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ESG: Moving From Confusion to Clarity

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Over the past several years, there has been a consistent increase in concern around environmental, governance, equity, justice, and related topics. These concerns are not new, but they have recently gained much broader prominence and are now actively discussed by the entire range of stakeholders, including investors, suppliers, customers, employees, communities, and regulators. These concepts are generally referred to collectively as ESG: Environmental, Social, and Governance.

The list in Figure 1 is far from exhaustive, and there is significant overlap in many of the concepts, both within and between categories. A key subset of ESG is DEI, or Diversity, Equity, and Inclusion. DEI straddles the social and governance categories. It is often focused on the internal workings of the company, but DEI concepts can also be used as a lens to see how a company serves its current and potential customers and how it interacts with its community.

Figure 1 - Issues and Topics Typically Considered Part of ESG

Environmental	- Greenhouse gas emissions - Waste and pollution	- Water use - Land use	- Energy use
Social	- Workforce diversity and inclusion - Pay and promotion equity	- Wage levels - Safety management	- Customer engagement - Customer betterment
Governance	- Structure and oversight - Purpose, code and values	- Stakeholder engagement - Transparency and reporting	- Ethical behavior - Cyber risk and systems

Prepared by Conning, Inc.

In no way is any insurance company exempt from scrutiny on ESG topics. The applicability of social and governance issues to insurance companies is obvious: insurers need to address issues such as diversity, wages, cyber risks, and ethics just as much as a manufacturer does. The applicability of environmental issues is a bit less obvious. An insurer can reduce its own carbon footprint by using energy wisely, but the larger concern is how an insurer invests and how an insurer is a supplier of risk mitigation services to companies. For property-casualty companies, one example is a move toward not offering insurance products to the coal industry because by doing so the insurer is enabling the coal industry to continue its contribution toward environmental problems.

"If you can't measure it, you can't improve it"

This quotation from Peter Drucker sums up part of the challenge with trying to make progress on ESG issues. Without a reasonably objective way to measure these things, how do you prove you are making progress?

Easy-to-quantify categories

If you need to be able to measure something in order to improve it, the first step is obviously to determine what to measure and how to measure it. Some of the ESG categories lend themselves to relatively simple quantifications. For example, energy use can be measured in kilowatt hours of electricity used and quantities of oil, natural gas, gasoline, and other fuels consumed. Quantities can be tracked from one year to the next, perhaps normalized based on the number of employees or revenues, and progress can be determined. While it might still be difficult to compare one company's result against another's, it is generally easy to determine whether a company has made progress compared to where it was in the past.

Harder-to-quantify categories

For other categories, the "raw material" for the quantification is relatively straightforward, but how to actually measure the item is not as obvious. Pay equity by gender is an example. A company knows the salaries and the gender of each person, but what is the most appropriate way to do the comparison? Should the comparison be done across the whole company, or should it be stratified by level, years of service, or something else?

A simple example using a hypothetical company can demonstrate how the comparisons can get complex quite quickly. Suppose a company has just two levels of positions: "Clerical" and "Managerial," and that everyone within a given level is paid exactly the same amount. Also suppose that the male employees are more heavily represented at the managerial level and women are more heavily represented at the clerical level. In this hypothetical company, the average salary for men will be higher than for women even though the company pays exactly the same amount to men and women performing the same jobs. The issue is not really unequal pay, but the lack of women at the managerial level. This company does not necessarily have to adjust its pay policy, but instead it needs to determine why women are underrepresented at the upper levels. There are at least two possible causes for this underrepresentation:

- Women may not have adequate access to career path opportunities. If this is suspected to be the case, the company would need to start measuring how many men and women are considered for promotion, how those decisions are made, whether men and women have equal access to training or other opportunities, etc.
- Women may have equal access to promotions, but perhaps the work environment once promoted leads them to quit. Men, in contrast, may be disproportionately quitting while at the clerical level, leading to underrepresentation there. If this is suspected to be the case, then issues of the work environment at each level would need to be investigated.

Even in this extremely simple example, notice that we already have three possible problems (pay policy, promotion, and employee retention/work environment), and there certainly are other possibilities. Each possible problem sends us in a different direction regarding what to measure in order to try to fix the problem. Start applying this analysis to a real company with hundreds of employees, perhaps operating in several geographies and divisions, and it is easy to see how the source of the problem may not be obvious, let alone what should be measured, or how to fix it.

Categories that defy qualitative measures

Finally, there are categories that do not appear to have anything that is measurable. Especially when addressing DEI concerns, inclusion concepts are not easily quantifiable. On its website, NACE (National Association of Colleges and Employers) defines inclusion as "equal opportunities and equitable outcomes exist for all."[1] Also on its website in a blog post, NACE member Karen Armstrong cites Verna Myers' oft-quoted phrase: "Diversity is being invited to the party. Inclusion is being asked to dance."[2]

Merely measuring the diversity of groups that make decisions and set policy does not demonstrate inclusion. Are the voices of everyone in the group heard and considered, or are some voices routinely ignored? Are activities planned based on implicit assumptions that result in consistently lower participation by certain groups? Those questions are key to inclusion, but are not easily quantified.

Just because something is hard to quantify does it mean nothing can be done. A brief search through the websites of the ten companies[3] with the largest amount of direct life-annuity premium found very high visibility for the companies' DEI efforts. Seven out of the ten had a Chief Diversity Officer—in the case of Mass Mutual,[4] a Head of Diversity & Inclusion. The three companies that did not prominently list such an officer, Transamerica, Jackson National, and John Hancock, are all U.S. subsidiaries of non-U.S. companies. These companies may well have some sort of DEI officer, but even if they do not, all three companies prominently addressed DEI concerns and their actions to increase to address them, especially on the career pages of their websites.[5]

So the lack of an obvious measurement is not a block to progress, it simply makes quantification difficult, resulting in the need to depend on anecdotal evidence to demonstrate that progress.

Attempts to reduce confusion

In order to move toward more quantifiable measures, several organizations are proposing ways to measure the various ESG components, including:

- PRI (Principles for Responsible Investment) was formed in 2005 when then United Nations Secretary-General Kofi Annan invited a group of large institutional investors to join a process to develop the Principles. The Principles were launched in April 2006 at the New York Stock Exchange. There are now more than 3,800 signatories, with Conning being one of them.[6]
- SASB (Sustainability Accounting Standards Board) sets sustainability disclosure standards that are "industry-specific and tied to the concept of materiality to investors. The standards are intended to capture sustainability matters that are financially material … Standard-setting is accomplished through a rigorous process that includes evidence-based research and broad, balanced stakeholder participation." SASB is the standard-setting arm of the SASB Foundation, which lists its mission as "to establish and improve industry specific disclosure standards across financially material environmental, social and governance topics that facilitate communication between companies and investors about decision-useful information."[7]
- TCFD (Task Force on Climate-related Financial Disclosures) states that its goal is "to develop recommendations for more effective climate-related disclosures that could promote more informed investment, credit, and insurance underwriting decisions and, in turn, enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system's exposures to climate-related risks."[8]

With all the standards being proposed, there are at least two groups attempting to bring some order to all these proposed standards.

CRD and the "Better Alignment Project"

The first group is called the CRD (Corporate Reporting Dialogue), which is a platform convened by the International Integrated Reporting Council and also includes SASB, GRI, CDP (formerly the Carbon Disclosure Project), and the CDSB (Climate Disclosure Standards Board). The CRD's "Better Alignment Project" started in November 2018 and published a paper in September 2020 that outlines their shared vision on financial accounting and sustainability disclosure.[9]

The group lifts up the mindset of the financial reporting eco-system as one to be emulated:

"In financial reporting, there is market agreement that there should be standards, and market acceptance that such standards require ongoing maintenance and evolution through rigorous, independent standard-setting processes, robust governance and due process oversight. Companies, investors and other stakeholders allocate resources to fund and participate in the standard-setting process, in addition to installing the right oversight through governance structures. It is this collective participation and transparent due process that results in a body of standards that are widely accepted as fit-for-purpose and used globally."[9]

The Better Alignment Project is attempting to achieve the same level of standards for sustainability issues as have already been achieved for financial matters. "Such standards would provide a common set of sustainability topics and related disclosure requirements that would result in high-quality information being shared in the public domain, which can then be consumed by a wide variety of data aggregators, analytics providers, ratings and indices … Only then will the proliferation of alternative initiatives stop, companies' frustration be reduced, and quality and consistency of the reported information be improved."[9]

The IBC and big 4 accounting firms

The second group consists of the IBC (International Business Council) of the World Economic Forum, and the "Big 4" accounting firms (Deloitte, Ernst and Young, KPMG, and PricewaterhouseCoopers). This group also issued a paper in September 2020, recommending there be metrics organized under four pillars: Principles of Governance, Planet, People, and Prosperity.[10] Wherever possible, the standards proposed by the group are taken from existing standards and disclosures, with the aim of building on the work already done by standard-setters rather than starting over. The metrics were selected for their applicability across industries and business models, but the intention is not to replace any relevant sector- and company-specific indicators already in use. Companies are encouraged to report against as many of the metrics included in its proposal as they find material and appropriate, on the basis of a "disclose or explain" approach.[10]

Clarity

Regardless of the standards, what is in or out, and the actual metric to be used, the direction toward more disclosure on a broader range of topics is clear. Insurance companies need to be developing the capability to report on multiple categories in each of the Environmental, Social, and Governance concepts.

Even in the absence of explicit disclosure requirements or established standards, insurance companies should be proactively disclosing their actions to address ESG and DEI concerns, reporting quantitative measures where possible, and supplementing with anecdotal evidence to complete the picture. If an insurer doesn't tell its own story, someone else will.

"In the absence of companies reporting effectively on their environmental impacts and framing the associated narrative, it is increasingly easy and common for third parties to fill the void of information with potentially spurious estimates and a damaging narrative of their own. This provides a clear business case for firms to report on material environmental impacts at a value chain level, alongside targets that are guided by science and clear plans to reduce negative impacts and increase positive contributions."—"Measuring Stakeholder Capitalism, Towards common Metrics and Consistent Reporting of Sustainable Value Creation," World Economic Forum, September 2020[10]

Clearly, silence is a poor choice.

A version of this article previously appeared in the February 2021 edition of The *Conning Commentary* which is produced by Conning's Insurance Research team.

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RELATED CONTENT

For those with access to Conning's Research Library, we invite you to learn more about ESG in the March 2021 paper [2021: Focus Series - ESG in the Insurance Industry].

Footnotes

[1] © 2021 National Association of Colleges and Employers (NACE) website, "NACE's DIVERSITY, EQUITY, AND INCLUSION STATEMENT," last accessed March 26, 2021; https://www.naceweb.org/about-us/naces-diversity-equity-and-inclusion-statement/

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[9] Statement of Intent to Work Together Towards Comprehensive Corporate Reporting, by the Impact Management Project, World Economic Forum and Deloitte, September 2020, last accessed March 26, 2021; https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf

[10] Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation, World Economic Forum, Deloitte, EY, KMPG, and PwC, September 2020, Last Accessed March 26, 2021; https://www.weforum.org/reports/measuring-stakeholder-capitalism-towards-common-metrics-and-consistent-reporting-of-sustainable-value-creation