sustainability ecosystem. These providers and vendors help efficiently implement proposals to drive business goals and sustainable strategy.

- Take stock of how evolving regulatory requirements impact your jurisdiction and evaluate your access to ESG research tools to assess externally and internally generated data.

- Use a standard taxonomy as a starting point (such as SASB, GRI and TCFD), and make sure to develop parametric customization of the standard taxonomies.

- Create an ESG data strategy that defines a governance model and a multiyear investment in technology to manage high-quality ESG data efficiently. The plan should map out an ecosystem of tools — including operational and digital technologies — for producing ESG data. The plan should also define governance programs that identify accountability for data management and public disclosure.

- In the planning process, engage leaders from lines of business to identify how the company can leverage ESG data across investment processes, portfolio construction, risk analysis and disclosure reporting. This group should agree on what to measure and what not to measure, based on the data’s value to sustaining critical stakeholder relationships. It should define methods of efficiently capturing and managing this data effectively.

- Secure board approval of an ESG data strategy (see Why Every Company Will Need an ESG Data Strategy by 2021 and What Chief Supply Chain Officers Can Do About It).

- Create an ESG task force to identify and implement governance issues that would have the greatest impact on cost and growth. This task force should also focus on ESG efficiency and help embed risk considerations into ESG planning and strategy.
Start by Focusing on Climate Change — Climate change is no longer a hypothetical risk. It is already transforming the global economy, reshaping markets and altering the investment landscape. Climate change is holistic in that it impacts a range of ESG issues.

Use alternative data sources and techniques to better understand cross-portfolio climate risk. To fully assess the climate exposure in their portfolios, CIOs must rely on unconventional methodologies and data sources, such as updated flood maps and satellite imagery.

Build the ability to stress test climate risk analysis in portfolio construction by integrating climate change into portfolio risk management. Varied approaches can offer differing degrees of complexity, granularity and actionability. These can range from a portfoliowide climate risk analysis to targeted climate stress tests focused on specific policy interventions and to comprehensive climate scenario modeling. Firms that use a data science platform will need configuration, building new models and access to relevant datasets. However, for firms that use a point solution, this may be a major change — leading to application replacement in some cases.

Evidence

1 Goldman Sachs Asset Management Global Insurance Survey 2021, Goldman Sachs

2 Seeking Higher Ground: Institutional Investors Respond To Climate Change, PGIM

3 ESG Assets May Hit $53 Trillion by 2025, a Third of Global AUM, Bloomberg Intelligence

Recommended by the Authors

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Harness ESG Exuberance

Why Every Company Will Need an ESG Data Strategy by 2021 and What Chief Supply Chain Officers Can Do About It

Market Guide for Corporate ESG Ratings and Research