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FINANCIAL INSTITUTIONS GROUP INSIGHTS

FROM PURPOSE TO IMPACT: INSURERS STEP UP FOCUS ON ESG INVESTING

At a recent virtual event organised by ANZ Financial Institutions Group, a panel of experts found that the insurance industry can – and will – play a key role in promoting ESG investing, but more still needs to be done.

Ahead of the recent United Nations Climate Change Conference (COP26),[1] a virtual panel assembled by ANZ's Financial Institutions Group gathered to discuss how insurers and investors can come together to enhance the impact of sustainable finance.

The panel discussion, titled "Sustainable Finance - Moving from Purpose to Impact", centered around how insurers can generate sustainable impacts that are aligned with their business purpose, and the role sustainable financing plays in their operational strategies.

The widely experienced industry panel comprised of Halina von dem Hagen, Global Treasurer and Head of Capital Management at Manulife; Liza Jansen, Insurance Investments at Prudential Corporation Asia and Sammie Leung, Partner at PwC Hong Kong. The discussion was moderated by Mara Chiorean, Singapore-based Sustainable Finance Director at ANZ, who is a seasoned sustainability professional with over ten years of prior technical ESG experience with firms such as CSR Asia and Johnson & Johnson.

INSURERS MAKE RAPID STRIDES IN THE RIGHT DIRECTION

As sustainability gets entrenched into how global economies and financial markets operate, the insurance industry is also focused on integrating ESG considerations into the underwriting, investment and operational areas of their businesses. However, this comes with challenges given the less direct impact on environment and society from insurers' business strategies.

Simon Ireland, Managing Director, International ANZ in his opening remarks, highlighted the need for bringing insurers, investors and third party advisors together to bridge sustainable financing needs and investor expectations in the financial ecosystem.

GIVEN THE WIDE FOOTPRINT AND LONG TERM NATURE OF THEIR BALANCE SHEETS, INSURERS HAVE MULTIPLE LEVERS TO IMPLEMENT THEIR SUSTAINABILITY STRATEGIES AND MAKE LASTING IMPACTS. ACCORDING TO HALINA VON DEM HAGEN, MOST INSURERS INCLUDING MANULIFE FOCUS ON FOUR KEY CHANNELS TO EXECUTE THEIR ESG AMBITIONS – INSURANCE PRODUCTS, INVESTMENTS, THIRD PARTY MANDATES, AND OWN OPERATIONS

[1] Source: https://unfccc.int/conference/glasgow-climate-change-conference-october-november-2021

In terms of insurance offerings, there is a focus on behavioral products that link the premia to incentives which support well-being and sustainability. As example, Dr. von dem Hagen highlighted that Manulife's insurance offerings, as a leading life insurer, are aligned to improve the well-being of customers and to promote healthy lifestyles.

Insurers are also increasing investment allocation to sustainable assets including in the alternatives space, according to Dr. von dem Hagen. For example, Manulife has CAD40 billion of green assets on its balance sheet, including in sectors such as renewable energy and agriculture, and is adding to this portfolio at a rate of CAD1 billion annually. For third party fund offerings, nearly 90% of Manulife's strategies fully integrate ESG considerations. Manulife has already achieved net zero position in operations, given the carbon removal through its substantially owned and operated forests and farmland outweighing company-wide operational emissions.

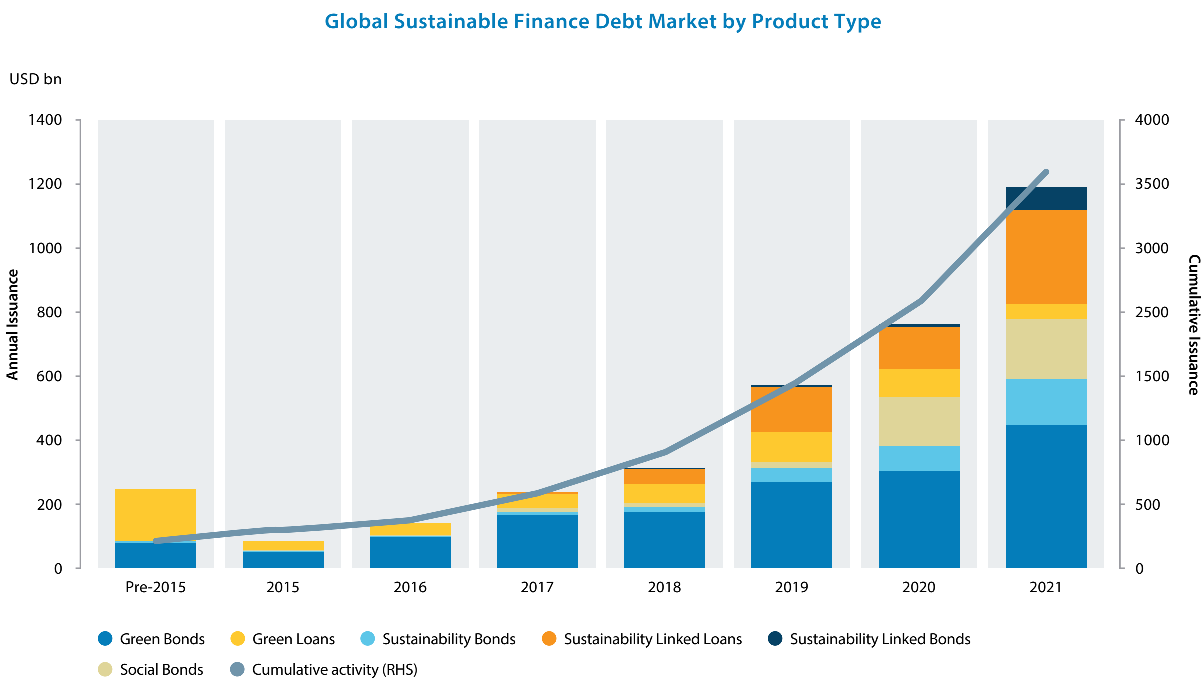
According to Liza Jansen, who is part of Prudential's Insurance Investment team, ESG integration in investment strategy and how impact is tracked in portfolios are becoming very important for investors. In terms of investments products, many investors like Prudential are less concerned about the format of the issuance, but rather focus on the impact and transition being achieved by the issuers. As an asset owner, it is important to set the right expectations from the asset managers and in turn have them engage the investee companies to get to the right sustainable outcomes.

Jansen also highlighted the need for quality data and transparency from companies to ensure the credibility and robustness of ESG approach being implemented by investors. Along with increasing regulation and standards, it is also important to consider the transition trajectory and local context of issuers to ensure efficient and just allocation of capital across geographies.

NEED FOR MORE INVESTMENTS INTO EMERGING MARKETS

While ESG labelled instruments including green bonds have gained traction in developed markets and countries like China, other developing countries have been slower to adopt such products, according to Jansen. Indeed, the US, European Union nations and China led the rankings for green bond issuances in the first half of 2021, even as overall green bond issuances are set to touch record levels of USD500 billion for the whole year and reach USD1 trillion by 2022.[2]

FIGURE 1:
Growth in Sustainable Finance Issuance



Source: Bloomberg, 30 September 2021

[2] Source: https://www.climatebonds.net/resources/press-releases/2021/10/1trillion-annual-green-bond-milestone-tipped-end-2022-5trillion

While setting the context for the panel discussion, ANZ's senior China economist Betty Rui Wang outlined the importance of China's decarbonisation policy and the need for significant sustainable investments over a long period. She mentioned that the path to carbon neutrality by 2060 can be very challenging. "China's decarbonisation or carbon neutral story is not a story happening only in 2060. It is happening right now," she said. It must also be noted that the China Banking and Insurance Regulatory Commission (CBIRC) has recently introduced a regulatory capital discount for insurers' investments in green bonds, under the new C-ROSS Phase II rules.

Jansen also highlighted the fact that applying the same ESG standards used by developed markets, to emerging markets could actually hinder those countries' progress rather than help. Access to cleaner energy options are limited and less affordable to emerging markets compared to their peers in developed markets. Therefore, there needs to be a bigger focus in transition investments with investors taking a more active role at the table of energy companies to assist them with plans to convert to sustainable energy sources.

Despite more capital needs in emerging market countries, certain ESG certification requirements make this process challenging. While companies in developing countries may already be issuing bonds that support green initiatives, they can't be labeled as such because they are not verified or certified, Jansen noted. This keeps much-needed capital out of emerging markets looking to reduce carbon emissions, "...just because they can't meet the requirements that are being set in developed markets," she said. "They are sometimes just too onerous for a lot of companies in emerging markets, which is a real hurdle."

As an example of efforts to bridge this investment gap, Prudential proposed an idea (the Energy Transition Mechanism[3]) that is currently being studied and developed in Indonesia and the Philippines by the Asian Development Bank that would help those countries and potentially other developing countries in Asia accelerate their transition from coal based power to renewable energy sources. The proposed mechanism entails low cost, blended finance which would be used for carbon reduction together with funds for renewable energy projects.

STEPHANIE VALLANCE, DIRECTOR, SUSTAINABLE FINANCE, INTERNATIONAL AT ANZ RECOGNIZES THAT EMERGING MARKETS IN ASIA ARE SLOWLY EMBRACING THE USE OF GREEN, SOCIAL, SUSTAINABILITY AND SUSTAINABILITY-LINKED BONDS AND LOANS AMID THE GROWING NUMBER OF GOVERNMENTS AND COMPANIES WHO HAVE MADE PUBLIC COMMITMENTS TO TRANSITION TO NET ZERO CARBON. "INVESTORS AND INTERMEDIARIES SUCH AS BANKS AND INSURERS HAVE A KEY ROLE TO ENSURE THE TRANSITION IS ORDERLY AND MEASURED, TAKING INTO ACCOUNT THE VARYING DEVELOPMENT PATHS OF EACH COUNTRY," SHE SAID.

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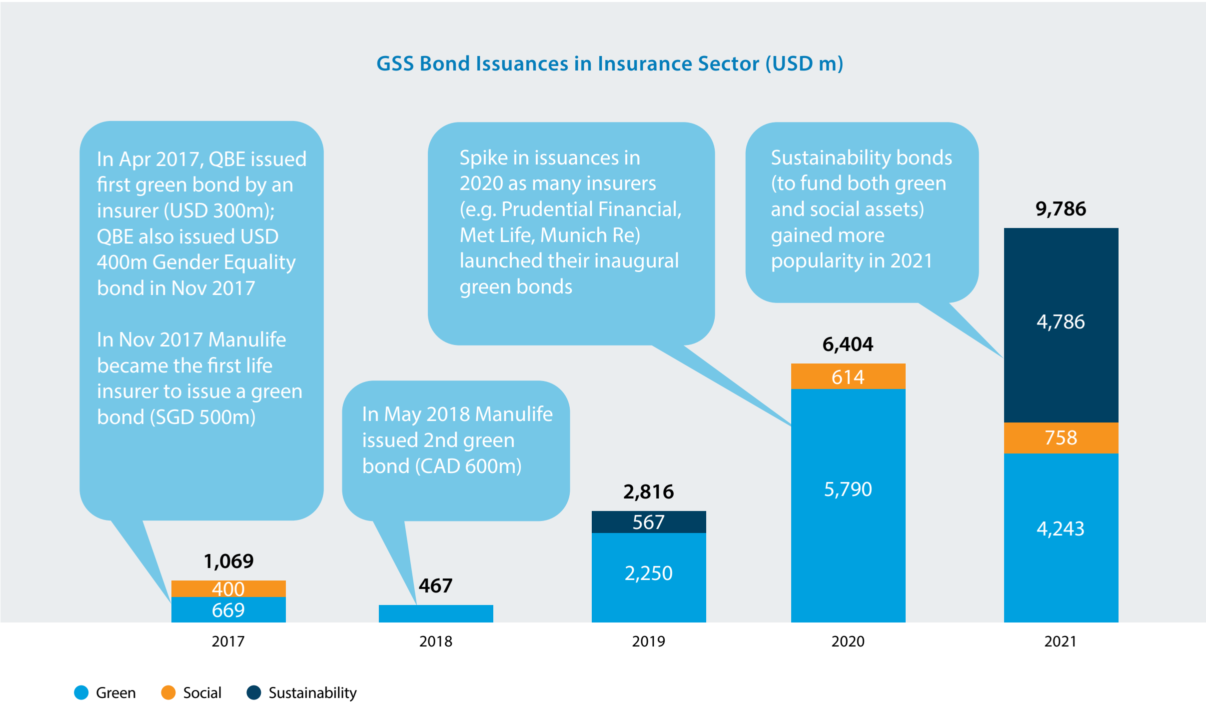
[3] Source: https://www.eco-business.com/news/adb-spearheads-plans-to-retire-coal-plants-in-philippines-vietnam-and-indonesia

ESG ISSUANCE FROM INSURERS ALSO ON THE RISE

As insurers improve the sustainability elements of their asset portfolio, there is also increasing focus on raising financing in sustainable finance formats from the bond and loan markets. Many insurers have raised ESG labelled financing for funding as well as for regulatory capital needs in green and sustainable formats in recent years – more than 50% of the insurance ESG bond issuances till date have been in regulatory capital formats.

FIGURE 2:
Sustainability Bond Issuances from the Insurance Sector



Source: Bloomberg, 30 September 2021

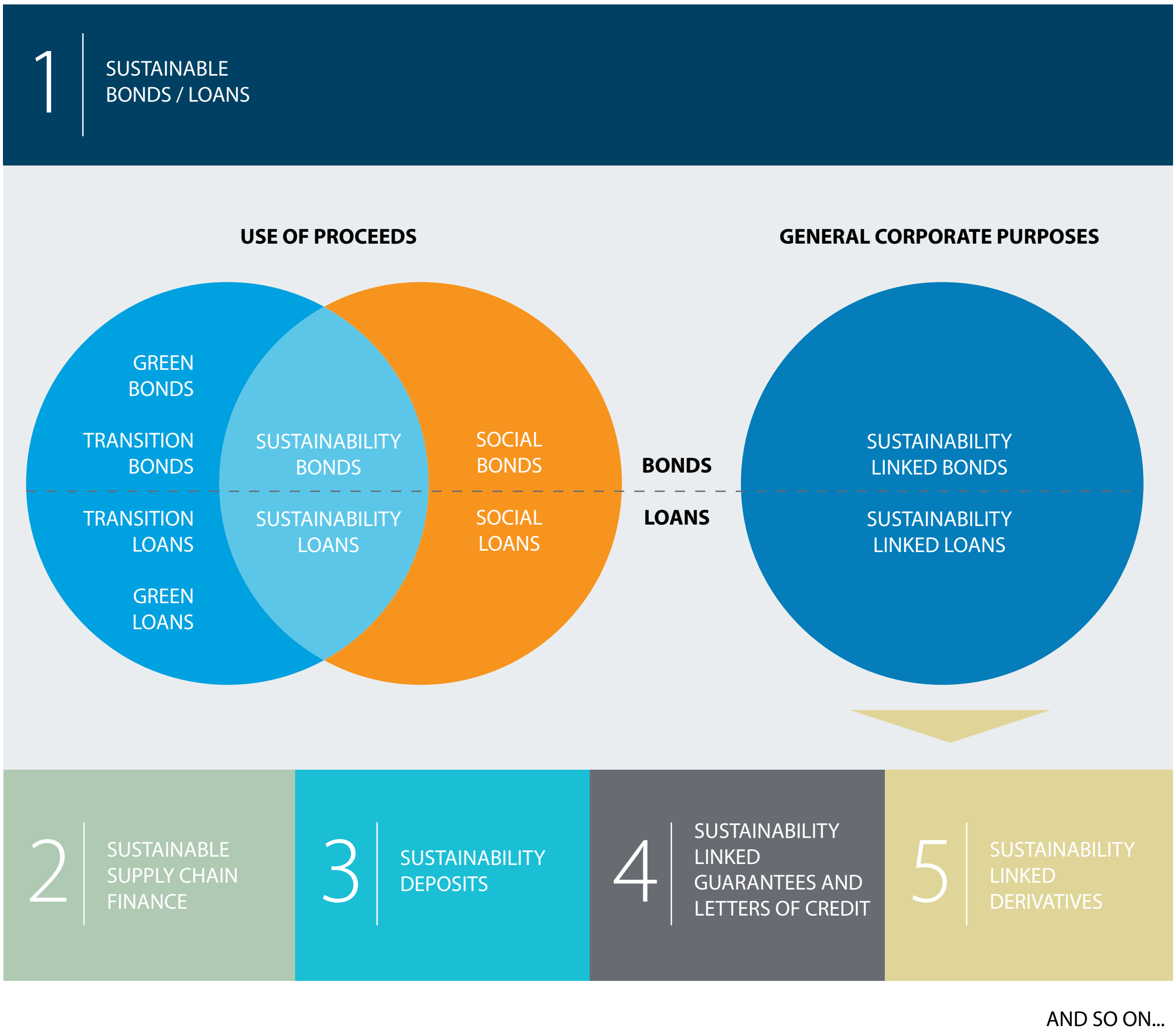
Among the insurers who pioneered ESG issuances from the insurance sector is Manulife, which was the first life insurer to issue a green bond, in 2017.[4] Dr. von dem Hagen highlighted that Manulife has enough assets to support more green, social or sustainable issuance, however such decisions on issuance format and structure would be based on market conditions and the specific need and duration of the capital being raised.

As a growing number of insurers seek to raise financing in the sustainable finance market, Dr. von dem Hagen suggested considering relatively shorter duration issuances, noting that she is apprehensive of issuing bonds with long durations, "not because of concerns on the asset side, but because this market is still evolving in terms of disclosure and monitoring requirements and the regulatory environment. If we need to issue a 10-year bond, as opposed to a 60-year instrument, I would be more than happy to entertain that in the form of a green bond."

Insurers are also looking to diversify their issuances into other formats including sustainability linked financing, however this would be subject to each insurer's sustainability strategy and their ability to set ambitious and impactful targets. Regarding sustainability linked issuances, Dr. von dem Hagen noted that issuers need to think through the process of setting the right targets, the measurement approach and the time horizon, taking into consideration the changing regulatory landscape and any potential for reputational risks given that the sustainability linked financings are likely to attract close scrutiny with respect to measurements of the targets.

[4] Source: https://www.prnewswire.com/news-releases/manulife-first-life-insurer-to-offer-a-green-bond-657439743.html

FIGURE 3:
Evolution of Sustainable Financing Products



ESG CONSIDERATIONS TAKING ON A MORE CENTRAL IMPORTANCE

The integration of ESG as a fundamental part of investment consideration for insurers is coming, noted Sammie Leung, a partner at PwC Hong Kong. For now, this function is largely outsourced to third-party providers, but as it becomes increasingly foundational to how insurance firms determine their investments, a growing number of in-house specialist teams are expected to become involved.

In the short and medium term, Leung said she sees many insurers leveraging third-party consultants while moving to build in-house expertise. "We are seeing a larger integration of the specialist teams in terms of structure and interaction, and how they actually become part of the risk and investment process." She also noted that the increasing focus from regulatory bodies would push most companies to be more transparent with ESG reporting. In terms of third party data providers and ESG certifications, she also expects to see more standardization, as the industry matures.

She pointed out that it won't be long before sustainable investing is as basic a consideration as anything else an insurance company needs to focus in its decision-making process. "In maybe a decade or two, when we talk about ESG, it will be so integrated that everyone dealing with money will need to have that fundamental mindset."

Lillian Quoc, Insurance Asia, Financial Institutions Group at ANZ, in her closing remarks highlighted the importance for insurers, investors and the broader ecosystem to continue to have these conversations, so that we can bridge the gaps and move closer to making an impact on our sustainability goals.

ULTIMATELY, THE PANELISTS CONCURRED, THE INSURANCE INDUSTRY HAS A KEY ROLE TO PLAY IN ENSURING ESG TENETS BECOME A FUNDAMENTAL PART OF INVESTORS' DECISION-MAKING PROCESS, AND ENHANCE THE TAKE-UP OF SUSTAINABLE INVESTING IN EQUAL MEASURE ACROSS ALL MARKETS. AND WHILE WE STILL HAVE A DISTANCE TO TRAVEL ON THIS COUNT, THEY CONCLUDED, TRUE PROGRESS IS BEING MADE AND THIS IS A POSITIVE FORCE FOR CHANGE.

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