How insurance CFOs can embed ESG into finance and the wider business

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10 minute read 1 Feb 2022

Sustainable finance considerations are shifting to the forefront of the CFO agenda faster than insurance finance leaders have anticipated.

Insurers have an opportunity to adopt business models that generate long-term value (LTV) for their customers, investors, employees and the wider community. Those who emerge as market leaders will be laser-focused on better protecting society, developing new products for the next generation of customers and redirecting capital to aid the transition towards net zero.

It is crucial for them to act quickly to embed environmental, social and governance (ESG) into existing business as usual (BAU) processes, not only given regulatory developments and mandatory reporting, but also because this is the right thing to do.

The finance function should be front and center in driving the business to deliver on its strategic sustainable finance ambitions. It plays a leading role in communicating the contribution of insurers to society with the use of key metrics, and in developing incentive programmes that drive concrete sustainability outcomes. It is critical for insurance CFOs to use their influence to design an approach to meet stakeholder reporting needs efficiently and to steer the organisation towards achieving its goals.

Key priorities for the finance function

The CFO plays four critical roles :

1. Co-develop the sustainability strategy of the business to focus on LTV and maintain financial resilience.
2. Rethink the capital allocation strategy to drive business agility, resilience and LTV, for example, by redirecting capital to sustainability-enabling projects.
3. Establish a controlled, efficient and transparent sustainability measurement framework and operating model to monitor and report internally and externally on ESG risks, opportunities and performance.
4. Drive a robust and well-controlled stakeholder narrative around sustainability, including the organisation's purpose and its link into the broader contribution of the insurance industry to society.

These are among the key priorities and opportunities we explore in our latest publication.

Sustainable finance: considerations for the insurance CFO (pdf)

PDF (1 MB)

Climate reporting: from voluntary to mandatory

Insurance CFOs should embrace the shift from voluntary to mandatory climate reporting as an opportunity to take a leading role in advising the business to create LTV. Climate reporting requirements are becoming increasingly relevant to policymakers as a means to ensure formal assessment of sustainability risks and opportunities. Recent milestones from the EU 2018 sustainable finance action plan demonstrate the shift from voluntary to mandatory climate reporting.

An evolving European regulatory reporting and policy landscape

- In April 2021 the European Commission adopted a proposal for the EU Corporate Sustainability Directive (CSRD). The proposal introduces more detailed reporting requirements, with companies required to report under mandatory EU sustainability reporting standards.
- Mandatory climate reporting will apply in October 2023 for all large EU companies under the CSRD.
- EU Sustainable Finance Disclosure Regulation (SFDR) came into effect in March 2021, which requires financial market participants and financial advisers to assess and publicly disclose ESG considerations.
- The European Insurance and Occupational Pensions Authority (EIOPA) is currently consulting on the use of climate change risk scenarios in the Own Risk and Solvency Assessment (ORSA), with guidance expected to be published June 2022.

Acceleration in the development of ESG reporting standards

ESG reporting is often confusing due to the variety of competing frameworks that insurers need to navigate. CFOs play a pivotal role in identifying the relevant reporting frameworks. The reporting decisions are critical to the success of strategically measuring and monitoring performance.

As expected, at the COP26 climate change conference held in November 2021, the IFRS Foundation Trustees formally announced the creation of the International Sustainability Standards Board (ISSB). The IFRS Foundation have set out an ambitious timeline in which they aim to release the first set of draft standards for comment in the first quarter of 2022, and to have a climate-related disclosures standard and a standard on general requirements for sustainability-related financial disclosures ready for use in the second half of 2022. More immediately, the Task Force on Climate-related Financial Disclosures (TCFD) is gaining momentum across the globe, and is becoming mandatory for a number of countries including the UK, Switzerland, Canada and Hong Kong. Below are key disclosures considerations for insurers across each of the four TCFD pillars, which are all underpinned by specific data and reporting requirements.

Governance

- Process and frequency by which the board are informed about climate-related issues
- How the organisation has assigned climate-related responsibilities to management-level positions
- Societal/ethical values within the board

Strategy

- How climate–related risks and opportunities are factored into investment strategies
- How potential impacts of climate–related risk influence client, cedant and broker selection

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Nonfinancial reporting advisory and assurance

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- Impact of sustainability-driven changes on product and balance-sheet movements
- Details of any climate–related products under development
- Any product charging structures that close the protection gap and shine light on broader societal benefits

Risk Management

- Processes for identifying and assessing climate-related risks for (re)insurance and investment portfolios including physical, transition, and liability risk
- Key tools used to manage climate-related risks for product development and pricing
- Climate–related scenario analysis on underwriting and investment activity
- Development of new risk transfer mechanisms to provide insurance solutions to uninsurable risks

Metrics and targets

- Metrics used to assess climate-related risks and opportunities in each fund or investment strategy, and how these metrics have changed over time
- Weighted average carbon intensity for each investment strategy
- Metrics considered in investment decisions and monitoring
- Aggregated risk exposure to weather-related catastrophes of their property business

Roadmap to reporting as a key enabler

Insurance CFOs have an opportunity to use their reporting expertise to build a reporting roadmap that puts LTV creation both at the core of the finance function and keeps the business honest.

There are signals that ESG reporting, covering more topics than only climate risk, will also become regulated in the future. One such signal is the proposed CSRD in the European Union, which is expected to require ESG disclosures to be made by a large number of firms and have these assured by 2023. CFOs should ensure that processes and controls supporting ESG reporting are well designed and maintained ahead of the implementation of proposals in the next two to three years. We have developed a four-phased approach that insurance finance functions can adopt for their ESG reporting.

1. Define – creating a value-based narrative

Understand the required changes for regulatory and reporting requirements, identify any reporting overlaps e.g with Solvency II and determine the standards for the finance function to report on.

2. Design – developing a reporting strategy

Assess the capability of existing architectures within the company, identify new data requirements and determine the need to procure external data. Optimisation of the data infrastructure can unlock data as an asset and support the ESG strategy.

3. Embed – integrating effectively into BAU

Understand how data flows through the business to embed non-financial information into business functions, and refine governance structures to support a strong control environment for reporting, with the finance function bringing expertise around this.

4. LTV – ongoing reporting and development

Utilising and enabling technology for non-financial information data management, will streamline manual ESG reporting processes. This integration of financial and non-financial information will assist in collaborative decision and reporting.

Overcoming significant challenges to reporting

Reporting on financed emissions

In order to measure and report on Scope 1, 2 and 3 emissions, insurers need the ability to measure and track the emissions arising from financing activities, also referred to as "carbon accounting". Despite growing pressure to report, tracing carbon impacts is still not an easy task. Insurers will be able to systematically build a better overall picture by determining the attribution factor for each class of assets.

Data management and reporting

There are three key challenges which have created a separation between the **ESG data** that insurers need for reporting, and the data available at their fingertips: Data suitability, data availability and data consistency. To address these, insurers will need to equip themselves with a combination of strong research expertise and sophisticated screening techniques, and develop data and technology capabilities to make the data gathering, manipulation, control and reporting processes controlled, efficient and repeatable.

Embedding sustainability into existing processes

More and more insurers are now on a journey to fully embed sustainability into all functions, within BAU, with a central team providing subject matter expertise. The role of the finance function in driving sustainability has significantly increased over the past 12 months, and we expect this trend to continue. Almost all finance processes are making an impact on ESG outcomes, with following key examples:

- External reporting: Design processes and controls around the production of climate-related financial disclosures including horizon scans for upcoming reporting requirements
- Planning, budgeting and forecasting: Set up a business plan against the ESG risk appetite by incorporating sustainability specific impact into income and cost measures and monitor non-financial metrics and outcomes
- Performance reporting: Define sustainability metrics and key performance indicators (KPIs), incorporate sustainability specific measurement models and frameworks to monitor against net-zero ambitions, carbon accounting and broader ESG goals, and align incentives down to performance scorecards
- Investment prioritisation and capital allocation: Ensure climate-related and broader ESG risks and opportunities factored into investment, capital allocation and asset strategies
- Model ownership and validation: Build, test and validate model as part of a broader sustainability model risk framework alongside the Risk function. Whilst these model are still in their infancy, increased regulatory requirements regarding scenario and stress testing on climate risk have accelerated progress made in developing models to understand, measure and monitor climate change risks and exposures
- Scenario testing: Specify and run scenarios and stress tests with a link to ORSA and Solvency Stress tests (SST)
- Property and lease management: Embed ESG into property selection and management, including physical risk assessments and investing in carbon efficiency upgrades for existing portfolios
- Responsible Supply chain management: Adopt a holistic approach to address the triple bottom line - people, planet and profits, manage procurement risk and capitalise on opportunities, for example via shared commitments and partnerships with Tier 1 suppliers and increased use of circular economy models
- Tax: Embed tax as a key lever into sustainability reporting and existing processes across the value chain
- M&A strategy playbook: Embed ESG objectives into the deal lifecycle by co-developing ESG strategy, providing insights supporting deal evaluation, pricing and negotiation, forming recommendation on value creation/protection post deal and and monitoring ESG objectives post acquisition

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It will be important for CFOs to upskill their team and re-think career paths to build capabilities necessary for enhanced corporate reporting and strategic planning, especially across sustainability, advanced data analytics, and emerging technologies – see our latest **Global Reporting** survey.

Special thanks to EY's James Tufts, Youri Lie, Carl Vanderwerff and Aishah Ahmed for their contributions to this article.

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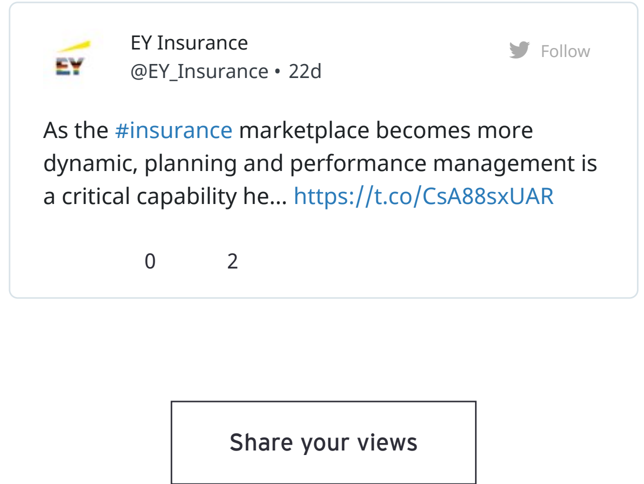

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Summary

We've seen an augmentation of the CFO role over the past couple of years into a stronger business partner to help steer the business. This trend is accelerated by the role that CFOs must play to embed sustainability into all functions to drive and reliably measure tangible sustainable outcomes.

This goes beyond managing increasing regulatory reporting requirements. Finance is best placed to play a central role to help businesses achieve sustainable development goals due to the skills it brings to the table around the investor story, capital management, controls and governance, actuarial, accounting and tax, data management and business planning.

About this article

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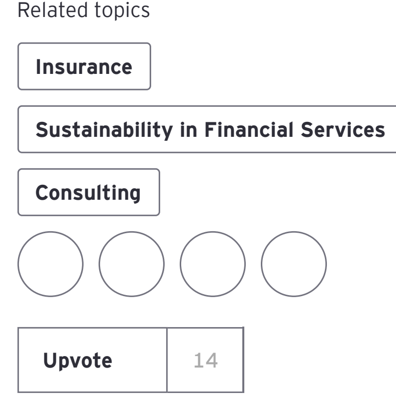

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