Robeco Insurance Solutions

The road to impact investing – a journey for insurers

- Impact investing is increasingly important for sustainability agendas
- Sustainable Development Goals offer a means of making an impact
- Robeco's strategies usable for unit-linked platforms and balance sheets

Sustainable investing has risen to the top of insurance companies' agendas, and global interest in it is snowballing. Five years ago, it was mainly Northern European insurers who were considering the relatively new concept called ESG integration as part of their investment criteria. But with climate change rapidly becoming a global concern, and Covid-19 changing how we live, the use of environmental, social and governance factors has become a global phenomenon. Insurers from the US to Asia are listing sustainable investing as their top priority for 2021 and beyond. What may be still missing though is how to make an impact in the process.

Article
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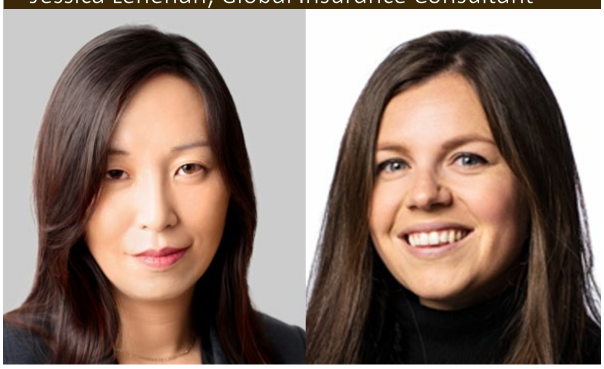


Yet, climate change is only part of the issue. Modern crises around biodiversity, food and water insecurity, inequality, human rights and other major issues cannot be ignored. And then we have the pandemic, which has put a greater focus on the importance (and fragility) of human life.

The S in ESG has gone from being the awkward middle child to something taken far more seriously in how it can be used to make an impact in investing. In this paper, we focus on how insurance companies are framing their agendas around sustainability, and the different impact investment tools they are using to translate their sustainability goals into tangible results.

What is impact investing?

Firstly, what is impact investing? The most commonly used definition is: "Investments that are made in companies, organizations and strategies with the intention of generating a social and environmental impact, alongside a financial return." There are three key elements to it:

- **Intentionality:** the investment should intend to create a positive social and/or environmental impact
- **Financial return:** the investment is expected to generate a financial return
- **Impact measurement:** the intended and non-intended impacts need to be measured and reported on.

So, before investing, it needs to be clearly defined what is the strategy's intended impact, and what is the expected return (and risk). Based on this intent, the methods for measuring for impact can be defined and monitored.

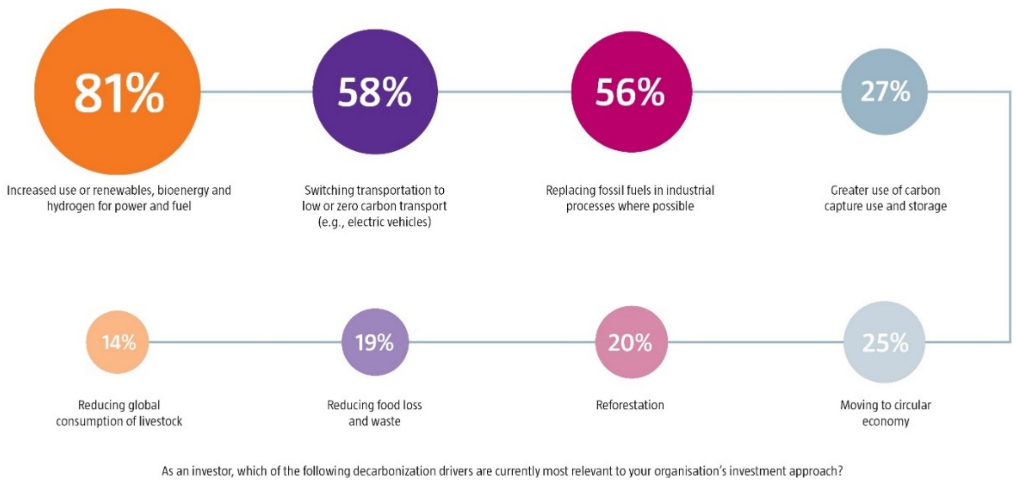
The principal differences between ESG integration and impact investing

Source: Robeco

The need for more impactful investing is well documented. Climate change affects both sides of an insurer's balance sheet, and it has become a regulatory necessity for insurers to address the issue. Across the globe, regulators are demanding stress tests on climate risk and may start seeking capital charges for 'brown' assets, while society is increasingly demanding that investments made on their behalf make a difference to the world.

And this need for change is clearly being reflected in the approach of institutional investors to their investment portfolios. Robeco recently conducted a Global Climate Survey among 300 institutional, insurance and wholesale investors accounting for more than 20% of total global assets. The results demonstrated the urgency and opportunities of climate investing, with 70% of all insurers now including climate in their investment process, and half of all institutions committing to net-zero carbon in the coming years.

Decarbonization drivers for investors



Source: Robeco 2021 Global Climate Survey

How are insurers approaching sustainability?

An overarching insurance theme seen globally is the public response to climate change and sustainability in general. The most marked reaction in the drive to align sustainable investing with public and governmental expectations has been the number of large insurers signing up to global initiatives. These include the UN-convened Net Zero Asset Owner Alliance, and the Net Zero Investment Framework, which both target net-zero greenhouse gas emissions by 2050. However, the fulfilment of these large promises requires smaller and more practical steps.

Insurers are approaching sustainability holistically, both through their protection and investment products, as well as via their own general account. There are also different extents to which sustainability is addressed, from the more basic ESG integration into the general investment process, to the more explicit areas such as buying impact investing products. What is particularly interesting and encouraging is that the largest insurers have begun to create their own sustainability agendas, on which they report progress annually. The scope of these agendas includes not only corporate social responsibility work, which tends to have a regional skew according to the locale of the insurer, but also what the company is contributing for the food of society.

How has the sustainability story developed over time with insurers?

Sustainable investing really came to the fore for insurance companies in the early 2010s, which coincided with the first real awareness that the Earth was facing a climate crisis. During this time, insurers and other institutional investors began to introduce 'responsible' policies, often focused on the exclusion of particularly carbon intensive and/or socially disruptive industries. More explicit ESG integration policies have been put in place, and most large insurers have signed up to extensive engagement and voting programmes.

Focusing on impact investing has become a core tenet of an insurer's sustainability and community engagement approach. It is not a completely new theme, though its scope and complexity has developed over the last decade. There has been a move from direct impact investing through vehicles such as green infrastructure or property, to more indirect impact investing, which does not directly provide additional money to physical green projects, but supports wider sustainability themes. These have gained in prominence since the introduction of the UN's Sustainable Development Goals (SDGs) in 2015.

Using the Sustainable Development Goals as a focus

Source: UN

Common impact investments tend to be focused in a few key areas, such as green bonds and green infrastructure, and also through SDG strategies. The former are the more traditional impact investments, with the latter becoming more popular in the last few years. In fact, many insurers now frame their sustainability agenda through the 17 SDGs, and therefore tend to pick either the full spectrum of goals to invest in, or a few specific goals which reflect their sustainability aims.

The 17 SDGs have made impact investing much easier, as they allowed insurers to pick out the issues that matter most to them. To demonstrate how the UN SDG's are becoming central to insurers' approaches to sustainability, the following table shows a peer analysis of some of the largest insurance companies globally and the SDGs they are looking to contribute to. These SDGs are published publicly within each insurer's sustainability agenda.

A peer analysis of the SDGs selected by 15 insurers

SDG Goals	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	Total
Aegon	✓		✓				✓	✓					✓					5
AIA	✓		✓	✓	✓					✓	✓		✓			✓		8
Allianz	✓						✓	✓	✓	✓	✓		✓				✓	8
CNP	✓		✓					✓		✓		✓	✓					6
Generali			✓		✓				✓				✓					4
Great Eastern Life			✓				✓	✓	✓				✓					5
IAG								✓	✓		✓		✓					4
Japan Post Insurance			✓	✓				✓			✓		✓		✓	✓		7
L&G			✓		✓		✓	✓	✓		✓		✓					7
Manulife			✓		✓		✓	✓		✓			✓					6
Munich Re	✓	✓	✓				✓	✓	✓		✓		✓					8
Prudential plc	✓		✓					✓					✓					4
QBE	✓							✓		✓	✓		✓					5
SunLife of Canada			✓		✓		✓	✓					✓					5
Zurich			✓					✓			✓		✓					4

Source: Aegon, AIA, Allianz, CNP, Generali, Great Eastern Life, IAG, Japan Post Insurance, L&G, Manulife, Munich Re, Prudential PLC, QBE, SunLife of Canada, Zurich

Many insurance companies also use their impact allocations as part of their marketing efforts around sustainability in general. The larger insurers tend to release annual sustainability progress reports which highlight the work being completed through their impact investments.

A good example of this is L&G, which makes direct investments in sectors such as 'future cities' through its L&G Capital arm. The amount of capital invested and the number of new homes created are cited in the firm's annual progress report, alongside the ways in which the cities involved have been made more sustainable for the future.

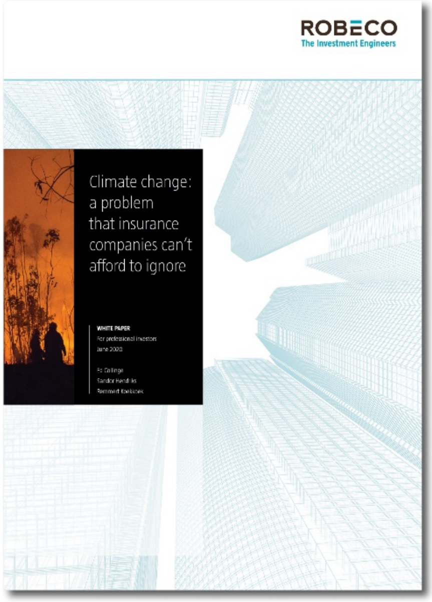
The availability of sustainable offerings on insurers' unit-linked platforms has also increased. These strategies labelled as 'ESG-focused' have become popular as interest in sustainability has risen in the public sphere. The most common ones offered tend to be thematic strategies, focusing on topics such as green technology, clean water and gender equality.

What insurance companies are investing in

The holistic approach by insurers to sustainability is evident through the development of their general account assets and the range of products on their unit-linked platforms. On the general account side, the basic means of adopting sustainability tends to be through ESG integration in investment decisions. Some may also want to see the ESG profiles of a portfolio bettering the benchmark by a certain percentage, particularly on carbon footprints or the intensity of water use, which are fairly straightforward to measure.

Another key topic is decarbonizing the balance sheet, as many insurers are focused on supporting the transition to a low-carbon economy. The latter trend is a topic we have discussed in our prior paper, 'The unique climate risks facing insurers'.

On the unit-linked side, explicitly ESG-focused offerings have become popular. These tend to use thematic strategies which focus on topics such as green technology, clean water and inequality. Larger insurers with asset management businesses are also building a new generation of climate and sustainability themed investment products that are open to outside investors, with some targeting the SDGs in a broader way.



Impact investing as a tool – tangible outcomes

Another important aspect of sustainable investing is how the chosen investment can be measured. It has led to a new phrase in asset management: 'If you can't measure it, you can't manage it.' This was quickly followed by: 'If you can measure it, you can improve it.'

At Robeco, we recognize the need for not only impact strategies that deliver financial returns, but ones that deliver tangible outcomes. The ability to measure the impact made is key to whether it can be properly described as impact investing.

There are three areas we focus on that are clearly measurable in terms of impact, and which we believe are valuable to insurers for both their balance sheet assets and unit-linked platforms:

1. Sustainable trends and thematic strategies
2. Strategies targeting the SDGs (both equity and credit)
3. Bespoke climate-focused and green bond strategies

Importantly, these offerings are structured not only as 'off-the-shelf' investment offerings, but also as customized segregated accounts. This means insurers can tailor the strategies according to their sustainability agendas.

The suitability of different types of strategy for an insurance company's purpose

	Trends & thematics	SDG Credits & equities	Climate fixed income funds	Green bonds
Insurance balance sheet	✓	✓	✓	✓
Unit linked platform	✓	✓	✓	✓
Asset class	Equities	Fixed income & equities	Fixed income	Fixed income
Purpose	Specific positive impact to sustainability themes	Broad sustainability purpose	Climate impact purpose	Environmental impact purpose
Fund offering	✓	✓	✓	✓
Seg account offering	✓	✓	✓	✓

Source: Robeco

1. Sustainable trends and thematic strategies

Trends and thematic strategies can be used to cover specific sustainability issues. They are being used by insurance companies as building blocks to create compelling ESG-focused unit-linked offerings on their platforms. These strategies are specific in nature and allow insurers to pick and choose their topic based on their own sustainability agendas.

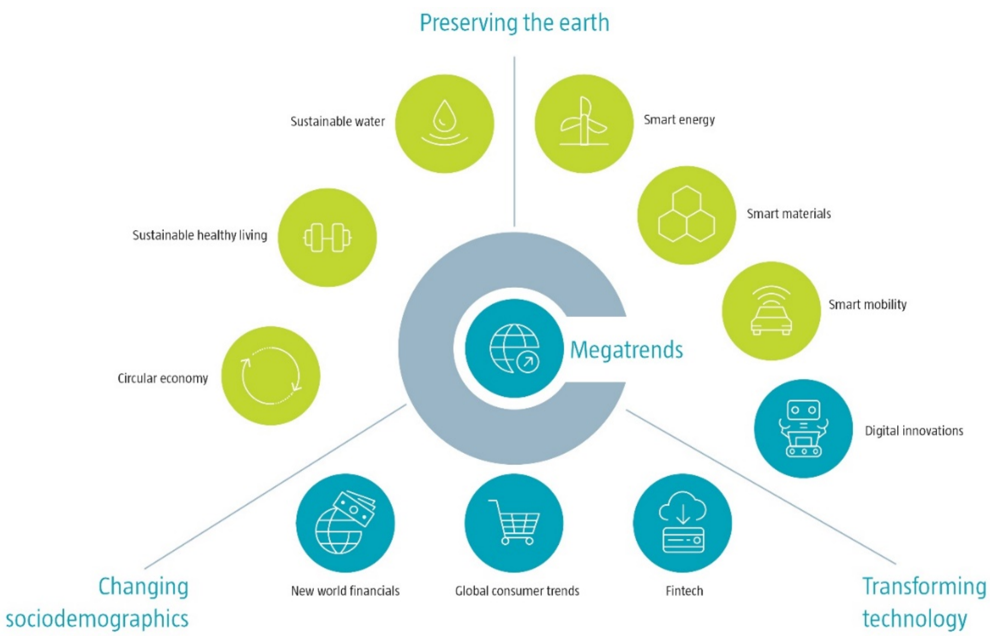
Robeco has offered trends and thematic strategies since the late 1990s. The suite of products is based on the concept of three megatrends that are shaping the world in the 21st century. These are 'Transforming technology', led by the inexorable rise of digitalization; 'Changing socio-demographics', including rising inequality which has got worse with the Covid-19 pandemic, and 'Preserving the Earth', addressing the profound impact of climate change.

The three megatrends that shape investment themes

Source: Robeco

All are investible, as the chart below shows, with some examples of the relevant Robeco and RobecoSAM strategy that invests in the companies operating under each theme.

A snapshot of Robeco strategies suitable for the three megatrends



Source: Robeco

The aim and SFDR classification of Robeco thematic stategies

	SDFR Classification	Aim of strategy
Sustainable water	9	Invests in structural winners along the water value chain, as water resources become more limited.
Sustainable Healthy Living	9	Invests in firms which capitalize on healthier lifestyles, focusing on consumer goods and health care
Circular economy	9	Invests in firms benefitting from the 'Make, remake and reuse' focus of the circular economy
Smart Energy	9	Invests in the transformation of energy to a low-carbon future, capturing the growth potential of decarbonization in the energy sector
Smart Materials	9	Invests in the transformation of the manufacturing supply chain through sustainable innovation
Smart Mobility	9	The mobility of the future is electric and this strategy invests in companies benefitting from the switch in transportation to a low-carbon future
Gender Equality	9	Invests in firms that are leaders in promoting gender diversity and equality
Digital Innovations	8	Focuses on robotics and automation, digital enablers and secure digital infrastructure growth
Fintech	8	Invests in the fintech universe sections of Payments, Security and Core Banking as the financial sector continually digitizes
Global Consumer Trends	8	Identifies strong global growth trends from a consumer spending perspective and invests in the winners
New World Financials	8	Invests in firms benefitting from attractive long term trends in Digital Finance, Ageing Finance and Emerging Finance

Source: Robeco

2. Strategies targeting the SDGs (both equity and credit)

The Sustainable Development Goals offer a focused form of impact investing, since investment strategies can target a goal directly, or a theme encompassing several of the goals. Robeco's SDG strategies, covering both fixed Income and equities, are suitable for insurers' balance sheets and unit-linked platforms.

Since many insurance companies focus on specific SDGs as part of their sustainability agendas, creating customised SDG strategies to target the relevant goals can contribute directly to reporting annual progress in sustainability agendas. In 2018, Robeco and RobecoSAM (now Robeco Switzerland) created a proprietary three-step framework to assess a company's contribution to one or more of the goals. A scoring system was then created that assesses both positive and negative impacts from the company's operations.

This enabled Robeco to become one of the first asset managers to launch an investment product specifically targeting the goals. From a standing start in 2018, the RobecoSAM Global SDG Credits strategy now has more than EUR 1 billion of assets under management, attracting investors from all over the world.

The framework assesses the suitability of candidate companies from a universe of about 600 bond issuers. This is narrowed down to about 50-60 bonds for the portfolio. The process asks three simple questions: What does the company do? How does it do this? And has it been involved in any controversies?

The three-step process for SDG Credits

Source: Robeco

Companies are given a score ranging from -3 (very bad) to +3 (very good) according to the negative or positive contribution it is making. The net score is then used to decide eligibility for the portfolio, with only positive net contributions considered.

This positive contribution doesn't just contribute to achieving the SDGs; it also benefits the investors in the strategy. Since Global SDG Credits strategy was launched, it has consistently outperformed its benchmark.

The suite of strategies has since been expanded to include three other fixed income strategies – Euro SDG Credits, SDG Credit Income and SDG High Yield Bonds – along with a sister strategy targeting equities. This Global SDG Equities strategy follows the same three-step selection process as its stablemate for credits, but looking at a company's shares rather than its bonds. This can mean different companies are selected if their equities offer better potential than their credits.

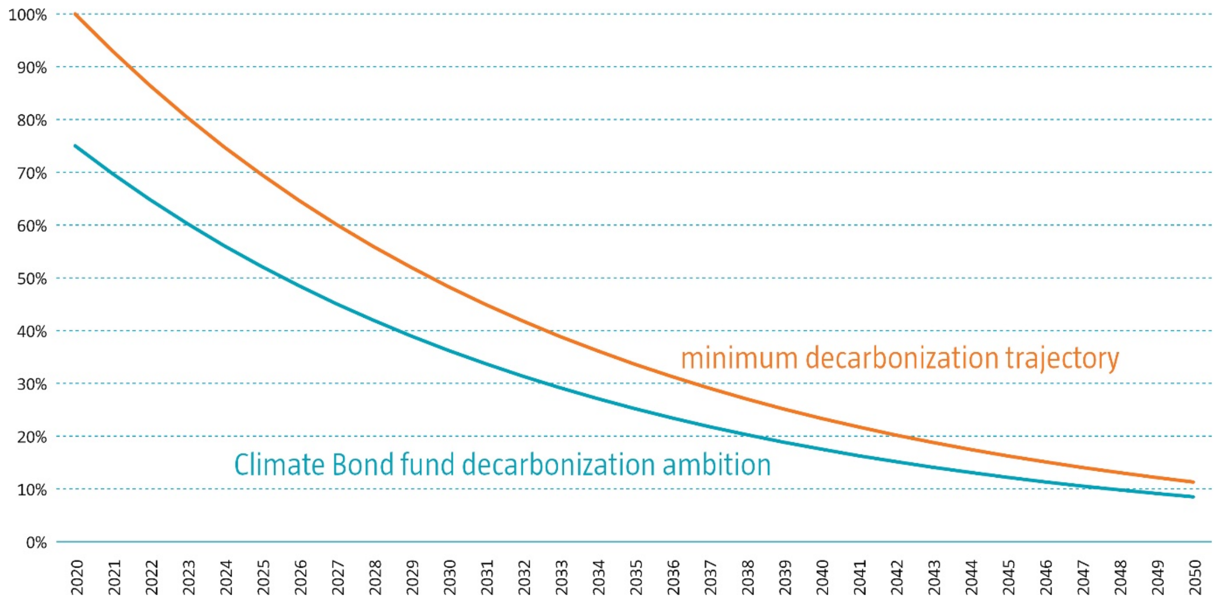
3. Climate-focused and green bond strategies

It is well documented that insurance companies are exposed to climate risks on both sides of the balance sheet. Decarbonizing portfolios offers a means of reducing climate risks on the assets side, and perhaps unsurprisingly the biggest demand to do this is within the fixed income space, as this is where insurers have most of their assets. Part of the work of Robeco's nine-strong Insurance and Pensions Solutions team is finding ways to achieve this within its insurance optimiser which targets both ALM considerations and carbon footprints

As a part of its climate change initiative, Robeco has become one of the first asset managers to launch climate fixed income strategies. Both are aligned with the Paris Agreement, which seeks to limit global warming to 2 degrees Celsius above pre-industrial levels, and ideally to a lower band of 1.5 degrees by 2050. RobecoSAM Climate Global Credits strategy invests in the bonds of companies whose activities are aligned with the 1.5 degree target, while Climate Global Bonds strategy invests in both credits and government bonds.

As there was no global benchmark for climate bonds, Robeco created a Paris Aligned Benchmark, as defined in EU regulation, in conjunction with Solactive, a German provider of financial indices. Performance will be measured against this index, rather than the usual benchmarks used for credit portfolios. It starts off with a 50% reduction in carbon compared to a standard credit benchmark, and then has an annual target of 7% decarbonization to be able to achieve carbon neutrality by 2050.

Decarbonization trajectories followed by the climate strategies



Source: Robeco

Candidates for the portfolios are those companies (or countries for sovereign bonds) that are committed to decarbonizing their business operations, and are either already aligned with the Paris Agreement's 1.5 degree target, or are on a trajectory to do so. As with the SDG strategies, a screening system is used to find these companies; high-carbon emitters which cannot or will not change are excluded.

Another area where insurers can make explicit impact allocations is through green bonds. These bonds are a means of investing in companies or organizations that use the proceeds to make a specific environmental impact, such as renewable energy or reforestation. They are typically issued by governments, agencies or supranationals, which means they can be bought across a wide spectrum, and not just from listed companies.

Robeco launched Global Green Bonds strategy in 2020 to tap into this growing universe. The eligibility of green bonds for the portfolio is based on an internally developed framework that targets those making a genuine environmental impact. A record amount of USD 222 billion in green bonds were issued in 2020, pushing the total amount now in existence above USD 1 trillion.

How regulation is helping

The move towards using sustainable investing as the rule rather than the exception has been boosted by a swathe of new EU regulations in the Sustainable Finance Action Plan. It represents the biggest regulatory change for insurers since Solvency II came into effect in 2016 to ensure greater stability following the financial crisis.

At the heart of the framework is the Sustainable Finance Disclosure Regulation (SFDR), a set of EU rules which aim to make the sustainability profile of investment products more comparable and better understood by end-investors. This will focus on pre-defined metrics for assessing the ESG outcomes of the investment process. As its name suggests, much more emphasis has been placed on disclosure, including new rules to identify any harmful impact made by the investee companies.

The most visible and impactful element of the SFDR the classification of investment products and mandates in three categories, as set out in Articles 6, 8 and 9. These aim to clearly label offerings across the EU to make comparisons by end investors easier, and to combat greenwashing.

- Article 6 covers strategies which do not integrate any kind of sustainability into the investment process
- Article 8 covers strategies which directly promote environmental or social characteristics
- Article 9 covers strategies which target bespoke sustainable themes such as the SDGs

The majority of investment products at Robeco are labeled as either Sustainability Inside (ESG is integrated) or Sustainability Focused (they follow specific targets), and fall under Article 8. The Impact Investing range labeled as RobecoSAM are classified as Article 9.

> 'We are very proud at Robeco that 95% of all of our strategies are classified as Article 8 or Article 9'

We are very proud at Robeco that 95% of all of our strategies are classified as either Article 8 or Article 9, including all of the strategies mentioned in this paper. Only a handful of products that cannot integrate ESG for operation reasons, such as those that use derivatives or cash accounts, fall under Article 6.

Identifying adverse impacts

Another requirement of the SFDR is identifying any harm that investments do through adverse impact statements that will be introduced from June 2021. These require an asset manager to describe its due diligence policy on how it will take the principal adverse impacts which investee companies have on sustainability factors into account when making investment decisions.

The EU has identified 64 adverse impact indicators that must be calculated, of which 18 will be mandatory to report, and 46 will be voluntary. The compulsory factors range from carbon emissions, fossil fuel exposure and waste levels (E) to gender diversity and due diligence over human rights (S) and a company's record on exposure to corruption, bribery or other scandals (G).

Preparation by regulators

Regulators within the EU and UK spent many months busy preparing the ground for how the new sustainability framework will affect the pan-European insurance industry. Two of the most recent papers were published by the European Insurance and Occupational Pensions Authority (EIOPA) and the Prudential Regulation Authority (PRA) in the UK. While the UK now lies outside the EU, it has a major insurance industry in the City of London that still needs to comply if British insurers want to continue doing business within the bloc.

The EIOPA has issued a consultation paper[1] looking at the use of climate change risk scenarios in the Own Risk and Solvency Assessment (ORSA) that every insurer must complete. The paper outlines an expectation for insurers to integrate climate change risk into their ORSA process in the short and long terms. Insurers are being asked to assess both physical and transition risks across their risk assessment processes, including the risks inherent in underwriting, financial markets, credit and counterparties, along with operational, reputational and strategic risks.

A 'Dear CEO' letter[2] issued by the PRA in July 2020 states that insurers should have fully embedded their approaches to managing climate-related financial risks by the end of 2021. One of the key focus points was the need for consistent communication of strategic responses to the board. Another was a recommendation to develop an integrated approach to scenario analysis into broader risk assessments. The initial PRA stress test has already signalled the impact that climate change stress could have on portfolio values.

Conclusion

As sustainable investing becomes a more significant – if not the central part – of an insurer's investment policy in the next few years, we see impact investing as an essential tool to help insurers accelerate their progress in meeting their sustainable goals.

This combines with increasing interest from policyholders to access socially responsible insurance products and growing regulatory requirements for more sustainable offerings. All these developments provide an opportunity for insurers to redesign their investment policy to meet these market trends.

Robeco's Insurance Solutions team is well placed in designing insurance-friendly investment strategies that can meet the evolving sustainability objectives of insurers globally.

[1] EIOPA Consultation Paper on draft Opinion on the supervision of the use of climate change risk scenarios in ORSA: https://www.eiopa.europa.eu/content/consultation-draft-opinion-supervision-of-use-of-climate-change-risk-scenarios-orsa_en
[2] Managing climate-related financial risk – thematic feedback from the PRA's review of firms' Supervisory Statement 3/19 (SS3/19) plans and clarification of expectations: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2020/managing-the-financial-risks-from-climate-change.pdf?la=en&hash=A6B4DD1BE45B2762900F54B2F5BF2F99FA448424

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