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Robeco Insurance Solutions

Weathering the storm – how insurers are tackling climate change

- Most insurers have signed or will adopt the Net Zero Carbon Pledge
- Oil and gas remains a sticking point but engagement is preferred
- Portfolios can be remodelled and rebalanced for decarbonization

Climate change has become one of the biggest issues facing insurers. They are uniquely vulnerable to global warming on both sides of their balance sheet, facing higher weather-related claims and the need to decarbonize their assets. In this interview, Ed Collinge, Robeco's Head of Global Insurance Strategy, gives his thoughts on how insurers are dealing with it.

How are insurers tackling climate change?

Article
For professional investors
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Ed Collinge, Head of Global Insurance Strategy

To use a weather analogy… with increasing wind speed. The 2022 Robeco Global Climate Survey shows that 84% of investors say that climate change will be central or a significant factor in their investment policy over the next two years. That's a huge rise from the 34% who said this two years ago.

And insurance companies also strongly believe in doing something about climate change, as the survey shows that 59% have now signed up to the Net Zero Carbon pledge, which commits asset owners to making their assets carbon neutral by 2050. That's a huge amount of investors who are saying they're going to reduce the carbon in their portfolios by around 25% over the next five years.

If you include those who are investigating it as well, basically 90% of insurance companies are on the verge, or have already signed up to, net zero. In all, firms controlling about

USD 12 trillion of assets are now committed to the Net-Zero Asset Owners Alliance, including many of the world's largest insurers.

In terms of this kind of impact, we're moving from ESG integration to a broader desire to make a real-world impact – how does that play out?

There's been a structural shift in the last few years away from ESG integration, which Robeco has been doing since 2010, much more towards wanting to make an impact through an investment strategy. Climate is the one area that has really resonated across insurance companies globally as it offers a clear means of making the right impact. You just have to look to COP26 in Glasgow recently, where over 90% now of the world's GDP signed up to net zero, limiting the impacts of climate change.

Wanting to make a broader impact also really came through in the climate survey. Building that into the modeling for insurer portfolios has been really exciting. Recently we've been working with UK insurers who've picked a number of the SDGs, where things like climate action, health and well-being mean something to them. They want to have a structural overweight in their public credit portfolios to firms that are making a positive impact to one or more of the SDGs. Using our SDG Framework, we can show an insurance company what the expected impact on returns will be by making these choices. It means we can offer innovative solutions to meet distinctive challenges.

'Clearly biodiversity is going to be the next big theme after climate'

Biodiversity also figures strongly in the climate survey; how will that play out?

This was quite an interesting outcome. You can focus on climate and getting to net zero, but that doesn't really help us if we've destroyed all the rainforests and the natural ecology of the planet. Biodiversity is actually a natural extension of the focus on climate. The regulators, in France, for example, now require insurance companies to have a policy on biodiversity. It only makes sense that as more people are focused on climate, then biodiversity comes to the fore.

Unfortunately, biodiversity is not yet seen as being important in the context of investing in the Sustainable Development Goals. The climate survey shows that 68% of people plan to follow SDG 13 for climate action, but if you look to biodiversity – SDG 14 (life below the sea) and SDG 15 (life above land) – that figure is only 27%. When you ask them what are you going to be doing about biodiversity in two years' time, however, that 27% figure on biodiversity jumps to 55%. So, clearly biodiversity is going to be the next big theme after climate.

Why are so many investors planning to divest from oil and gas companies if they are changing their business models and making net-zero commitments?

If you sign up to net zero or moving to a lower-carbon world, there are two things you can do. You can make a proactive choice to change your investment portfolio, which is where 22% of investors in the climate survey are saying they'll exclude the majority of the energy sector, because clearly that will mean a big reduction in CO_2 in their portfolios. But that doesn't get rid of the core problem, because for us to get to net zero, we need to change the companies operating in the underlying economy. We're doing that through active engagement and active ownership; if you no longer invest in energy companies, then you lose your voice, and the ability to change these companies.

Subsequently, the majority of investors, and insurance companies in particular, are beginning to embrace how they can actively engage on behalf of the assets they own. Rather than leaving it to their asset management partners to do the active engagement and ownership, which they perhaps did historically, they're now centralizing that process and having a voice themselves in terms of how they engage with corporates or sectors to make that change.

This will actually change industries as well, because an oil company signing up to net zero, for example, is going to be a very different firm in 10, 20, or 30 years' time than the one you are invested in today, as they move to renewable technologies and the like. From the scale of the net-zero transition, you get a sense of its potential to make a positive impact.

What is now driving the insurance agenda globally and insurance portfolio allocation themes?

Five years ago, there was a huge structural shift into selling unit-linked or variable annuity business, where the policy holder is taking the investment risk rather than the insurance company, and that hasn't changed. What has changed is the ESG element. In Europe, the EU has basically forced insurance companies to have an ESG framework, and that's something that sits well with them, given their role in providing downside protection in any unfortunate scenario.

The US was not really bothered about ESG until regulators started to bring in stress tests and consultation papers on everything to do with climate. The NAIC and New York regulator are now specifically looking at how much climate exposure New York-based insurance companies have. This is hugely exciting, because for the first time ever, we have pretty much a global movement towards more sustainable investing from insurance companies.

'For the first time ever, we have a global movement towards more sustainable investing from insurance companies'

Can insurers just 'flip a switch' to get to net zero, or is it much more complex?

Taking that step to net zero is a leap of faith because you're talking about timeframes over the next 28 years until we get to 2050. And none of us know exactly what's going to happen over the next 28 years. So when people sign up to net zero, it's not the flip of a switch where everything changes overnight. Insurance companies are clearly medium to long-term investors, so it's not a case of just suddenly changing the investment portfolio: it's about looking at how they are going to bring in a reduction of 5% of CO_2 per annum in their portfolios.

Part of that is finding out the current carbon position of the insurance company's portfolio, which requires reliable data. We've beefed up our data capabilities in recent years by hiring data scientists who can crunch all the numbers and make sense of it all. Building this into insurance analytics is something we do a huge amount of really cool work on, bringing in all those insurance constraints, cashflow matching and sustainability – whether it's impact investing or carbon reduction – and building that into a portfolio.

What about the problems with getting hold of this data and the consistency of measurement?

This is an area that's improving – carbon data is getting pretty reasonable now. You ultimately have three different flavors: scope 1 is the carbon the company produces itself; scope 2 is the carbon produced by the energy needed to produce its product; and scope 3 comes from how the product is used. If you think of a car manufacturer, scope 3 is everyone driving their cars around. Scope 1 and 2 data is pretty reliable, and scope 3 in how the end-product is used is pretty reliable for some industries. But there's still a lot of opaqueness in certain industries, for example in the banking sector, where it's much harder to find out the carbon that is being produced as a result of their lending. This clearly is a work in progress.

We do though have a pretty reasonable starting point and you've got to start somewhere, because this isn't something that's going away. You really can't sit on your hands and just say that we'll wait five years for the perfect data, because then the market will have moved away from you anyway. You need to focus on the sort of analytics that you can look at now.

How would decarbonizing portfolios work in practice without simply excluding the high emitters?

A good example is looking at the funding behind where most of the carbon is held. The utilities and energy companies responsible for much of the emissions issue a lot of long-dated debt. So, if you're a life insurer, you're probably sitting on these 20-year-plus bonds that are in high carbon intensive industries. And if you run off their portfolios over time, the carbon intensity is going up in their book rather than down, because they've got their carbon at the long end.

‘You really can't sit on your hands and just say that we'll wait five years for the perfect data’

What an insurer might do is rebalance their portfolio when credits mature, so that when money is available to reinvest, they won't stick it at the long end of the curve in terms of where the carbon exposure is – they can start bringing it forward. This means you won’t become a forced seller of carbon at some point in your net-zero journey. And we’re only talking about achieving 5%-7% of carbon reduction per year to remain on a net-zero pathway.

Human nature is to kick the can down the road, and 28 years is a long time. Will the selling pressure grow as we get closer to 2050?

By investing in the lower-carbon companies today, you should benefit in the long term, because you won't become a forced seller in the future. And ultimately these should be the companies that will do much better than others, particularly if you're in a sector like energy, where people want to keep investing in it, but they want to find the firms that are on the right carbon trajectory.

This is something that we build into our fundamental analysis now, looking at the world's 200 worst carbon emitters and examining their current trajectories to net zero. Most of them haven't yet signed up to net zero, so we need to engage with them to get a plan in place. The companies that do have a clear plan are going to be the winners.

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