Sustainable investment in European insurance

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Contents

Executive Summary

The looming climate crisis and the Covid-19 pandemic have highlighted environmental, social and governance (ESG) issues as never before. Across the financial industry, ESG has grown from a marginal trend to a central concern.

Insurance companies are highly exposed to ESG challenges, with long-term investment horizons, risk-management capabilities and stringent regulatory frameworks. But they're also potentially well equipped to turn some of those risks into opportunities.

We wanted to investigate how insurance investors are responding to ESG challenges. So in 2020, we commissioned in-depth research across Europe's five largest insurance markets – the UK, Germany, France, Italy and Switzerland.

In this report we cover current practices, future objectives and views of the key decisions makers (mainly chief investment officers) at 60 European insurance companies.

"Insurance companies are highly exposed to ESG challenges... but they're are also potentially well equipped to turn some of the risks into opportunities."

Five distinct themes emerged from the survey. We set these out below.

Theme 1: Key drivers of ESG insurance

Why do respondents adopt ESG into their investment strategies? The survey identified several key drivers.

The most important by far was risk management – 81% of respondents said this was the main reason they were considering ESG.

By contrast, relatively few insurance companies currently see ESG as an opportunity – most continued to see it as a risk factor rather than a value creator. In our survey, a minority of respondents (33%) said ESG was a marketing or business opportunity.

But there are signs this is changing, especially in the life sector. With life insurers coming under increasing pressure from policyholders, some are using their ESG credentials as a way to attract clients.

Theme 2: Continuous Improvement of ESG practices

European insurers continue to improve their ESG practices. But it's clear from the survey that there's more to come.

We've identified two groups in particular where innovations in ESG practices are likely to come from.

First are the sustainable investment **pioneers**. Chiefly large firms, these companies were first to adopt ESG practices and remain at the forefront.

The second group, we've called **leapfroggers**. They are typically smaller firms that have only recently adopted ESG. But their late entry means they're poised to exploit the market's maturity by innovating through new impact or climate frameworks.

Many of the factors that have traditionally impeded ESG integration (such as a lack of reliable data, heterogeneous methodologies and reluctance from portfolio managers to embrace sustainability) are now fading. However, there are still competing priorities, including asset-liability management, the search for yield, and capital requirements. This suggests that ESG is likely to remain an input to insurers' investment strategies – rather than its defining factor.

Theme 3: Juggling E, S and G: how insurers respond to the different aspects of sustainable investment

The sustainable practices adopted by European insurance companies fall into four broad categories (with plenty of overlap): **exclusion**; **ESG integration**; **stewardship**; and **impact and thematic investing**.

Although most respondents consider ESG as a single factor, nearly all recognised the drawbacks of this broad-brush approach.

So far, it's the 'E' that's dominated. That's because environmental factors are the most quantifiable and immediately material of the three elements. These issues attracted the overwhelming majority of attention from insurers, who employ all the elements in the ESG patchwork to address these issues (from coal exclusions to engaging with companies on climate risk to investing in climate solutions).

The Covid-19 pandemic led to greater focus on social issues, particularly in the context of economic recovery and safeguarding jobs. However, respondents still viewed the 'S' factor as less material than environmental issues. There's no consensus on how social issues should be measured, or how social indicators should be integrated into investment strategies.

Theme 4: Climate change as a driver of innovation

Of the concrete ESG portfolio objectives set by insurance companies, almost all focus on climate change. These include carbon-footprint reductions, allocation to 'green' assets and net-zero commitments.

This focus is driven by regulation, which emphasises climate change as central to sustainable finance. Regulators have also facilitated climate action by providing investors with the necessary tools to measure risk and their contribution to the energy transition.

This emphasis has yielded an array of increasingly sophisticated analytical tools and methodologies. It demonstrates the industry's innovative capabilities and its vast potential to address the rest of the United Nations' Sustainable Development Goals (SDGs) in the same way.

Theme 5: The role of asset managers

Most European insurance companies extend their ESG policies to outsourced assets and place ESG at the core of their discussions with asset managers.

Asset managers have a pivotal role to play in the transition to a sustainable investment model. Lagging asset owners will look towards their managers for tools and support in navigating the sustainable-investment landscape. Simultaneously, leading insurers will increasingly scrutinise managers as they attempt to curb 'greenwashing' (presenting themselves as more sustainable than they are in reality) and integrate ESG effectively.

The rapid development of sustainable investment in the European insurance landscape presents a clear opportunity for asset managers to extend their role beyond asset management and help their clients manage extra-financial risks and find solutions to the SDGs.

"Of the concrete ESG portfolio objectives set by insurance companies, almost all focus on climate change. These include carbon-footprint reductions, allocation to 'green' assets and net-zero commitments."

Introduction

Context and methodology

We partnered with investment consultancy firm INDEFI in the second half of 2020 to assess ESG practices among Europe's insurers.

INDEFI conducted one-to-one interviews with investment decision-makers at 60 insurance companies, mainly chief investment officers.

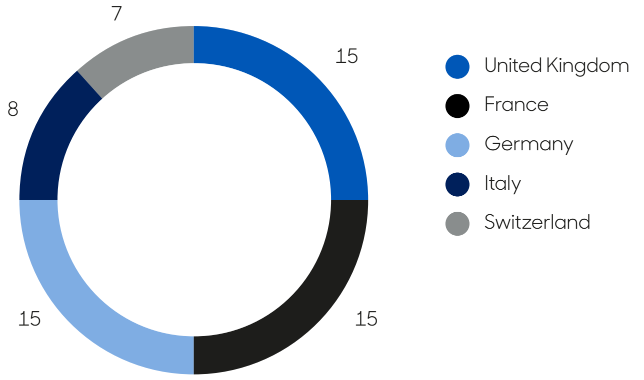
This research covers the five largest European insurance markets. Our respondents form a comprehensive and representative panel of business lines, and ESG philosophies.

Between them, these companies have assets under management of close to €4,500 billion and represent around 42% of the total European insurance market.

Our panel represents nearly two-thirds of insurance assets in the UK and Switzerland, half of those in France and Italy, and one-third of those in Germany. Because we have built our country-level panels to avoid size bias in responses, highly fragmented markets like France, Italy and Germany don't have the same level of representativeness as those from Switzerland and the UK.

Chart 1: Share of insurers by country of incorporation

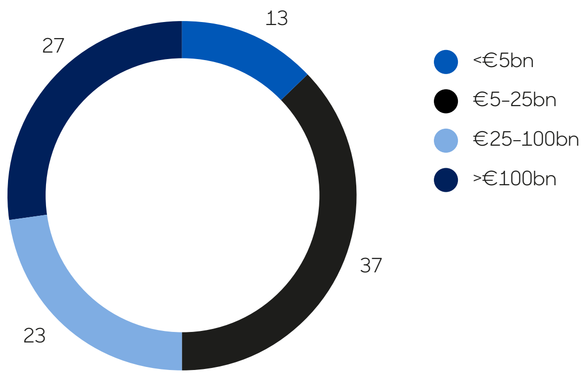
(# of respondents)



Source: abrdn ESG Insurance Survey, April 2021.

Chart 2: Share of insurers by AuM

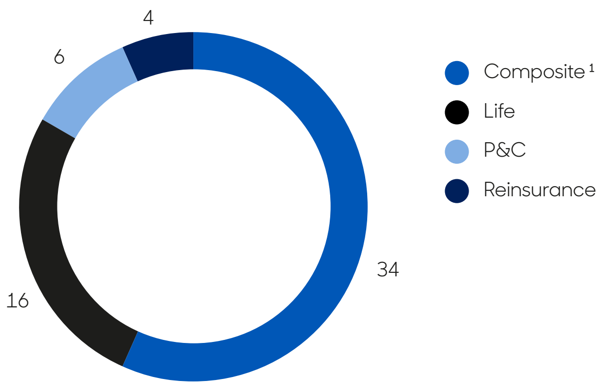
(% of respondents)



Source: abrdn ESG Insurance Survey, April 2021.

Chart 3: Share of insurers by business line

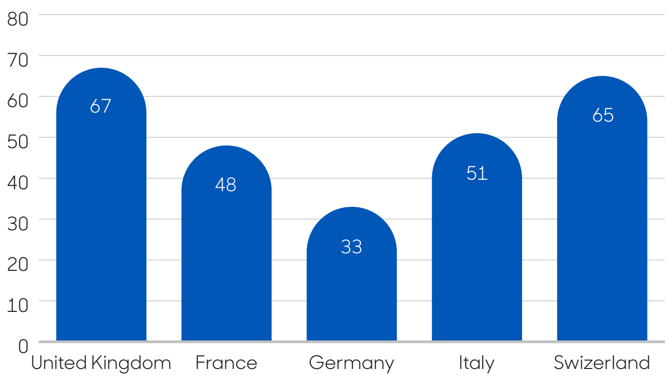
(# of respondents)



Source: abrdn ESG Insurance Survey, April 2021.

Chart 4: Panel representativeness

(% of total insurance market covered by the panel)



Source: abrdn ESG Insurance Survey, April 2021.

[1] For the remainder of the report, composite insurers will be categorised according to their main business line Life or Property and Casualty – P&C by assets under management.

Theme 1

Key drivers of ESG insurance

Respondents highlighted six important drivers behind the growth in sustainable investment among insurers.

- **Values and ethics:** insurance companies want to translate their organisation's core beliefs and values in their investment portfolio.
- **Risk management:** insurance companies recognise the financial materiality of ESG factors, so integrate these characteristics into their investment processes to deliver the most efficient risk-adjusted returns.
- **Stakeholder management:** insurance companies seeking to address growing pressure from a multitude of stakeholders to manage assets more sustainably (clients/policyholders, board of directors, NGOs and employees).
- **Regulation:** insurance companies are either encouraged or required to comply with ESG regulation. This leads them to develop sustainable investment practices and increase transparency.
- **Business/marketing opportunities:** insurance companies consider that sustainable investing provides them with a commercial advantage in appealing to new and existing customers.
- **Investment opportunities:** insurance companies identify opportunities to invest in asset classes or products that will benefit from sustainable development trends (e.g. exposure to sustainable thematic products).

Illustration 1: Main drivers of sustainable investment in insurance by country

(% of respondents)	UK	Germany	Switzerland	Italy	France
Values and ethics	50% – 75%	25% – 50%	25% – 50%	>75%	50% – 75%
Risk management	>75%	50% – 75%	50% – 75%	>75%	>75%
Stakeholder management	>75%	50% – 75%	>75%	25% – 50%	25% – 50%
Regulation	50% – 75%	50% – 75%	50% – 75%	25% – 50%	>75%
Investment opportunities	25% – 50%	25% – 50%	<25%	<25%	25% – 50%
Business opportunities	25% – 50%	25% – 50%	<25%	<25%	25% – 50%

Main drivers of sustainable investment in insurance by business line

(% of respondents)	Life	P&C	Reinsurance
Values and ethics	50% – 75%	25% – 50%	>75%
Risk management	>75%	50% – 75%	>75%
Stakeholder management	50% – 75%	25% – 50%	25% – 50%
Regulation	>75%	25% – 50%	>75%
Investment opportunities	25% – 50%	<25%	<25%
Business opportunities	25% – 50%	<25%	<25%

<25% · 25% – 50% · 50% – 75% · >75%

Not all insurance business is created equal

While the integration of ESG in insurance has progressed across all markets and business lines, the motivations for this differ significantly.

Nevertheless, there are clear commonalities across all business lines. For example, 74% of all respondents highlighted regulation as a core driver of ESG considerations. Likewise, the motivation for translating the organisation's values into investment decisions does not appear to be influenced by business line, but rather by the firm's country of operation. While 88% of Italian and 62% of UK insurance companies sought to align the values of their organisation with their ESG practices, only 50% of Swiss and 42% of German institutions did so.

Investment horizons and, by extension, the nature of asset allocation are core drivers of sustainable investment. So the specifics of each business line influence the weight given to each of these drivers.

Motivation for sustainable investing depends on time horizon

Life-insurance companies were quick to identify their long-term investment horizon as a clear motivation to implement ESG practices (66% of life-insurance respondents). As the financial impacts of ESG factors tend to materialise over the long term, they are perceived as most relevant to assets with long holding periods. Therefore, life-insurance companies with significant exposure to illiquid assets see the need to consider long-term risks, particularly climate change.

"We are long-term investors, which means that ESG factors, particularly climate-related risks, will materialise in a timeframe shorter than the holding period of our private assets or the maturity of our long-maturity bonds."

Life insurer, France

By contrast, the high-liquidity needs of property & casualty (P&C) insurance lead to a different viewpoint. Shorter investment horizons and highly liquid asset classes tend to make ESG factors less significant.

"We consider ESG factors to be long-term risks. The majority of our assets are held in money-market funds and short-maturity investment-grade bonds. Not only is there little ESG analysis we can do on these asset classes, but we are also faced with the reality that ESG factors are unlikely to influence our investment performance."

P&C insurer, UK

So it's no surprise that 82% of life-insurance companies highlight risk management as a key driver of ESG practices compared with 67% of P&C companies.

Exposure to policyholders and stakeholders motivates sustainable practices

Client expectations are a clear driver of sustainable investment practices for 33% of insurance companies. However, this varies significantly between business lines and depends on the nature of the insurance product.

Across Europe, clients primarily use life-insurance products as savings vehicles. Therefore, they broadly understand that these assets are invested in financial instruments (particularly in the case of unit-linked products). So clients are most likely to express specific expectations for the way their assets are managed. 57% of life-insurance companies have noted a significant rise in client questions related to ESG.

"We have seen a huge increase in client requests related to ESG. Clients are increasingly aware of the impact of their savings on the environment. We get questions about exclusion policies. It is not every day, but it is clearly a new factor to consider."

Life insurer, Switzerland

Conversely, few clients make a direct link between their P&C insurance contracts and the investment function of insurance companies. This means that P&C and health-insurance companies are under less pressure to develop sustainable investment practices.

"Clients choose our insurance products for the cover and price that they receive. I would suspect that very few of them know that their premiums are invested, so it is a stretch to argue that they would have any sort of expectations regarding the way we manage their assets."

P&C insurer, UK

It is not only policyholders who exert pressure on insurance companies, however. While policyholders have been the most vocal stakeholders, insurance companies are also subject to scrutiny from their own employees. Non-governmental organisations (NGOs) have taken a significant interest in insurance companies as they recognise the powerful role of asset owners in effecting systematic change, whether that concerns climate change or pressing societal issues.

"ESG is coming at us from every angle. Younger portfolio managers are much more interested in sustainable investment. We are under scrutiny from NGOs who regularly publish reports calling out lagging asset owners. ESG has become a necessary consideration to manage the reputation of our firm."

Life insurer, France

Respondents have also highlighted a specific herding effect. As industry associations and peers put ESG at the forefront of discussion, insurance companies are encouraged to keep up with the evolution of the market to ensure they do not lag behind.

"We will never be at the cutting edge of ESG. We are too large an insurance company to stick our neck out. We want to be middle of the road, but with the current speed of things, it is difficult to even stick to the middle!"

Life insurer, UK

This multi-faceted pressure inevitably encourages insurance companies to consider ESG across the whole value chain. However, managing all stakeholders' expectations can be a challenging and sometimes impossible task. The pooled nature of insurance assets may lead to conflicts between the interests of different stakeholders. This can lead to contradictory objectives and may result in inaction.

"Our clients are extremely diverse, and we have to manage assets according to what we deem to be the most efficient use of their capital to guarantee their returns given risk and liquidity constraints. There are some sectors that we can exclude that would suit everyone, like controversial weapons, but what about fossil fuels? We cannot have a values-based approach to excluding fossil fuels as we cannot claim to represent all of our clients' preferences by doing so."

Life insurer, UK

Reinsurance is in a class of its own

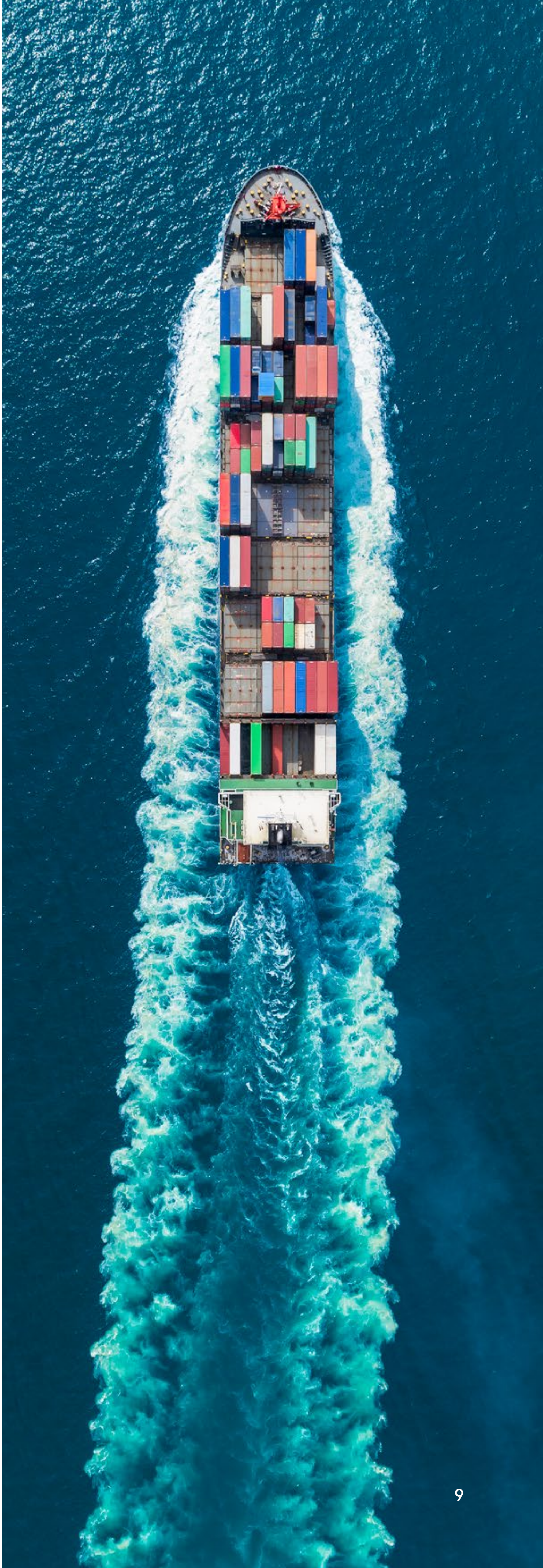
Reinsurance companies have specific motivations in considering ESG. The nature of their business provides a clear incentive to consider ESG in both their assets and their liabilities. Most often, extra-financial considerations have emerged from the latter. Of our reinsurance respondents, 75% started their sustainable investment journey by applying extra-financial criteria to their liabilities.

Perhaps the most prominent example of this development concerns climate-related risks. Indeed, several reinsurance companies in the panel reinsure natural catastrophes, which gives them a clear head start in physical-risk analyses. With their longstanding experience in modelling natural catastrophes, they are able to conduct such analyses on both their liabilities and their assets.

This means that reinsurance companies have a distinctive lens through which to view sustainable development. They are more likely than the panel average to have sustainable policies that cover both assets and liabilities and, for natural-catastrophe reinsurers, a clear bias towards climate-related risk analyses and practices.

100%

Share of reinsurers adopting the Task Force for Climate-related Financial Disclosures (TCFD) framework to conduct physical and transition-risk analyses



81%

Share of respondents citing risk management as the primary driver of their ESG practices (% of respondents)

89%

Share of respondents believing ESG considerations can lower financial risks (% of respondents)

ESG in insurance investment – a risk factor...

Most respondents argued that the very purpose of an insurance business is to manage risks. As a result, insurers need to have the most accurate depiction of risk in all its forms. For them, considering ESG risks is a clear component of that mandate.

Accordingly, insurers need to have the most accurate depiction of risk in all its forms. So considering ESG risks is a clear component of their mandate.

"Our business as an insurance company is to manage risk. It is our core business. So, it is only logical that we consider all elements of risk. We have seen growing evidence that ESG factors are indicators of risk, which we therefore need to actively monitor and potentially mitigate."

Life insurer, Italy

"As insurers, our role is to manage and mitigate risks as effectively as possible. Considering ESG in our investment decisions is clearly a component of that responsibility."

Life insurer, UK

The risk-management driver has the widest reach as it covers institutions of all types, regardless of their original appetite for socially responsible investing. It allows insurance companies to address ESG factors and implement sustainable investment practices without ethical considerations. It is a pragmatic driver.

"We consider ESG factors in our investment decisions to the extent that they are material. Not less, but certainly not more."

Life insurer, UK

Of our respondents, 89% argue that active consideration and management of ESG factors can lower financial risks. Despite this relatively high figure, a minority of respondents are still not convinced of the direct link between the ESG quality of assets and their inherent financial risks. These respondents highlight the short-termism of markets or the lack of sufficiently robust data to conduct performance analysis of the 'ESG factor'.

"ESG factors are risks. If you have poor governance, or atrocious social practices, you are exposed to fundamentally financial risks. However, if you have a great governance structure, it does not necessarily mean you have a good business model."

Life insurer, UK

...but rarely an investment opportunity

This focus on risk management is accompanied by a relatively low consideration of ESG as an investment opportunity. Although insurance companies are quick to identify the risks inherent in an unsustainable business model, they rarely identify the most sustainable companies as providing an investment opportunity.

Only 24% of respondents claim to consider sustainability factors when identifying investment opportunities. Among these respondents, the main investment opportunities are seen in key sustainability themes, particularly in green private assets. While this remains relatively marginal at present, insurers are increasingly considering ESG as an opportunity, following the robust performance of ESG products during the Covid-19 crisis.

Insurance companies' exposure to unlisted asset classes is often limited, however, with most portfolios investing in long-only fixed-income products. This limits the upside potential of investment opportunities and therefore their consideration as a key driver of sustainable investment practices.

Beyond investments: the business opportunity of ESG

One third of insurance companies consider sustainable investment to be a business or marketing opportunity. Along with increased pressure from policyholders, the opportunity to differentiate their value proposition to end-clients has led some insurers to see ESG in a new light. Insurance companies, mostly large commercial life insurers, are indeed appealing to clients by promoting their sustainability credentials and offering innovative (unit-linked) products to allow them to 'give meaning to their savings'.

"Clients are increasingly attentive to the sustainability of their savings. It means we get more questions from our distributors, but it also means we have an opportunity to show them that we can do more than manage their assets. We can help them invest in a way that is aligned with their core values. That is clearly a new way of thinking about the life-insurance business."

Life insurer, Italy

Nevertheless, this proportion is relatively low compared with other drivers, particularly among P&C or reinsurance businesses. The most common explanation is the perceived remoteness of investment strategies from a client's commercial decision. For example, few clients will choose a car or home insurer on how the insurance portfolio is managed. Therefore, the business opportunity to promote sustainability credentials is relatively limited.

"Most of our policyholders do not make a direct link between their insurance policy and the fact that we invest assets. Few of them know that their premiums are invested at all. They choose policies for the protection they receive, for the price, and for the service. I doubt anyone has ever chosen an insurance policy and considered sustainability."

P&C insurer, UK

But as insurance companies become increasingly vocal about their ESG practices, the question of firm-wide consistency arises. Can insurance companies take ESG beyond their investment process and into their business model? Respondents highlighted three areas where sustainability objectives extend beyond the investment function.

01

Aligning investment and underwriting

The first step towards firm-wide consistency is the alignment of sustainability policies across assets and liabilities. However, respondents said this alignment is neither justified nor warranted across all insurance business lines. For example, life-insurance companies have little leeway to choose their retail clients.

By contrast, reinsurance and P&C companies report clear opportunities to use ESG criteria in their underwriting activities. Although full alignment is still in its infancy, the most common example relates to the insurance of physical assets and their exposure to climate-related risks. The argument is that if an asset is excluded from investment because of its exposure to physical or transition climate risks, then it should not be insured.

"I struggle to see how we could justify to our board, to our employees, or to ourselves, that we exclude coal-fired power plants from our investment portfolios but continue to insure them. If we believe they are stranded assets, then they should be stranded assets on both sides of the balance sheet."

P&C insurer, UK

However, such initiatives can limit the firm's commercial activity. So, rather than refuse business altogether, some firms prefer to measure their exposure to climate-related risks and raise premiums accordingly.

02

Aligning ESG and CSR

Most insurance companies had corporate social responsibility (CSR) policies before they started to consider ESG factors in their investment portfolios. The emergence of sustainable investing has led many to seek alignment between these two areas. Two factors encourage this alignment.

The first is a values-based consideration. If a firm is excluded from the investment portfolio for ethical considerations, then the insurance company should ensure that it does not itself violate those considerations.

The second is a risk-management consideration. If solid CSR practices allow firms to lower their financial risk, then the insurance company should apply those CSR practices internally and expect them of its portfolio holdings.

The most common implementation of this alignment is linked to climate-related objectives. Of those insurance companies that are seeking to lower their portfolio's environmental footprint, 46% have also implemented measures to lower the impact of their own operations.

46%

Share of respondents claiming full alignment between their investment and CSR strategies (% of respondents)

41%

Share of respondents whose strategic positioning was impacted by ESG considerations (% of respondents)

03

Aligning own account and unit-linked investments

Life-insurance companies face a specific challenge to ensure consistency across their two main products: general-account and unit-linked investments.

41% of life-insurance companies aim to ensure a minimum standard across all investment solutions available to their clients. Mostly, insurance companies want to ensure that the unit-linked products they offer do not violate sustainability objectives pursued by general-account assets.

Respondents highlighted the challenges of this alignment as unit-linked products often include funds managed by external managers.

The common strategy across life-insurance companies is to ensure a solid ESG foundation on their general-account assets, primarily driven by risk-management considerations, and to provide clients with the opportunity to select unit-linked products that go beyond this minimum framework.

Unit-linked products are considered an opportunity for insurance companies to renew their offering and allow clients to invest according to their values. Ethical products, primarily stemming from the UK market, have historically been the most common illustration of this approach. More recently, insurers have developed thematic and impact funds to cater for a growing appetite from clients.

Some insurance companies now recognising the opportunity to build a competitive edge through sustainable products. This has led to a wave of innovation: from ESG model portfolios (which offer clients unit-linked solutions entirely composed of ESG-labelled products), to thematic or impact products that speak to clients' desire to generate positive impact from their savings.

41% of insurance companies claim that this opportunity has led their firm to adjust its strategic positioning in the market and seek to use its sustainability credentials and product range to fuel growth and attract new clients.

Regulation: need for transparency spurs insurers into action

- Almost three-quarters of insurance companies (74%) mentioned regulation as a key driver for their sustainable investment practices.
  - This is especially true in France, where most firms have aligned themselves to Article 173 of the Energy Transition Law and now expect further strengthening of regulation at a European level.
  - In the UK, firms are adapting to the SS319 supervisory statement from the Prudential Regulation Authority (PRA), and there is expectation of further strengthening of regulation on both a national and a European level. Smaller and lagging insurers are not necessarily ready for this change and are seeking the help of their asset managers.
  - In Germany, Italy and Switzerland, local regulation has historically been less stringent, but insurers have been driven towards the adopting of sustainable investment practices in anticipation of European-level regulation.
- While most regulation today acts on a comply-or-explain basis, the transparency requirements have proven to be a stepping stone for action.
  - Transparency has allowed insurers to compare themselves and learn from industry best practices. This has led firms to action as they try to mitigate the reputational risk of being left behind.
  - Moreover, insurers recognise that the comply-or-explain framework is likely to be temporary and have therefore strengthened their approach to avoid being caught out when regulation tightens.

Covid-19: Exaggerating differences in ESG uptake

- The pandemic has generated different reactions among insurance companies, generally accentuating their approaches towards ESG rather than fundamentally altering them.
- The majority of insurance companies claimed that the pandemic did not alter their perception of ESG. For most, it was a welcome test of the resilience of their sustainable investment practices.
- On rare occasions, the pandemic significantly altered insurance companies' approach to sustainable investing. Initially reluctant insurance firms have used Covid-19 as an opportunity to lower or remove ESG consideration from their agenda. Only a few respondents saw the pandemic as an opportunity to start considering ESG, particularly in light of the strong performance of ESG products in the first half of 2020.
- By contrast, more advanced ESG players see the pandemic as an opportunity to invest in social products and increase their efforts towards sustainable investment.
- The overall result has been a validation of the importance of ESG and of business resilience in general, as the pandemic has shown the effect that adverse natural conditions can have on the economy.

"Being greener is more expensive, so why are we trying to be greener in the middle of a crisis? It does not have any logic to me, I might be missing something. It is like if you were in the middle of the battlefield and you do not want to get your shoes dirty with mud."

Life insurer, UK

"The pandemic is a fraction of what we can expect from climate change. It proves that resilience and sustainability are more important today than ever before."

Life insurer, France

Key takeaways

The centrality of risk management to the insurance business is the main reason respondents are considering ESG factors in their investment strategies.

Meanwhile, few insurers spontaneously identify sustainable investments as an opportunity, as ESG is considered more of a risk factor than a value creator.

Commercial life-insurance companies are under increased scrutiny from their policyholders. A few are seeking to exploit their sustainability credentials as a differentiator to attract new clients and generate business opportunities.

Theme 2

Continuous improvement of ESG practices

A sustainable investment journey

Sustainable investment practices are a relatively recent initiative among insurance companies. While firms have regularly used some extra-financial information on an ad-hoc basis for decades, dedicated policies and methodologies have only really emerged in the past five years.

And even though most of the market leaders have longstanding ESG experience, 39% of insurance companies claim to have less than three years of active consideration of ESG in their investment policies.

Some 63% of respondents have formalised action plans dedicated to sustainable investment, indicating that more is to come. These objectives and improvement areas cover insurance companies at all stages of maturity, from newcomers to the pioneers. All respondents – even those who are most advanced – are still looking to improve.

"It has been over 10 years since we started considering ESG, yet we are still discovering new ways to address the subject. There is still much we do not know. It is a continuous effort to improve our practices."

Life insurer, France

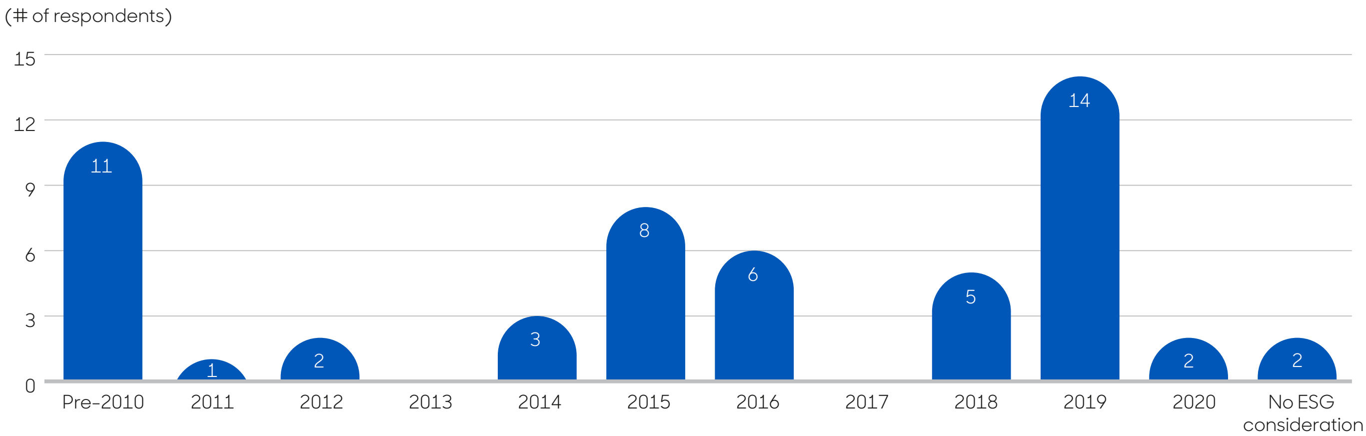
While there's no typical sustainable investment journey for insurance companies, most fall into three categories.

Improving pioneers: these institutions (mostly large companies that dominate their domestic markets) are at the cutting edge of ESG and still looking for ways to sharpen it. At the forefront of sustainable investment, their practices have evolved along with the maturity of the market.

Market followers: these institutions do not claim pioneering status and have broadly kept up with market developments. They rarely seek innovation but aim to keep up with new themes. They represent the pragmatic core of respondents.

Leapfroggers: these institutions are latecomers to sustainable investing but benefit from the market's maturity. Their late entry allows them to skip the intermediary steps of the pioneers' evolution. This group is mainly composed of smaller, local insurance companies historically subject to little or no ESG regulation. They seek to leapfrog the competition and provide new innovative approaches to ESG, sometimes jumping directly to in-depth climate-risk analyses or impact investments.

Chart 5: Years since first active consideration of ESG



Source: abrdn ESG Insurance Survey, April 2021.

Many challenges are still unresolved

This drive towards sustainable investment still faces many challenges. Most of these stem from the nascent nature of ESG practices; others appear more structural.

The fading barriers of ESG analysis: towards mainstreaming and harmonisation

Respondents are clear in highlighting that most obstacles are gradually disappearing. While these challenges have yet to be fully resolved, significant improvements have been made by the industry in recent years, and the European Union (EU) new sustainable finance regulation is expected to contribute to breaking down the remaining barriers.

A common challenge highlighted by 46% of insurance companies is the lack of homogeneity in the ESG landscape. This covers data (lack of common reporting standards, poor data quality) and methodological divergences in its use. While insurance companies don't expect to have a single ESG methodology, most assert that increased standardisation would provide them with a comparable base from which to assess both individual securities and externally managed funds. Many expect the European Commission's regulatory changes (see insert) to solve most of these issues.

"Access to ESG data has been an issue for a long time. Now, we are almost submerged by ESG data. What we really need now is standardisation. However, it must not be an excuse to stay inactive."

Life insurer, Italy

"Investment management is a quantitative field and, for now, ESG is still too qualitative. Companies are free to report on the indicators they choose, and there is no harmonisation. Until we have access to reliable data, we will not be able to integrate this information effectively."

Life insurer, Germany

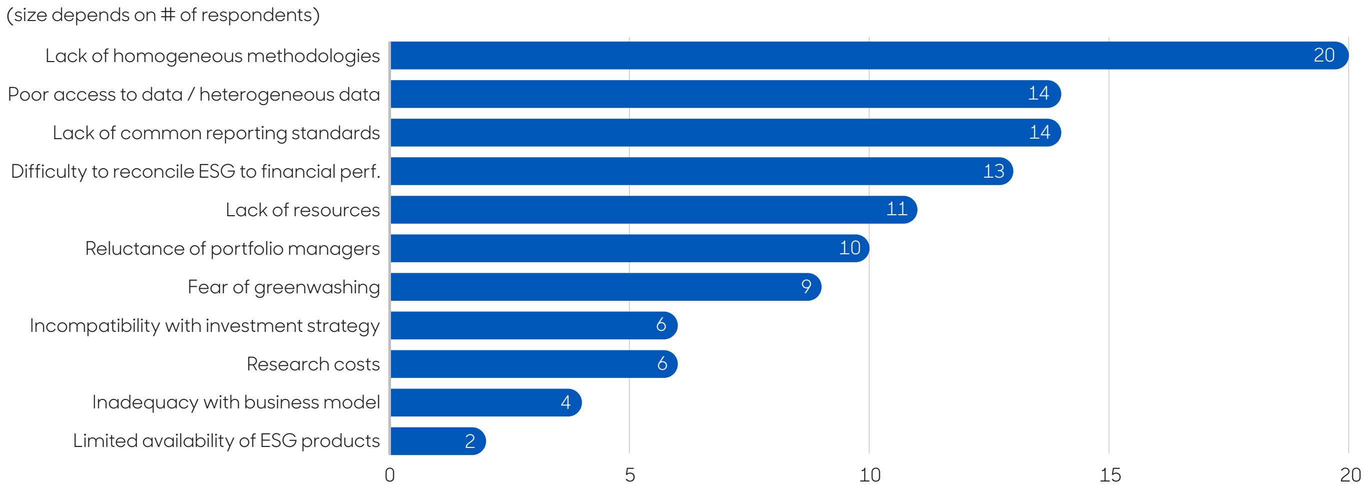
But some challenges concern people rather than data. 19% of insurance companies highlighted reluctance among their internal portfolio managers to implement sustainable investment practices. However, most expect this resistance to fade as ESG becomes increasingly mainstream and as generational shifts occur within investment teams.

Illustration 2: Illustrative roadmaps of insurance companies' sustainable investment journeys

	>5 years ago	4 years ago	3 years ago	2 years ago	1 year ago
Improving pioneers	ESG policies Exclusion lists	ESG analyses (often score-based) Best-in-class screening Voting policy	CO2 footprint analyses Controversy monitoring	Physical risk analyses Forward-looking analysis (best-effort)	Climate stress tests TCFD reporting Impact investments Shift in strategic positioning
Market followers		ESG policies Exclusion lists	ESG analyses (often score-based) Best-in-class screening Voting policy	CO2 footprint analyses Controversy monitoring	Physical risk analyses Forward-looking analysis (best-effort)
Leapfroggers					Climate stress tests TCFD reporting Impact investments Raw indicator analysis

Exclusions · ESG Integration · Stewardship · Impact · Climate · Other

Chart 6: Main challenges towards the implementation of sustainable investment practices



Source: abrdn ESG Insurance Survey, April 2021.

"We have portfolio managers who have done their job, and well, for several decades. All of a sudden, we are expecting them to consider a whole new field of analysis. There was definitely a lot of reluctance in the beginning, but it is a question of time and constructive dialogue. We need to work with the investment teams to show that ESG can bring value, not constraints."

Life insurer, France

"The times where you could deal with ESG as you wanted will soon be over. A wave of regulation and harmonisation is coming. We see this as an additional workload, if anything, as the new regulation will imply much bureaucracy."

Life insurer, Germany

Regulation: towards a harmonised framework

- A new triptych of European regulation provides investors and asset managers a more harmonised framework on sustainability.
  - The Non-Financial Reporting Directive (NFRD) aims to harmonise corporate reporting of non-financial and diversity information. It aims to provide investors with a standardised set of indicators on which to base their ESG analyses.
  - The Sustainable Finance Disclosure Regulation (SFDR) requires all financial-market participants (asset managers, institutional investors, distributors) to disclose firm-level and product-level ESG information in a standardised framework.
  - The EU taxonomy for sustainable activities provides a classification system for sustainable activities to tackle greenwashing and provides investors with a standardised framework to report their contribution to the energy transition.
- While it may overlap with some pre-existing national regulation, this regulatory initiative will considerably enhance investors' ability to compare firms, funds and asset managers according to a common set of criteria.
- This regulatory evolution may be the essential tool required to address many of the challenges mentioned in this section.

Chart 7: Importance of ESG in investment strategy

(% of respondents)

Source: abrdn ESG Insurance Survey, April 2021.

The structural challenge of ESG: destined to remain an input?

A clear challenge for insurance companies is how to consider sustainability beyond reporting and effectively implement changes in their portfolios. Although ESG has become a central talking point, it is currently often superseded by more structural objectives.

Only 24% of respondents argue that ESG can be considered a primary driver of investment strategy. Asset-liability management, the search for yield in a low-yield environment and solvency-capital requirements are all regarded as more important than ESG in defining insurance companies' investment strategies.

"The longlasting low-yield environment, combined with the economic crisis linked to the pandemic, means that we cannot consider ESG beyond what is strictly material. We consider ESG only when it helps us generate better risk-adjusted returns."

Life insurer, UK

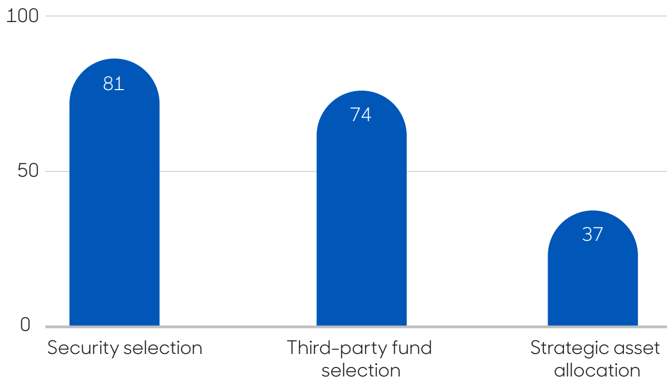
In fact, ESG is rarely seen as a driver in its own right. It is most often perceived as an additional element to improve the investment strategy. It is considered an input into the investment strategy rather than its defining factor.

"I would not say that ESG has fundamentally reshaped our investment strategy. What drives our investments is our asset allocation, itself linked to our liabilities and Solvency II capital requirements. We consider ESG as a tool to help us select the right investments and have a more comprehensive view of our risk profile, but not as the primary driver of our investment strategy."

Life insurer, France

Chart 8: Share of firms considering ESG at different levels of the investment process

(% of respondents)



Source: abrdn ESG Insurance Survey, April 2021.

There have been some initiatives (37% of respondents) to influence strategic asset allocation based on sustainability criteria. However, this has mainly taken the form of increased allocations to private assets (the preferred area for impact and thematic innovation) and marginalisation of less transparent asset classes (e.g. hedge funds).

"We want to implement ESG across our entire portfolio, and it is starting to influence our strategic asset allocation. We have had to reconsider investments in some asset classes where transparency is not sufficient to conduct adequate ESG analysis."

Life insurer, Switzerland

"Impact has to be achieved in private assets in my opinion. It is where you can have real influence on portfolio companies and make a real difference. It is mainly through those asset classes that we will be looking to finance the energy transition, for example."

Life insurer, Germany

Chart 9: Frequency of ESG consideration influencing investment decisions

Source: abrdn ESG Insurance Survey, April 2021.

Insurance companies reported that ESG was more often a consideration when evaluating individual securities (81% of respondents) or the selection of investment products (74%).

Most recognise that ESG-integration practices have primarily impacted investment reporting (70%) and that the impact of sustainable investment practices on investment portfolios has been relatively minor. 60% of respondents recognise that ESG has affected investment decisions on rare occasions at most.

Life-insurance respondents also highlighted a structural constraint linked to their buy-and-hold strategies. As they are unable to easily liquidate their fixed-income positions, exclusions and ESG integration are often limited to new investments. This may lead to controversial companies staying in portfolios longer. It also limits the speed at which new ESG policies may be implemented.

"I would not say ESG has had a fundamental impact on the way we manage our assets. It has definitely increased our reporting requirements, though. ESG is really only relevant for a few companies. Most of the time it is not that big an issue."

Life insurer, Italy

Exclusions are usually restricted to a minimal subset of the investment universe. Most respondents highlighted the marginal effect of this practice on the overall investment strategy. Similarly, although allocations to impact and thematic products are growing, they are often limited to peripheral asset classes (mainly private assets) and are hindered by the lack of adequate products on the market.

"Excluding coal and investing in green bonds is great, but it is really quite marginal. There are maybe five companies in our investable universe that would be excluded due to their exposure to coal. I think it would make more sense to have a true, systematic, ESG-integration methodology."

Life insurer, Switzerland

Key takeaways

European insurance companies are all on a journey to improve their sustainable investment practices. None have so far reached the peak of ESG.

Pioneers are continuously exploring the cutting edge of sustainable investment, but innovation may also stem from leapfroggers (recent entrants to the ESG landscape) who exploit the market's maturity to innovate through new impact or climate frameworks.

Past barriers to ESG integration (lack of reliable data, heterogeneous methodologies, reluctance of portfolio managers) are fading, but the persistence of competing priorities indicates that ESG is likely to remain an input to investment strategies rather than its defining factor.

Theme 3

Juggling E, S and G: how insurers respond to the different aspects of sustainable investment

Sustainable investment practices used by insurance companies fall into four non-mutually exclusive categories.

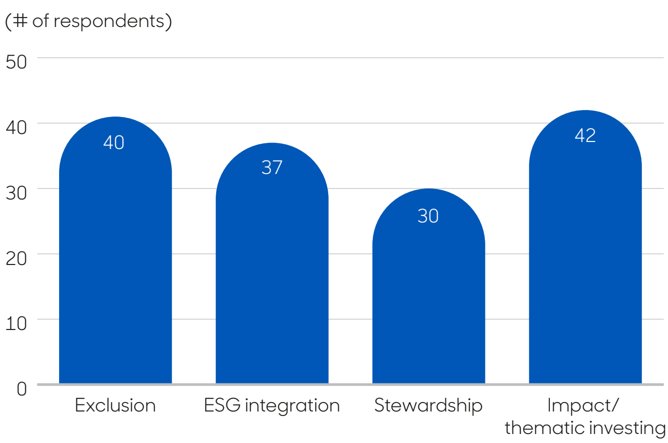
Exclusion: systematically excluding a list of companies based on their sector (sector-based exclusions), violation of international norms (norms-based exclusions) or their country of operation (geographic exclusions).

ESG integration: explicitly and systematically considering ESG factors in investment decisions, whether when selecting individual securities, defining benchmarks, or adjusting strategic asset allocation. This covers wide-reaching methodologies, including best-in-class strategies and using minimum ESG scores, and integrating non-financial data into valuation models.

Stewardship: sometimes called active engagement, this covers voting policies and dialogue with investee companies on sustainability issues.

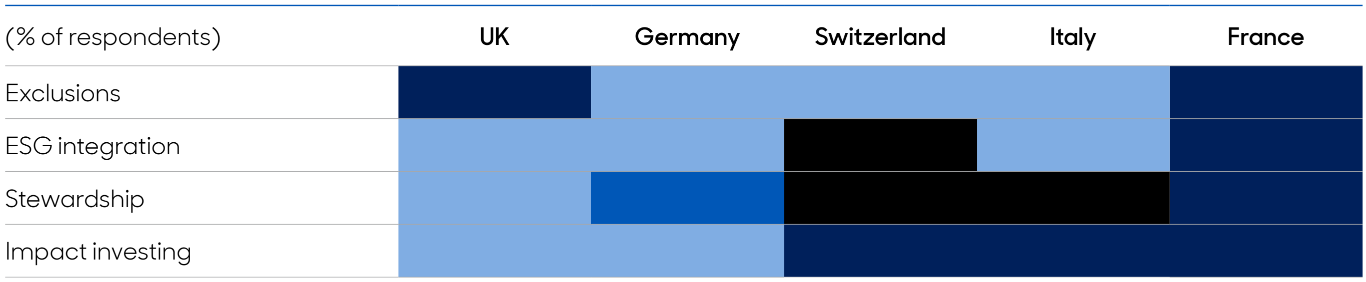
Impact and thematic investing: selecting investment products that either seek exposure to themes likely to benefit from sustainable investment trends (thematic products) or seek to generate a positive and measurable social or environmental impact alongside financial returns (impact products).

Chart 10: Main sustainable investment practices

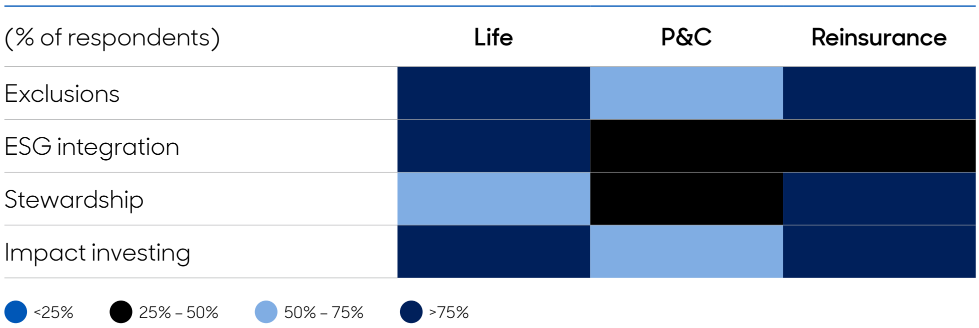


Source: abrdn ESG Insurance Survey, April 2021.

Illustration 3: Main sustainable investment practices by country



Main sustainable investment practices by business line



Is ESG too broad a concept to be helpful

Respondents overwhelmingly agree that ESG is a nebulous term. This is because it seeks to address diverse, intertwined and far-reaching concepts.

"ESG is an acronym that covers everything from the carbon emissions of a company to the composition of its board to whether its business model is aligned with what we believe will be the world of tomorrow. It is simply too broad a concept to be addressed as a single factor."

Life insurer, France

61% of respondents, primarily smaller firms early in their sustainable investment journey, consider ESG as a single factor. The most common illustration of this practice is the use of third-party rating agencies and the scores they attribute to companies. As these scores represent the combination of many underlying factors, some insurance companies see them as a way to get a holistic understanding of a firm's ESG quality without the need to conduct their own in-depth research.

Others prefer to focus on the individual sub-factors of ESG. These insurance companies are usually larger institutions with established ESG policies and dedicated research analysts.

These ESG perspectives fundamentally affect the investment practices that insurance companies favour – as in these examples.

- Exclusions rely on specific topics rather than an overall ESG score. Firms can be excluded based on their environmentally harmful activities (e.g. the exclusion of coal-fired power plants) or on their violation of social norms (e.g. the exclusion of firms violating International Labour Organisation standards or in breach of human-rights agreements).
- Dialogue and engagement with firms is most often conducted on a specific topic (e.g. insurers engaging with oil majors on their decarbonisation objectives).
- Impact investment products seek to contribute to one or several of the UN SDGs.
- Integration, by contrast, is perhaps the one investment practice where an overall score can be used as is. However, many insurance companies still prefer to assess companies on their underlying ESG characteristics rather than an all-encompassing score.

Chart 11: Consideration of ESG as a whole or as a collection of sub-factors

(% of respondents)

Source: abrdn ESG Insurance Survey, April 2021.

Environmental, social, governance: by order of importance?

If ESG is too broad a concept then where are insurance companies concentrating their efforts? Most have focused on the environment – 50% of respondents considered this the most important of the ESG factors.

This isn't to say respondents lack interest in social or governance factors. Instead, the dominance of environmental concerns is driven mainly by regulation (most current ESG regulations emphasise climate-related risks) and the fact that environmental impacts are quantifiable and material.

Interest in the social component increased during the pandemic. But there still isn't a consensus on exactly how to measure it – or how to integrate social factors into investment decisions.

Corporate governance, on the other hand, appears to 'predate' ESG. Respondents often considered these factors as being within the scope of their financial analysis, rather than viewing through a sustainability lens.

"Climate change is the main focus. We have an ESG policy that covers all subjects but, in reality, most of our efforts are around climate change. Everything points in that direction, particularly regulation."

Life insurer, France

Environmental objectives are now so overarching that they've spread beyond the traditional remit of ESG policies. In fact, 40% of insurance companies without ESG policies still address climate change: for example, by measuring their carbon footprint, financing green assets or excluding coal.

40%

Share of respondents without an ESG policy who nonetheless address climate change (% of respondents)

"Sustainable investment, for us, is an environmental topic. It is clearly where we see the most potential for risk. It is also the main challenge of our time. We focus our efforts and limited resources on climate-related risk analysis."

Life insurer, Switzerland

Environmental: the only consensus

Climate change is the main focus of ESG policies, but environmental analysis also stretches beyond to cover areas such as biodiversity and plastic pollution.

To address environmental concerns, respondents make use of all four of the sustainable investment approaches referenced earlier: exclusion, ESG integration, stewardship; and impact and thematic investing.

Exclusions: Respondents mainly use exclusionary screens in relation to sectors responsible for high carbon emissions, or seen as environmental hazards (such as coal, tar sands or fossil fuels.)

This strategy forms the backbone of insurance companies approaches to climate action. 54% of respondents exclude some or all coal-related activities. This is particularly the case in France (93% of respondents exclude coal), but less so in Germany (42%) and Italy (28%).

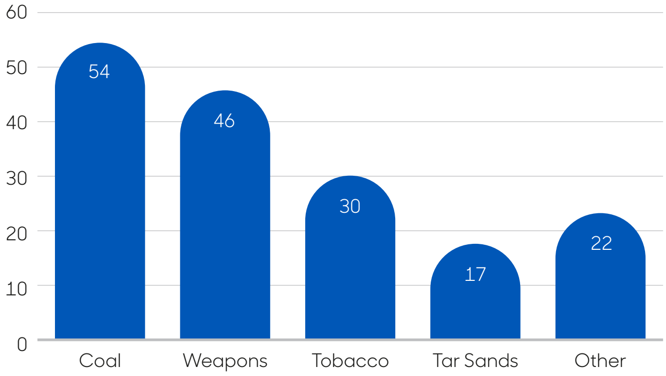
Chart 12: Most important ESG factor

(% of respondents)

Source: abrdn ESG Insurance Survey, April 2021.

Chart 13: Most common sector-based exclusions

(% of respondents)



Source: abrdn ESG Insurance Survey, April 2021.

However, there's inherent limitations to exclusions. Coal exclusions are relatively easy to implement as they only affect a small portion of the investment universe, but isn't as easy for other areas.

Extending the exclusion to encompass all fossil fuels can prove to be a structural constraint, particularly for passive investors, who seek to minimise their tracking error.

"We are passive investors, so we do not really have the choice of what constitutes the benchmark. We cannot simply decide to exclude 5% or 10% of our investment universe."

Life insurer, Switzerland

Stewardship: To exclude or engage? Questions about the efficacy of exclusions continue to spark debate. Most investors make use of both practices. Excluding companies whose business models are unadaptable to a sustainable transition (such as coal), or where dialogue has proved unsuccessful.

Often engagement initiatives are collaborative, through platforms including Climate Action 100+ or the Principles for Responsible Investment (PRI). These pressure issuers to increase transparency and improve management of climate-related risks. When these initiatives don't yield results, insurance companies can then switch to exclusions as a last resort.

ESG integration: The use of environmental factors, particularly carbon footprints, as inputs to valuation models is the prime example of the integration of ESG in fundamental analysis. ESG integration practices allow insurers to take a more nuanced approach to environmental concerns than with exclusions. .

Impact and thematic investments: Finally, insurance companies actively seek to provide capital to climate-related solutions, primarily in the form of renewable-energy infrastructure, energy-efficient real estate and climate-focused listed products. These investments have the double objective of securing long-term sustainable returns from climate-proof private assets and of demonstrating the insurance company's active contribution to the fight against climate change. Although these investments remain marginal, they are the fastest-growing segment in the ESG landscape.

"We are always on the lookout for opportunities to invest in products that have a tangible impact, as long as their overall characteristics fit with our asset-allocation requirements."

Life insurer, Italy

24%

Share of firms invested in social infrastructure or social housing(% of respondents)

Social: growing attention, buoyed by the pandemic

Few respondents (13%) spontaneously highlighted a specific focus on the 'S' of ESG. There are no indications of, for example, specific integration practices seeking to incorporate individual social factors in their investment strategies. Rather than being a specific focus of the investment strategy, the social dimension is an element of analysis that fits within a wider framework.

Although it is not the central focus of most investor practices today, diversity is the most common individual component of social analysis, particularly in the UK (23% of respondents assess diversity as an individual factor) and in France (27% of respondents). The most frequent example is insurance companies encouraging board diversity through voting policies.

"We have included in our voting principles a section on gender diversity. We will systematically refuse to vote in favour of board nominations if there is not at least one female member on the board."

Life insurer, UK

Diversity has sparked interest among respondents, yet few have a clear view on how this factor could influence their investment strategy. Insurance companies nonetheless recognise nascent initiatives to address the issue, including the emergence of gender-equality indices and funds.

Diversity is also a growing concern for insurers' asset managers. 6% of respondents now include diversity criteria in their requests for proposal (RFP) for new investment mandates. While this figure may appear small, most initiatives are recent endeavours and are likely to find further echoes in the market in years to come.

Beyond diversity, the current pandemic has revived interest in the social components of ESG. Health, wellbeing and employee support have become central talking points in recent months.

Impact-investment initiatives have sought to address the economic aftermath of the pandemic through investment products whose objectives include the safeguarding of employment. In France, for example, the *Fédération Française de l'Assurance* and the *Caisse des dépôts* have pledged €2.2 billion of assets to support companies that were affected by Covid-19. Insurance companies in France contributed to this investment programme, which is composed of three tranches of investment in unlisted assets (€1.1 billion to support small and mid-sized firms, €200 million to support the tourism industry, and €800 million to support the healthcare industry).

"It is in periods of crisis such as this one that we are able to truly demonstrate our social value. We have contributed to specific investment products to save companies and jobs in France. It is essential for institutional investors like us to contribute and generate a positive impact for society."

Life insurer, France

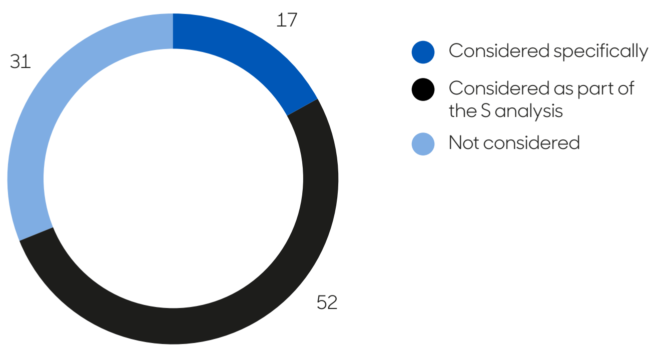
More widely, efforts to support social inclusion in this period have furthered investments in purpose-driven social infrastructure and housing, primarily in France and the UK.

Governance: business as usual?

For many insurance companies, the consideration of governance factors predates ESG. Good corporate governance has historically been considered part of fundamental analysis. As a result, many investors consider governance issues outside of a holistic ESG framework.

Chart 14: Level of consideration of diversity and inclusion among firms who consider ESG

(% of respondents)



Source: abrdn ESG Insurance Survey, April 2021.

"We do not have an ESG policy. However, we do have very specific expectations in terms of corporate governance. It is an essential part of the quality of a company, much more than other environmental or social factors."

Life insurer, Germany

Governance concerns, particularly around the composition of administrative boards, are often addressed through shareholder engagement and voting policies. However, few insurance companies have specifically identified the 'G' component of ESG analyses as a central focus, which limits the development of specific investment practices linked to the subject.

"It is difficult to imagine investing in a 'governance' impact fund. The corporate-governance side of ESG is more an element of fundamental risk analysis."

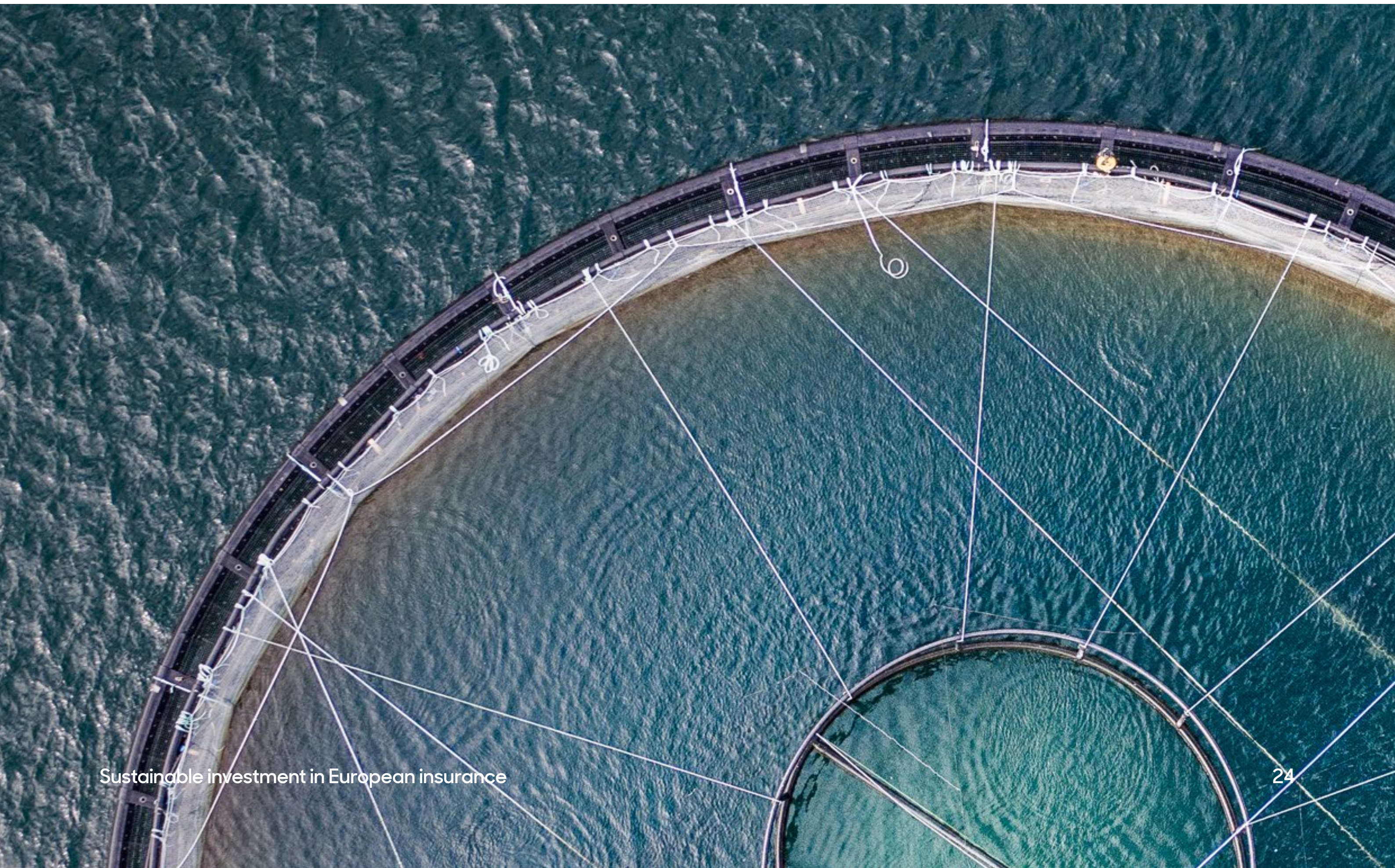
Life insurer, Switzerland

Key takeaways

Although most respondents consider ESG as a single factor in their analysis, nearly all recognise the limitations of such a sweeping approach.

Nonetheless, there's a clear hierarchy in the components of ESG. Environmental issues have overwhelmingly attracted most attention from insurers, who employ all the tools at their disposal to address these issues (including coal exclusions, engaging with companies on climate rise, and investing in climate solutions).

While the pandemic has buoyed interest in the 'S', particularly in the context of economic recovery and safeguarding jobs, insurers have yet to reach a consensus on what social indicators are most material and how to effectively integrate them into their investment strategy.



Theme 4

Climate change as a driver of innovation

Climate change

Insurance companies increasingly refer to the UN SDGs as a framework for measuring impact and identifying sustainability objectives. The 17 SDGs cover the most pressing issues of the next decade, including poverty, health, equality, biodiversity, peace and justice. Each of the SDGs has specific targets to be achieved by 2030.

Not all the SDGs are addressable by the investment industry. But far and away, the areas that have gathered most interest and concrete action are those relating to climate change. Of all portfolio-wide ESG objectives, 96% are climate change related.

"We are not yet at a level where we can claim to have specific objectives to improve the world. The only thing we can claim is that we are trying to reduce the carbon footprint of our portfolio."

Life insurer, Switzerland

There are two key reasons behind the industry's focus on climate change – regulations and measurability. Together, these factors are leading companies to develop innovative methodologies to tackle the risks and opportunities ahead.

This combination of regulation and measurability may prove decisive in how insurers expand their sustainable investment targets and address the other SDGs. The focus on climate change demonstrates the innovative power of the investment industry, but the breadth of the SDGs that remain unaddressed indicates the vast potential for further innovation.

Climate as the only example of clear objective setting

Climate targets are diverse in nature and complexity. But they all share a common trait – they are quantifiable.

Targets fall into two main categories: reducing exposure to climate risk (notably through carbon-reduction objectives) and contributing to the energy transition (in particular, through exposure to 'green' assets).

Reducing carbon footprints – 30% of respondents have a target to cut the CO_2 emissions of their portfolio, either in absolute or relative terms. Some insurance companies go further, with 13% publicly committing to reach 'net-zero' either by 2030 or 2050.

Ramping up green investments – 58% of respondents plan to increase their allocations to green assets, usually in the form of green bonds and private assets (real estate, infrastructure). However, most of these objectives are in relative terms and affect only a marginal share of the portfolio.

"We have decided to allocate a set percentage of our annual investment flows to green assets. It may still represent a small share of our overall portfolio, but it is a strong conviction of our investment board that it is the way forward."

Life insurer, France

As many insurance companies primarily invest passively, these changes inevitably require a transition away from traditional benchmarks. 39% of firms have planned to shift towards ESG or climate benchmarks for their passive equity allocations.

"We are passive investors. If we want to make any kind of change or contribution to the fight against climate change, it would almost necessarily imply a higher tracking error than we are comfortable with. That is why we are starting to consider shifting to climate benchmarks in our investment strategy."

Life insurer, Germany

50%

Share of respondents with portfolio-wide ESG objectives (% of respondents)

96%

Share of ESG objectives related to climate change (in % of portfolio-wide objectives defined by respondents)

39%

Share of firms that use specific ESG benchmarks for assessing or managing their assets (% of respondents)

Meeting the Paris objectives

These objectives lead towards alignment with the target from the 2015 Paris climate change conference of limiting global temperature rises to less than 2°C above pre-industrial levels. While meeting this specific target is still rare among insurance companies, 35% argue that their environmental efforts should bring them closer to this goal.

This forward-looking consideration requires firms to make use of all the tools currently available to them and even seek to develop their own methodologies to measure their progress. However, it should be noted that the insurance industry is still maturing on the concept of temperature alignment. While most mention 2°C as an objective, few demonstrate a real appreciation for the magnitude of difference between 2°C and 1.5°C, in terms of both real-world outcomes and actions needed to achieve them.

"We have started to measure the temperature of our portfolio. It shows that we are doing better than the benchmark, but in all honesty, I am not sure what to do with that information. If the benchmark is at 4°C and I am at 3°C, is that good? And even If I am at 1°C, if the benchmark is at 3°C, will I have solved anything?"

Life insurer, France

Regulation encouraging and facilitating climate-change objectives

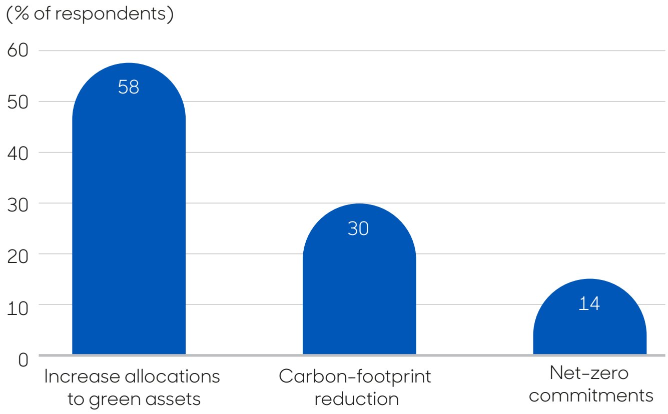
The emphasis placed on climate change as the focus of insurance companies' sustainability targets is, in large part, the result of encouraging and facilitating regulation. Indeed, most regulatory evolutions linked to sustainable investment have a specific focus on climate change.

In France, for example, Article 173 of the country's energy-transition law requires institutional investors to disclose their sustainable investment practices. For investors with over €500 million of assets under management, the regulation also expects institutions to disclose specifically their contribution to the fight against climate change. This focus and the expectations of quantified metrics have been a major factor in investors' focus on CO2-reduction objectives and have fuelled green-asset allocations.

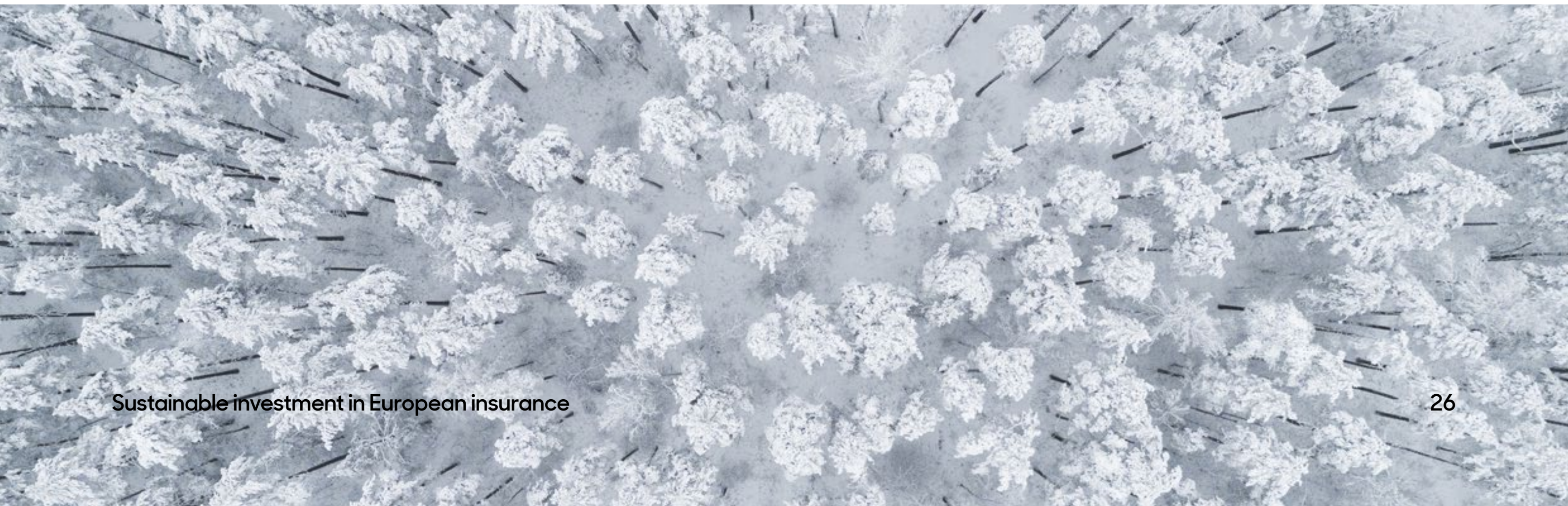
"Everything points towards climate change. Every year, we have to disclose what we do to help fight climate change. No one is asking us what we are doing to address inequality or hunger. Regulation sets priorities."

P&C insurer, France

Chart 15: Climate-related measurable portfolio objectives



Source: abrdn ESG Insurance Survey, April 2021.



EU taxonomy and its role in tackling climate change

At the continental level, sustainable finance regulation also puts climate change at the core of its approach. The EU taxonomy for sustainable activities, for example, is specifically designed to categorise activities around six pillars, all related to environmental objectives:

- climate-change mitigation
- climate-change adaptation
- protection of water and marine resources
- transition to a circular economy
- pollution prevention and control
- and protection and restoration of biodiversity and ecosystems.

This taxonomy allows investors to identify which assets are 'green'. They can set performance thresholds for economic activities that make a substantive contribution to one of the six environmental objectives, do no significant harm to the other five and meet minimum safeguards. Harmonisation initiatives like these, with precise guidelines, allow investors to define clear targets without the fear they will be accused of greenwashing. No such initiatives exist beyond the realm of environmental objectives today.

"With the taxonomy, we will finally be able to safely say which assets are green and which ones are not. It makes it easier for us to communicate and removes the greenwashing risk. It is precise enough to be reliable and to allow us to define measurable objectives. I am not sure it is even possible to have an equivalent 'social taxonomy'. It is clearly not on the cards yet."

Life insurer, UK

Regulatory authorities play an equally important role in supporting insurance companies to address issues that could pose a material risk to their solvency. Currently, it appears that this has led to a focus on climate change as the most material factor in ESG.

"There is a reason why regulation is forcing climate change up the agenda. It is clearly a systemic risk for our economy and, by extension, for our solvency. We are seeing the effects of climate change today. While gender equality is perhaps equally important, it is less likely for that subject to fundamentally redefine the way our economy functions. It will not lead to significant stranded assets. Climate-change risks are simply more material."

Life insurer, Switzerland

Thinking climate in future strategic decisions

The UK Prudential Regulation Authority (PRA) took action to ensure more companies think strategically about climate change.

Its supervisory statement SS319, introduced in 2019, was in response to a PRA review that showed few firms considered the future financial risks of their actions in strategic decision making. The PRA said that while risks crystallise over longer time horizons, they are already becoming apparent.

Firms now are expected to disclose their strategic approach and

- Embed consideration of financial risks from climate change in their governance arrangements.
- Incorporate financial risks from climate change into existing financial risk-management practices.
- Use (long-term) scenario analysis to inform strategy setting, risk assessment and identification.
- Develop an approach to disclosure on the financial risks from climate change.

"We have started using the PRA's format to assess our exposure to climate change risks. It has been a very useful analysis as it has given us a clear first picture of where we stand. Our next step will be to build on this analysis to identify targets."

P&C insurer, UK

57%

Share of firms that use climate-change scenarios in risk management and asset allocation (% of respondents)

France's Prudential Supervision and Resolution Authority (ACPR) has sought to support banks and insurance companies to manage climate-related risks. In 2020, it published scenarios and hypotheses to be used in climate stress tests in a pilot exercise, thereby providing one of the first harmonised sets of guidelines on how to tackle this new type of analysis.

Focus on what we measure: physical, transition and climate stress tests

An additional explanation for the insurance industry's focus on climate change is the measurability of climate risks. Insurance companies benefit from a range of tools specifically designed to assess climate change and its impacts. For example, the recommendations of the TCFD have been widely recognised as a comprehensive framework to measure and tackle climate-related risks and opportunities.

"We can only manage what we can measure. I would even say that we should only manage what we can measure and compare. We are only just being able to do this on climate change. We now broadly know what we need to measure. Hopefully, we will be able to extend this to other topics."

Life insurer, Switzerland

Respondents highlight that such initiatives have allowed them to delve deeper into climate-risk analyses, something they have not been able to do with other ESG factors. This deeper analysis has mainly taken the form of scenario analyses, which allow assessments of physical and transition risks. The most recently available tools, climate stress tests, aim to speak directly to the core of the insurance business: risk and solvency.

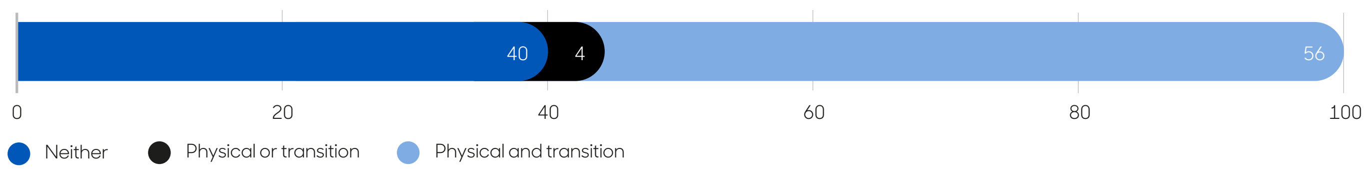
Scenario analysis

The use of climate-change scenarios in active risk management has gained significant momentum among insurance companies. Encouraged by regulation (see insert), 57% of respondents have already started to assess the potential impacts of climate change on their investment portfolios according to different scenarios. These are usually based on the World Energy Outlook from the International Energy Authority or the Representative Concentration Pathway trajectories from the Intergovernmental Panel on Climate Change.

To conduct these analyses, insurance companies increasingly make use of the TCFD's recommendations, which have become established as the reference framework for climate-risk analyses and management. In this framework, analyses cover both the physical and transition risks posed by climate change. 56% of respondents have already conducted a complete climate-risk analysis, with a further 4% conducting either physical or transition-risk assessments.

Chart 16: Use of physical and/or transition-risk analyses

(% of respondents)



Source: abrdn ESG Insurance Survey, April 2021.

Physical-risk analysis

According to the TCFD, physical risks result from event-driven (acute) or long-term (chronic) shifts in climate patterns. These physical risks may have financial implications for organisations in the form of direct damage to assets or indirect impacts in the form of supply-chain disruptions.

60% of insurance companies have begun to assess their exposure to such risks. However, physical-risk analysis requires very detailed information on companies, and this may not be publicly available. As a result, insurance companies have either partnered with third-party data providers or focused their analysis on directly held private assets.

"We have a global portfolio with assets spread across all geographies. It is therefore imperative for us to know how climate change will impact assets in different regions. We are clearly at the beginning of this type of analysis, and we are still faced with data-quality issues. However, it has allowed us to identify specific real estate assets that were at high risk of flooding under business-as-usual climate scenarios."

Life insurer, France

Real assets (i.e. real estate and infrastructure holdings) are the natural first step for many insurance companies as they are directly exposed to physical risks. Moreover, access to the information required (mainly location and sector) is relatively easy compared with large-cap equity holdings.

Transition-risk analysis

According to the TCFD, the transition to a lower-carbon economy may entail significant business risks for companies and their investors, in the form of policy and legal risks, technology risks, market risks and reputational risks.

56% of insurance companies have conducted transition-risk analyses. Compared with physical-risk assessments, transition-risk analyses require more qualitative inputs and a thorough understanding of companies' vulnerabilities to each risk category. As a result, most insurance companies use proxies to assess their exposure to these risks, the most common of which are carbon footprints.

Respondents agree that carbon footprints are only a first step, however, as they do not capture the full breadth of transition risks and they focus on past information rather than trajectories.

"We have started to look at transition risk in more detail. Historically, we would look at the carbon footprint of a company and place an internal price on carbon that would impact the company's valuation. We realised that this would only give us a partial view, so we are looking to refine our analysis and assess which part of the business is likely to be impacted by new carbon regulation."

Life insurer, Switzerland

Climate stress tests

The latest innovations in climate-related risk analyses are climate stress tests. Climate stress tests go a step beyond analysing different climate scenarios and seek to project the impact on an insurance company's financial returns and solvency in different climate-change scenarios. 9% of respondents have begun to conduct these stress tests, and 52% are looking to conduct them in the future.

These stress tests are seen as the clear next step for climate risk assessments, but most insurance companies recognise the early stages of these initiatives despite regulatory authorities seeking to provide support.

"We are often frustrated with climate scenario analyses. We identify which assets are most at risk, but we have limited visibility on what that really means in terms of downside risk. We welcome the support that we are receiving for authorities on this subject. It is truly a daunting task, but a necessary one."

Life insurer, France

More broadly, respondents highlight two main limitations to the development and usability of climate stress tests: horizon and disclosure.

65%

Share of firms that perform carbon-footprint calculation (% of respondents)

Early adopters of these tests highlighted a mismatch between their investment horizon and the decades-long timeframes over which climate stress tests were conducted. Not only does the exercise require the projection of climate scenarios to 2050, but it also requires projections of interest-rate curves and equity prices over the same period.

> **"I do not understand how I can project my portfolio to 2050 when I am mostly exposed to short-term assets. There will always be a mismatch between my portfolio's investment horizon and the impact of climate change."**

Life insurer, UK

Corporate disclosures further constrain the usability and effectiveness of climate stress tests. Indeed, respondents highlighted the necessity for portfolio companies to publish their own TCFD reports and long-term trajectories to improve inputs to their stress-test models.

> **"We are very glad that companies will now have to publish their own TCFD reports. This will allow us to get more granular insights and manage our exposure more accurately. Without this, we are forced to estimate on too many levels for the exercise to be decision-useful."**

Life insurer, UK

Finally, climate stress tests require the involvement of analysts outside the investment department (e.g. from the compliance and risk department and asset-liability-management department), which provides an opportunity to extend the reach of ESG, despite some resistance from staff unaccustomed to dealing with it.

57%

for scenario analysis

9%

for climate stress tests

Use of scenario analysis and use of climate stress tests (% of respondents)

Key takeaways

Of the concrete ESG portfolio objectives set by insurance companies, almost all focus on climate change. These include carbon-footprint reductions, allocations to green assets and net-zero commitments.

This focus is driven by regulation, which has emphasised climate change as central to sustainable finance. Regulators have also facilitated climate action by providing investors with the necessary tools to measure risk and their contribution to the energy transition.

This emphasis has yielded an array of increasingly sophisticated analytical tools and methodologies. It demonstrates the industry's innovative capabilities and its vast potential to address the wider SDGs in the same way.

Theme 5

The role of asset managers

Insurance companies do not limit their sustainable investment practices to their own activities. ESG has now become a central part of discussions with asset managers. As insurers continue on their sustainable investment journey, their expectations of asset managers are clearly increasing.

> **"It is difficult to justify why I would exclude coal from my in-house portfolio, but then delegate to an asset manager who invests in coal. If I am convinced of an ESG risk, it must be considered across all assets, including delegated portfolios."**

Reinsurer, France

Most sustainable investment policies today already extend to outsourced assets (81% of respondents), and ESG criteria are increasingly included in RFPs (35% of respondents).

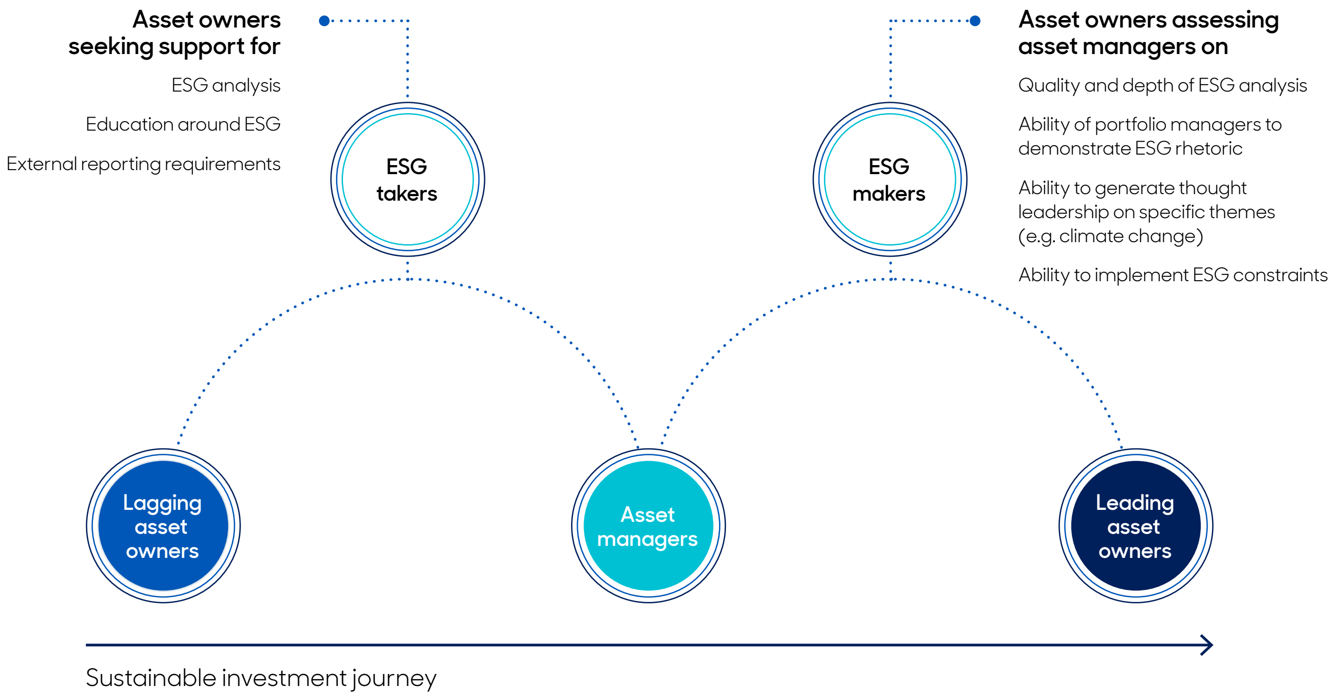
35%

Share of firms that integrate ESG criteria in their RFPs (% of respondents)

81%

Share of firms whose sustainable investment policy extends to outsourced assets (% of respondents)

Chart 17: Asset managers at the pivot of the sustainability investment transition



Source: abrdn ESG Insurance Survey, April 2021.

Asset managers pivotal to sustainable investment transition

While the majority of respondents place significant importance on ESG in the selection and monitoring of asset managers, their expectations differ depending on their level of maturity.

Novice ESG players primarily seek insights and support from their asset managers. Given the complexities of sustainable investment, insurance companies rely on asset managers to provide them with analyses and reporting. 30% of respondents feel they lag behind asset managers and are therefore not in a position to challenge their ESG methodologies. Overall, this category of insurance company is satisfied with its asset managers' methodologies and ability to tailor to basic guidelines (e.g. adherence to exclusion lists).

"We are actually quite lucky that the vast majority of third-party asset managers already consider ESG criteria, as we are lagging behind on our side in terms of expectations. This is clearly something that we will change soon."

P&C insurer, UK

"I do not think anyone would be crazy enough to greenwash. There is so much scrutiny today that it would be suicide."

P&C insurer, Germany

At the opposite end of the spectrum, the most advanced ESG players are in a better position to assess managers on their sustainable investment practices. These assessments are increasingly central to manager selection and are putting laggards at risk of being evicted from the insurance-outsourcing market. These insurance companies are increasingly wary of ESG-washing, seek effective ESG integration and are able to impose their own ESG guidelines on investment mandates.

Clearly, these companies are in a position to identify greenwashing among their managers. Excessive marketing of sustainability credentials and the race to rebrand existing fund ranges as ESG have led them to probe asset managers on examples of ESG integration or engagement.

"So many asset managers are greenwashing. Everyone is a pioneer. Everyone is the most ESG. It is not always easy to judge who is serious about sustainability and who is not, but as time goes by, we are starting to see some masks fall."

Life insurer, UK

The most basic expectations concern the asset manager's firm-level commitments to sustainable investment. Signing up to the UN Principles for Responsible Investment has become a prerequisite for 52% of respondents. Insurers increasingly seek to identify asset managers with a coherent house view on ESG. Beyond the publication of ESG policies, insurers expect sustainability to be reflected across the firm. Proprietary research capabilities (31% of respondents) and the ability of portfolio managers and sales to 'speak ESG' (28% respondents) are increasingly used as indicators of effective ESG integration.

"We do not want to see the ESG analyst every time we have a sustainability question. If the portfolio manager is not able to answer basic ESG questions, that tells me that he will not actively consider the factors in his investment decisions."

Life insurer, France

Chart 18: Breakdown of respondents by type of ESG set-up

(% of respondents)

Source: abrdn ESG Insurance Survey, April 2021.

The quest for effective integration: an opportunity for asset managers

Insurance companies are increasingly extending their sustainable investment practices beyond reporting and into action. This is their quest for effective ESG integration.

The effectiveness of ESG integration stems from the level of interaction between ESG and financial analysis and the ESG responsibilities borne by portfolio managers. Whether ESG analysis is conducted by a separate team or by financial analysts, portfolio managers must be in a position to make effective use of this new information.

"A few years ago, we had ESG analysts and financial analysts. We soon realised that having real integration was not sustainable, so we trained our ESG analysts on financial analysis and vice versa. The results are very positive. It is this type of mindset we would like to see among our asset managers."

Life insurer, France

Insurance companies are increasingly looking to their asset managers to address this challenge, with two central objectives: effectively managing risks and contributing to solutions.

01

Effective risk management

The first objective, which is core to the insurance business, is to exploit ESG information to improve risk-management practices. Insurance companies have pressed their asset managers in different ways to ensure this transition.

Some have required a shift to climate benchmarks in their equity and fixed-income mandates, a practice likely to continue as the EU's Climate Transition Benchmark and Paris-aligned Benchmark become more mainstream.

"Most of our assets are held through passive equity or fixed-income mandates. We have entered into discussions with our managers to shift their benchmarks to more climate-resilient ones. If they are reluctant to do so, we will simply find other managers."

Life insurer, UK

Others are looking to reduce their exposure to the riskiest assets, primarily from a climate-change perspective. Insurance companies increasingly expect their asset managers to avoid the riskiest assets by making use of innovations in climate-related risk assessments (physical risk, transition risk, scenario analysis etc.).

Insurance companies are also open to practices don't intrude as much on the investment process. For example, asset managers are now regularly expected to engage with issuers to ensure that their business models are resilient in various climate scenarios.

"We hoped that we did not have to ask our fixed-income managers to exclude coal. We expect them to do so simply based on risk considerations. If they have done their scenario analyses correctly, they cannot expect to hold coal assets in a portfolio with a long time horizon."

Life insurer, Switzerland

Novice ESG players, not yet in a position to make demands of their asset managers, instead need support from them on risk management. They identify a clear opportunity for asset managers to guide them in their understanding of extra-financial risks, particularly regarding climate change. Beyond education, some are looking to their asset managers for analytical tools and services.

02

Contributing to solutions

The second goal of insurance companies is to contribute to sustainable objectives through their investments. They're looking for new ways to address the SDGs and look to their asset managers for the necessary innovation.

Private 'impact' assets and innovative listed instruments such as green or sustainability bonds are attracting insurers' attention. These assets help them to achieve their sustainability objectives and provide their clients with innovative, impactful investment solutions (primarily through unit-linked vehicles in life insurance).

These two objectives represent a clear opportunity for asset managers to extend their relationships with insurance companies beyond their role of asset management, providing and co-constructing ESG and impact solutions and services.

"There is an evident opportunity for asset managers to market ESG or impact products. However, there is a much wider opportunity to build a dialogue with us on new tools and analyses. It can reinforce some partnerships and weaken others."

Life insurer, UK

Key takeaways

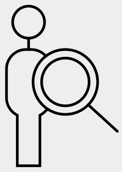
Most European insurance companies extend their sustainable investment policies to outsourced assets and put ESG at the core of their discussions with asset managers.

Asset managers have a pivotal role to play in the transition to a sustainable investment model. Lagging asset owners will look towards their managers for tools and support in navigating the sustainable investment landscape. At the same time, leading insurers will increasingly scrutinise managers in an effort to curb greenwashing and to seek effective integration.

The rapid development of sustainable investment in the European insurance landscape presents a clear opportunity for asset managers to extend their role beyond asset management and help their clients manage extra-financial risks and contribute to solutions to the SDGs.

Country focus:

France

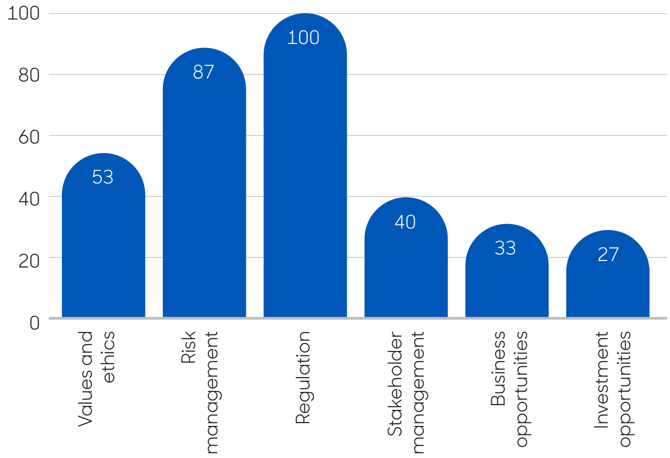


Overview

- ESG has become an unconditional component of French insurers' investment practices as all respondents have defined ESG policies.
- Insurers have grappled with sustainable investing since at least the publication of Article 173 in 2016 – 73% now have resources dedicated to ESG.
- This relative head start puts French insurers in an 'ESG-maker' position. Their asset managers are expected to tailor their products to ESG specifications, and their integration methodologies are under scrutiny.
- All insurers surveyed have implemented specific measures regarding climate change, and two-thirds of respondents are targeting alignment with 2°C or below.
- The French insurance industry has also been proactive in supporting the local economy during the Covid-19 pandemic. It has launched investment programmes dedicated to financing affected sectors and companies.

Chart 19: Main drivers of sustainable investment practices

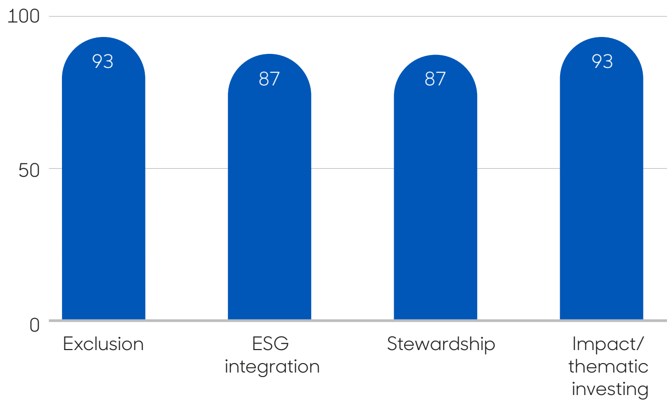
(% of respondents)



Source: abrdn ESG Insurance Survey, April 2021.

Chart 20: Main sustainable investment practices

(% of respondents)



Source: abrdn ESG Insurance Survey, April 2021.

Key drivers of ESG

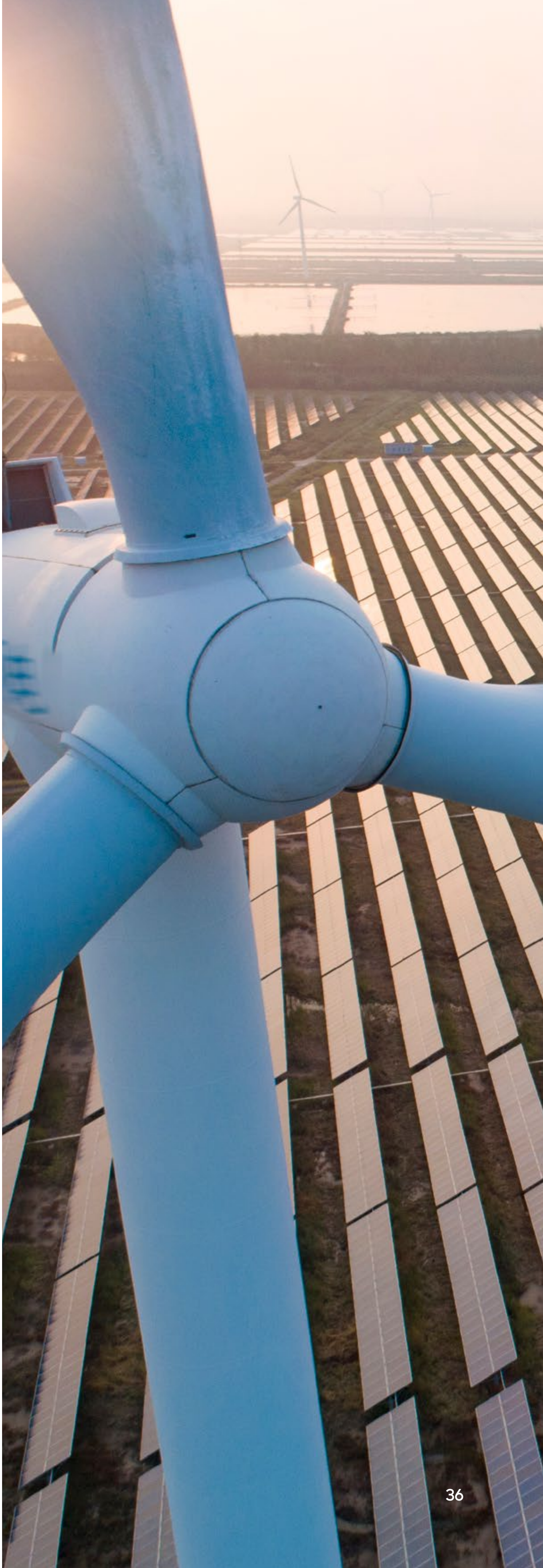
- 53% of French insurers, primarily mutual insurance companies, claim their sustainable investment strategies are values-driven.
- All respondents highlight regulation as a driving force for ESG, an illustration of the central role Article 173 has played in the mainstreaming of ESG in the French market.
- Likewise, ESG was considered a valuable risk-management tool by 87% of respondents, particularly when related to climate-related risk analyses (including stress tests and scenario analyses).
- Stakeholder expectations were a key factor for two sub-groups: mutual insurance firms who have frequent interactions with their members; and large (>€100 billion) commercial firms with high reputational risk.

Key ESG practices

- ESG practices in France were historically focused on two approaches: sector-based exclusions (93% of respondents exclude coal, 53% exclude tobacco) and best-in-class ESG integration (mostly based on the computation of scores and the exclusion of low-rated firms).
- While 87% of respondents either have an active voting policy or engage with issuers, this practice is seldom central to insurers' sustainability practices, primarily as a result of French insurers' low equity exposure.
- As insurers gear up with dedicated resources, practices are becoming more complex with the introduction of climate stress tests, bondholder engagement and impact investments.

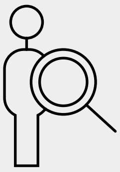
What next?

- Climate change will continue to be a central focus, whether in the form of increasingly granular analyses (scenario analyses, climate stress tests, integration of climate risk in asset-liability-management frameworks) or through financing climate solutions, primarily through private assets.
- French insurers increasingly recognise the limitation of their traditional best-in-class approach to ESG integration and will seek to address the most material issues individually. Recent initiatives in biodiversity assessments and local job creation indicate this return to more tangible analyses and away from all-encompassing scores.
- Finally, French insurers will benefit from the Article 173 experience and are likely to have a head start in SFDR reporting. This is despite national/European contradictions, which still need to be ironed out.



Country focus:

UK

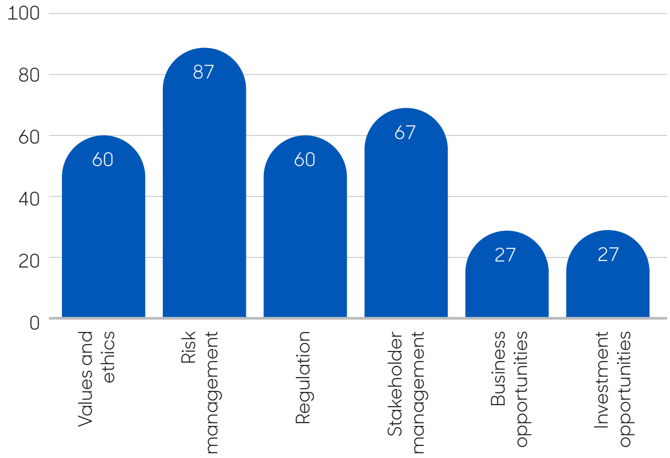


Overview

- Sustainable investment in the UK has predominantly been driven by pension institutions, particularly local-government pension schemes and foundations/religious institutions, giving the UK the longest history of ethical investing. However, large insurance companies, with the significant support of their affiliated managers, are catching up fast.
- 47% of respondents formalised their first ESG policies less than two years ago. Respondents are clear that this is a first step and that the UK's efforts to become the leading sustainable finance hub will inevitably require insurance companies to take a key role.
- The most advanced ESG players in this market draw their expertise from affiliated managers or their strong ties to Continental-based insurance branches (in the Netherlands, Switzerland or France).
- Others are looking to third-party asset managers for this expertise and can be considered ESG-takers. Significant opportunities exist for asset managers to accompany this evolution and provide ESG services and products.

Chart 21: Main drivers of sustainable investment practices

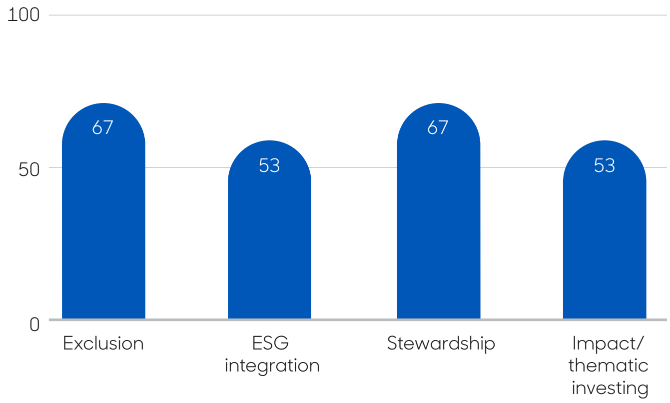
(% of respondents)



Source: abrdn ESG Insurance Survey, April 2021.

Chart 22: Main sustainable investment practices

(% of respondents)



Source: abrdn ESG Insurance Survey, April 2021.

Key drivers of ESG

- Ethical products have existed in the UK since the 1960s, primarily as a result of demand from foundations and religious institutions. This background has since shaped values-driven investing in the wider investment landscape, including among insurance companies who see ESG as an opportunity to apply values to investment (60% of UK respondents).
- Regulation, or the anticipation of regulation, has become a key driver for 60% of insurance companies to consider ESG and, more specifically, climate change.
- However, risk-management objectives are the main driver identified among insurance companies (87% of respondents).

- 73% of life-insurance companies highlighted stakeholder pressure as a key motivation to develop sustainable practices and offer new products to demanding clients. By contrast, P&C insurers and reinsurance companies were less exposed to this pressure.

Key ESG practices

- Insurance companies have emphasised the importance of stewardship since the launch of the UK Stewardship Code in 2012.

  The 2020 revised code has expanded the definition of stewardship. Its aim is now to lead to "sustainable benefits for the economy, the environment and society."
- 67% of respondents undertake stewardship activities, whether through voting policies or direct dialogue with companies. The balance is primarily composed of smaller insurance companies with limited resources to engage on their own.
- As a result, UK insurers tend to err on the side of dialogue in the exclusion-engagement debate and therefore have few systematic exclusions beyond controversial activities (e.g. weapons, gambling).
- While climate change is rising up the agenda, UK insurers also have dedicated social objectives with investments in social housing and infrastructure or the inclusion of diversity criteria in RFPs for assets managed by third parties.

What next?

- Pressure continues to rise – from clients, employees and regulators. This will encourage insurance firms to pursue sustainable investment.
- The PRA's recent supervisory statement on management of climate-related risks is likely to spur innovation among insurance companies and their managers.
- More so than in continental markets, respondents, particularly smaller insurance companies, highlighted that they will rely heavily on their asset managers' expertise and services to stay up to speed with regulatory and market evolutions.
- It is still unclear whether insurance companies will be subject to the EU's SFDR, particularly as the UK government and regulators have chosen not to refer to the European initiative in their roadmap towards mandatory climate-related disclosures, published in November 2020.
- Insurers will nonetheless be subject to regulatory climate disclosure as the FCA is set to require asset managers, life insurers and pension providers to comply with mandatory TCFD-aligned disclosures.

Country focus:

Germany

Overview

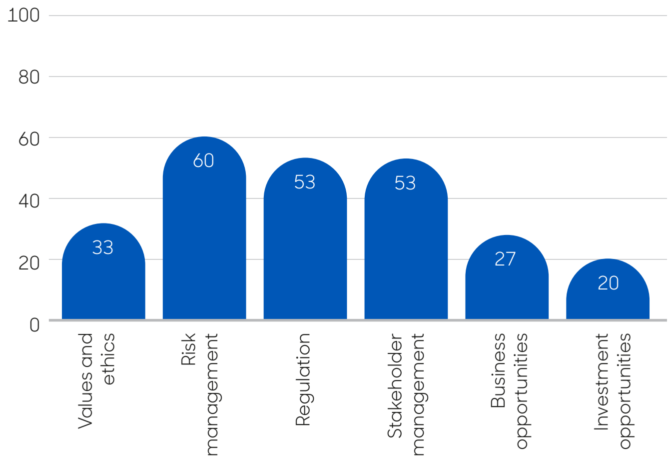
- The German insurance market is highly polarised around sustainable investment practices.
- Large multinational institutions appear as market leaders with established practices and dedicated resources. Smaller institutions have struggled to keep up the pace and have long waited for regulators to take up the subject.
- The recent SFDR guidelines are a catalyst for German insurance companies to catch up with their European peers.
- For smaller insurance companies, Master-KVGs (the preferred investment platform for German institutional investors) play an important ESG role. They act as the first screen for third-party managers and ensure implementation of exclusion lists.

Key drivers of ESG

- The materiality of ESG is still debated among German insurers: 40% of respondents do not believe that active consideration of ESG factors can lower financial risks.
- Regulation is the clearest ESG driver for German insurers, particularly with the introduction of European-level disclosure requirements.
- Stakeholders, particularly employees, have been a driving force for German insurers, followed by increasing expectations from life-insurance clients.
- Few respondents (33% of the panel) sought to implement their organisation's values in their investment strategies.

Chart 23: Main drivers of sustainable investment practices

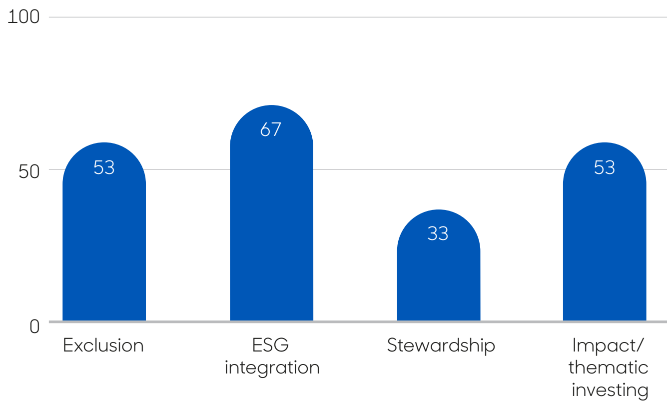
(% of respondents)



Source: abrdn ESG Insurance Survey, April 2021.

Chart 24: Main sustainable investment practices

(% of respondents)



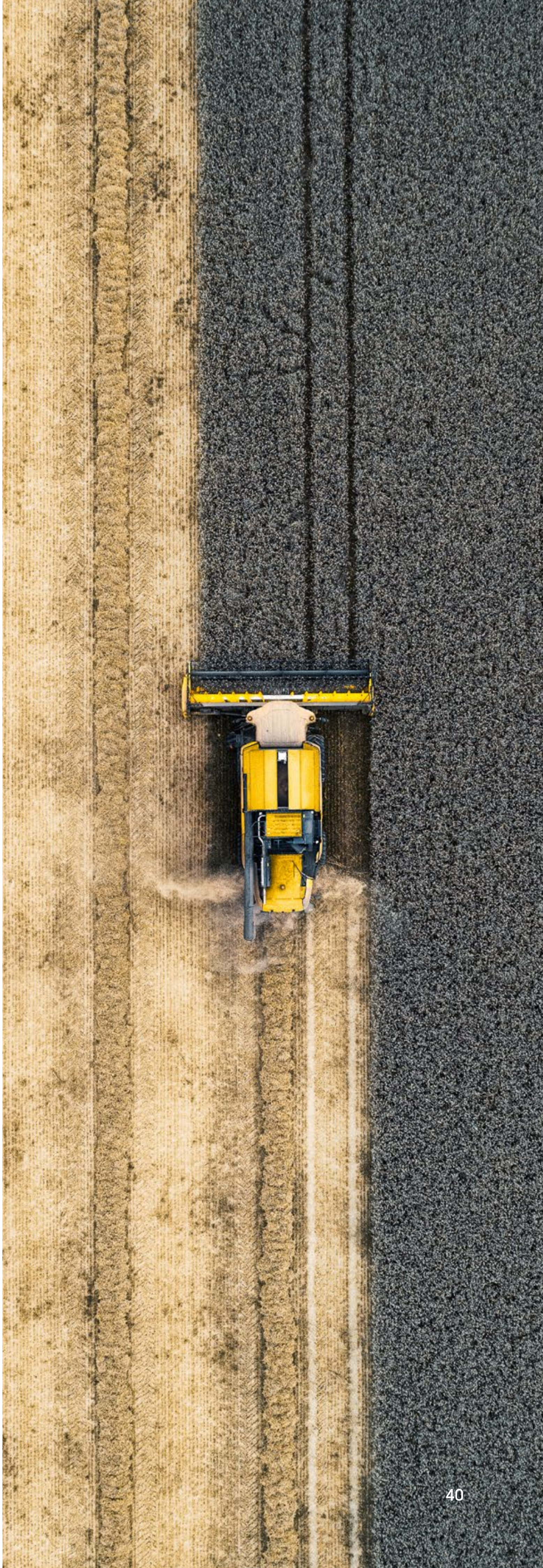
Source: abrdn ESG Insurance Survey, April 2021.

Key ESG practices

- 53% of German insurers have ESG exclusion lists, with coal and nuclear weapons being the most frequently banned areas.
- ESG integration is the most common practice in Germany with two-thirds of respondents conducting extra-financial analyses before investments. Among smaller insurance firms, this relies on the use of third-party data providers rather than proprietary analysis.
- Stewardship is a relatively rare practice among German insurers. Only one-third of respondents have dedicated ESG voting policies or enter into dialogue, individually or collectively, with issuers.

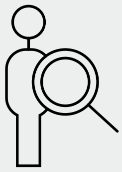
What next?

- The EU's SFDR will impact the German insurance market more than other European markets. Respondents indicate that they had been waiting for a harmonised regulatory framework before delving into ESG.
- In response to this new regulation, German insurers are gearing up to formalise their approach. Their late-bloomer positioning will prove beneficial as they will start with a near-clean slate and develop practices along the lines of the EU's recommendations.
- Nonetheless, most German insurers will continue to rely on third-party providers in the short term to conduct and report ESG analyses. Asset managers may play an important role in helping smaller insurance companies to navigate the new regulatory environment.
- Large multinational insurance companies are likely to provide a blueprint for the rest of the market to follow in defining their sustainable investment approach.



Country focus:

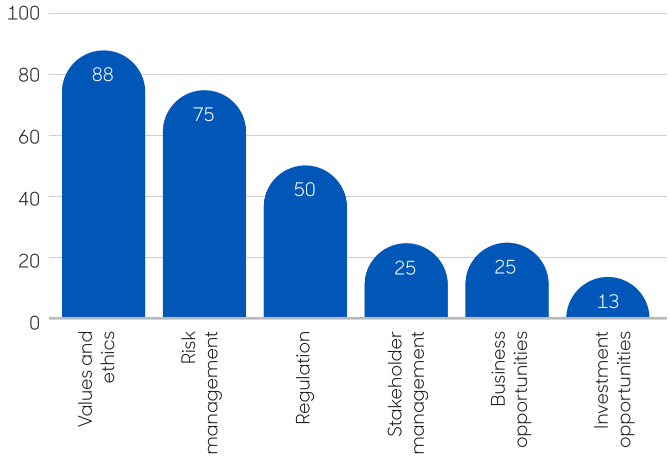
Italy



Overview

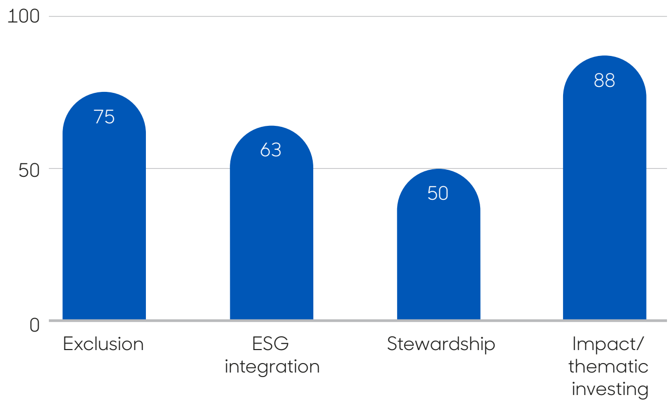
- Italy's sustainable investment landscape is hugely diverse.
- Advanced players fall into two categories:
  - international groups benefiting from advances in neighbouring countries to develop their practices at home
  - or firms with sustainability at their heart. After building capabilities in CSR, they're now focusing on investments.
- Half of firms lag their asset managers and aren't looking to take on the role of 'ESG makers'. This means they will need asset manager support to keep up with regulation.

Chart 25: Main drivers of sustainable investment practices



Source: abrdn ESG Insurance Survey, April 2021.

Chart 26: Main sustainable investment practices



Source: abrdn ESG Insurance Survey, April 2021.

Key drivers of ESG

- Italian regulators have not taken a stance on sustainable investing, resulting in local firms lagging their European counterparts in their uptake of ESG.
- Insurers in Italy have historically been close to society. For this reason, values and ethics are a key motivation for 88% of respondents to adopt sustainable investment practices.
- All respondents agree that ESG considerations can lower financial risks, but only 75% of them consider risk management a main motivation to develop sustainable investment practices.
- Stakeholder pressure was a key motivation for 25% of respondents, mainly large insurance firms, demonstrating the lower level of interest towards ESG from Italian markets, NGOs and clients.

Key ESG practices

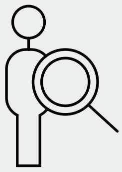
- Italian firms rely heavily on exclusions (75% of respondents), with ESG integration and stewardship popular but limited to advanced players.
- Impact investing is adopted by 88% of respondents and relates to illiquid asset classes, which are usually managed externally and represent a minority of insurance firms' portfolios.
- Most efforts around ESG have been on the 'E' factor, with 63% of respondents saying that they have implemented measures to fight climate change. But only 60% of them have specific CO_2 reduction targets.
- Having dedicated sustainability resources is common in Italy. But in 75% of cases, these resources are separate from the investment department and focus on CSR. So companies are struggling to integrate sustainability in investment considerations.

What next?

- The importance of sustainability in investment decisions is rising, and future changes in the European regulatory environment will move smaller or lagging firms to update their policies to reflect the new normal set by the most advanced players in Europe.
- Insurers will shift their focus from CSR to reflect their values in their investment decisions as well. This is a change that will most likely require the guidance of experienced asset managers.
- While firms update their internal capabilities, they will try to build exposure to ESG by investing in sustainable products, such as green bonds and impact funds.
- Climate change will remain at the heart of sustainable endeavours, with a probable increase in insurers' efforts towards the 'S' factor and therefore towards Italy's numerous small and medium-sized enterprises, which have been severely affected by the Covid-19 pandemic.

Country focus:

Switzerland

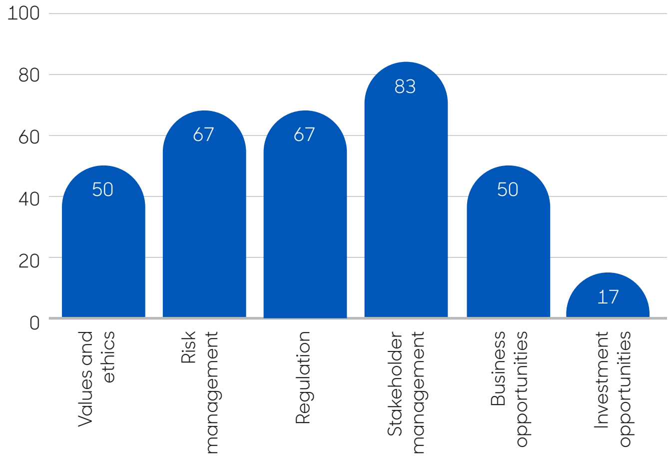


Overview

- Swiss insurance companies are currently moving quickly on ESG having been less active on the topic than their European counterparts for some years. However, there is a degree of polarisation within the country.
- Large groups with international activities are clearly leading the way. They are taking advantage of their more advanced expertise, stemming from their need to comply with regulations in neighbouring European countries, and are now using it as a differentiator.
- Smaller and purely domestic players have had no regulatory reason to step ahead so far but are just now in the process of reacting to increased stakeholder pressure.

Chart 27: Main drivers of sustainable investment practices

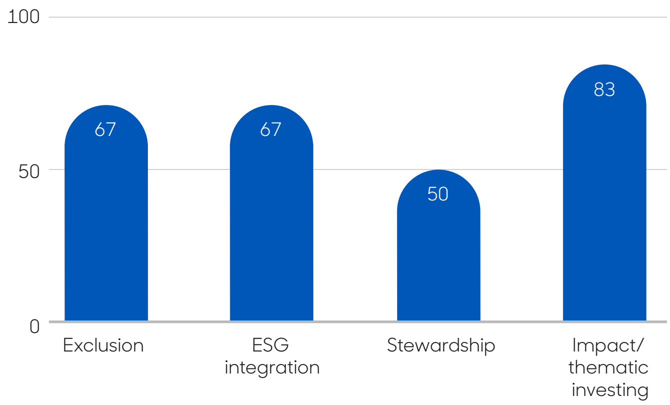
(% of respondents)



Source: abrdn ESG Insurance Survey, April 2021.

Chart 28: Main sustainable investment practices

(% of respondents)



Source: abrdn ESG Insurance Survey, April 2021.

Key drivers of ESG

- Although there is not one dominant driver for Swiss insurance companies to engage on the sustainability route today, public opinion and the general trend in the financial industry appear to be very strong.
- Stakeholder pressure is mentioned by 87% of Swiss respondents, in particular by life-insurance companies. Pressure is stemming as much from life-insurance clients as from NGOs and employees.
- Two-thirds of insurance companies acknowledge ESG considerations as a valuable risk-management tool.
- Only 50% of respondents identify their company's values as a driver for their sustainable investment policy, the lowest figure across the five markets studied.
- Swiss regulation is not currently stringent, but 67% indicate that they want to be prepared for more stringent regulation in future.

Key ESG practices

- All medium and large insurance companies apply exclusions. The use of exclusions was initially driven by the pension-fund industry through an exclusion list drafted by the Swiss Association for Responsible Investments (SVVK). It was quickly adopted across the country and now serves as a baseline for insurance companies.
- Two-thirds of insurance companies adopt ESG integration practices, most often in the form of qualitative ex ante analysis of ESG factors. In these cases, ESG criteria are an integral part of the investment framework. In most cases (67% of respondents), there are specified portfolio-wide ESG objectives.
- Impact and thematic investments play an important role, with 83% of insurance companies being active in the field, primarily through green-bond investments and renewable-energy infrastructure, in Switzerland as well as abroad.

What next?

- Regulatory pressure from Swiss authorities, which has so far been minimal, is expected to pick up over the next few years. This is in addition to the European regulation coming into force and affecting the significant proportion of Swiss insurance companies that are active in surrounding countries.
- Most companies indicate that they are working on the co-ordination of their corporate and sustainability policy to consistently address the asset and liability side of their balance sheets.
- Clients' expectations are increasing over time, which will create pressure to move towards explicitly sustainable products.
- The flexibility and agility to build tailor-made ESG solutions for any investor's specific need is seen as the most important requirement of asset managers.

Key takeaways

France

Following the implementation of disclosure regulation in 2016, widespread uptake of sustainable finance is likely to foreshadow the effects of the SFDR on lagging markets.

UK

Drawing on their longstanding experience with ethical products and stewardship activities, UK insurance companies will pursue their journey towards the new frameworks of sustainable investing, buoyed by strong local regulation and large internationally affiliated managers.

Germany

The lack of local regulation and clear methodological harmonisation has hindered development of sustainable investment practices among domestic German insurers, who are nonetheless the most likely to undergo a significant change following SFDR implementation.

Italy

Most sustainable investment practices in Italy are driven by values, translating into a relatively high rate of impact-investment initiatives. Extra-financial considerations are sometimes confined to the realm of CSR and kept away from investment decisions.

Switzerland

International insurance companies are showing the way for the rest of the market, encouraged by rising stakeholder pressure and the business opportunity that differentiation through sustainability can bring.

Beyond Europe: insights from global insurance firms on Asian and North American ESG

During this research, we interviewed several global insurance firms. Their insight revealed Europe's relative maturity, in terms of its sustainable investment practices, compared with other markets.

Europe has a head start on sustainability, compared with their American and Asian counterparts, according to respondents. However, these markets may quickly catch up as they build on Europe's experience to develop their own frameworks.

Asia – ESG building momentum

In the Asian market, ESG is picking up significant steam and is now widely embraced.

Initiatives are very heterogeneous across countries, as local governments and industry associations attempt to tackle the issue in their own way. The challenge that European companies face in accessing quality ESG data is even more relevant in Asia's emerging markets. Practices are likely to diverge from European approaches, particularly regarding the exclusion of coal, on which many local economies still rely.

We can roughly segment the Asian marketplace along a number of different axes.

- **Developed, low-yielding economies** with the presence of either a dominant pension-fund industry or a sovereign-wealth fund and liquid capital markets.
  - The most prominent markets in this category are Japan, South Korea, Taiwan and (to a lesser extent) Thailand and Malaysia.
  - These markets resemble Europe in their regulatory initiatives and as investors follow the example set by the dominant institutional investors. Liquid capital markets allow for the development of sustainable investment products.
  - Taiwan focuses more on engagement and voting while other markets emphasise transparency on carbon footprints and their reduction.

- **Emerging, higher-yielding, fossil-fuel-dependent economies** with relatively illiquid, underdeveloped capital markets.
  - These provide a major obstacle to the transition towards ESG.
  - Initiatives focus less on environment and more on the social factors. Inclusive finance and health & protection take precedence over climate and carbon-footprint-oriented goals.
  - Energy transition is hindered by underdeveloped and very concentrated capital markets, forming a major obstacle for corporate enterprise. In this area, Covid-19 and recent financial crises have made access to developed-market capital more difficult. However, multinational organisations and foundations can play a role in enabling better access, as well as in the energy transition.

    GuarantCo and CGIF are examples of foreign initiatives providing easier and less costly access to capital.
  - Some markets have embarked on better ESG reporting, notably Indonesia. Here, the local regulator is forcing all banks and non-bank financial institutions to submit annual ESG reports by 2025. So far, the emphasis is more on governance disclosure and risk management and less on environmental and social aspects. The key challenge is the lack of uniform ESG metrics, although expectations are that the mandatory reporting will bring transparency and action.
- **China sits in a category by itself**. While it has some of the characteristics of the second group, it also has a well-developed capital market. So far, the main initiative has been the issuance of green bonds.

North America – ESG not in the mainstream, yet In North America, the lack of regulation has led to a very diverse landscape in which ESG has yet to become mainstream. Nonetheless, the dominant approach focuses on materiality.

Fiduciary concerns have led American institutional investors to adopt ESG practices to the extent they contribute to the risk-return objectives of their mandate. Risk management is therefore the key driver as shown by the growing interest of California-based institutions following the materialisation of the physical impacts of climate change.

In both markets, most ESG initiatives are led by large institutional investors (sovereign-wealth funds, pension institutions), but rarely by insurance companies. Global insurance firms with a solid European footprint are likely to stay ahead of the curve as they will be the first to apply their experience globally.

" The firm operates in three main markets, and even though the investment styles tend to match, our board in the US is a bit less interested in taking into account ESG considerations compared with the European and Australian counterparts. Generally, US insurance firms are lagging behind in terms of sustainable investment practices."

Life insurer, UK

" Our first wake-up call in terms of sustainable investment practices came from the American side of the business as, after the recent wildfires, the Californian regulator introduced measures for insurance firms in terms of their portfolios' carbon emissions."

Life insurer, UK

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