«Delivering
on net zero
requires
a wholesale
business
transformation!»

Towards Net Zero: Harnessing the Transformation Agenda

—
Armando Hammer

—
Larissa Ruprecht

—
Theresa Ertl

—
Keira Spinner

Even as Covid-19 takes hold of our attention, the pressing challenge of climate change remains. Looking beyond the current crisis, arguably the greatest transformation challenge humankind has ever faced is staring right at us: the world has ten years to halve global greenhouse gas emissions to avoid global warming of above 1.5 °C, beyond which the devastating impacts of climate change become irreversible. Delivering on net zero requires a wholesale business transformation, and functions across the organization need to play a vital role in implementation. No area remains untouched – from strategy, product development, sales and marketing, innovation and underwriting to corporate finance, risk and compliance, procurement, and people.

Turning Business Commitments into Real Action on Climate

Covid-19 has shown how systemic risks can have exponential impacts across the entire economy, and how unprepared and vulnerable our systems can be to a crisis like this. Financial institutions need to emerge from this crisis stronger, more resilient, and more sustainable than they were before. 2020 marks the start of what has been highlighted as a crucial decade by the international scientific community for achieving net zero by 2050. The opportunity to combine the ongoing rebuild with a net zero transition is significant, since financial institutions can advocate for ambitious transformations as they recover from the current crisis and unlock value creation opportunities at the same time.

As they reshape and navigate a post-pandemic, transitioning world, financial institutions will need to:
- strategically redirect capital flows towards a net zero future, understanding levers of value creation and destruction,
- keep pace with evolving regulator, client and beneficiaries' expectations of risk management and stewardship, and
- safeguard corporate and asset resilience and prices in systemic risks, including climate risks.

The insurance industry has a vital role to play in the transition to low-carbon, climate-resilient and sustainable communities and economies. Having a combined role as risk managers, insurers and investors with over USD 30 trillion of global assets under management underlines this role. Climate change in particular presents a triad of physical, transition and liability risks to the insurance industry, and climate awareness is increasingly being integrated into underwriting, investment and group-wide risk management practices. Many large insurers have begun to take decisive action in order to reduce their greenhouse gas (GHG) emissions and exposure, for example by introducing policies for coal, oil and gas.

A large number of financial institutions have pledged to decarbonize their portfolios to net zero emissions by 2050 through the Net Zero Asset Owner Alliance. In addition to the Net Zero Asset Owner Alliance, the eight founding members (AXA, Allianz, Aviva, Generali, Munich Re, SCOR, Swiss Re, and Zurich) continued their pioneering work in setting up the Net Zero Insurance Alliance (NZIA). Through the UN-convened NZIA, insurers commit «to individually transition their underwriting portfolios to net zero GHG emissions by 2050, consistent with a maximum temperature rise of 1.5 °C above pre-industrial levels by 2100»[1]. The members individually set science-based intermediate targets every five years, and independently report on their progress publicly on an annual basis.

The transition to net zero brings opportunities for the insurance sector, especially in the following areas:
- Product innovation: Capturing new markets and sources of capital driven by resource efficiency and the development of new technologies, products and services can influence product innovation.
- Growth in client segments: New regulations or customer behavior are likely to lead to a boom in certain segments (for example in new renewable energy production methods, battery production or rare earth mining).
- Product differentiation: Differentiation by offering insurance products with investments aligning to net-zero-aligned portfolios or projects or by pricing greener risks.

However, the transition also creates additional challenges for insurers:
- Informed reserving and pricing: Insurers need to demonstrate insights into the carbon intensity of risks to appropriately price risks and hold sufficient reserves for future claims. Having the required data available and accessible also brings further challenges for insures who need to provide transparent reporting on their net zero efforts.
- Asset origination: Additionally, regulatory and internal requirements on risks associated with liquidity and solvency present constraints on moving to net zero. Furthermore, the market for «green assets» continues to grow but needs further capacity.
- Strategy or impact measurement: The impact measurement is particularly complex for asset managers who have indirect exposure to a significant amount of institutions with data, methodology and stakeholder challenges.

Regulatory Momentum and Stakeholder Pressure Are Converging to Drive Changes to Net Zero

In the last few years, numerous countries have committed to net zero goals in order to achieve the ambitions of the Paris Agreement. In the European Union, the 2050 net zero target is at the heart of the EU Green Deal and is written into law through the EU Climate Law, which binds EU institutions and the member states to take the necessary measures at EU and national level to meet the targets.[2]

In Switzerland, the 2050 climate strategy lays out the roadmap for reaching the 2050 net zero climate target.[3] One of the central cornerstones for realizing the target is the revision of the 2011 CO_2 Act. As the revised act was rejected at the ballot box in June 2021, the CO_2 reduction goals were extended until the end of 2024, and a new revised draft which specifies measures until 2030 is currently in consultation.[4] Regulatory measures like these are putting pressure on the real economy to move in the direction of net zero, and thus indirectly also impact the insurance industry.

But even apart from regulatory pressure, the insurance industry itself has a fundamental interest in doing everything possible to counteract global warming. In this context, net zero is an instrument in the fight against global warming. At the same time, its goal is simply the consistent implementation of the insurance industry's business model: the management of risks.

Managing risks requires transparency, and current regulatory developments support this need. In the European Union, the upcoming Corporate Sustainability Reporting Directive (CSRD) will hold extended disclosure requirements for listed and large companies. These are currently detailed in the form of the development of new European Sustainability Reporting Standards, which in the recently provided first draft standards will contain a dedicated topical standard on climate change, and which includes references to established standards such as the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD).[5]

Also in Switzerland, the Federal Council instructed the Federal Department of Finance (FDF) together with other departments to prepare a consultation draft regarding the implementation of the TCFD recommendations for Swiss companies, which is expected in summer 2022. It will oblige listed and large companies, banks and insurance companies to publicly report on climate-related issues and will likely be implemented by means of a separate executive order on the counter-proposal to the responsible business initiative.[6]

For the financial market in particular, the Swiss FINMA introduced disclosure requirements for climate-related financial risks for insurance companies in supervisory categories 1 and 2 via the revised FINMA Circular «Disclosure – Insurers» as of 1 July 2021. Furthermore, the FINMA issued a greenwashing guideline, which ultimately leads to more transparent disclosure requirements when dealing with sustainability and therefore also GHG emissions.[7]

Disclosure requirements on their own do not directly contribute to reaching net zero, as they do not contain any obligation to reduce GHG emissions. Instead, they create transparency and a uniform language in the context of sustainability. In this function, however, they play a vital role by indirectly contributing to the fact that market participants, such as insurers, can highlight their focus on net zero. Thanks to the disclosure obligations, insurers can perform their investments in accordance with their goals, knowing how their investments impact GHG emissions.

Moreover, disclosure increases the pressure on insurers to strengthen their efforts in achieving their own net zero targets if they want to avoid losing competitiveness due to a poor ESG (environmental, social and governance) rating. In consequence, the regulatory developments are pressuring insurance companies to set ambitious net zero goals. Many insurance companies have thus chosen to set themselves goals towards achieving the net zero target. UN-convened initiatives are leading the way, with major European insurance companies being members of the Net Zero Insurance Alliance and the Net Zero Asset Owner Alliance.

When it comes to achieving their net zero goals, insurers have different possibilities and means at their disposal besides investment activities, such as the Science-Based Targets initiative (SBTi) which will be examined in more detail below.

About the Science-Based Targets initiative (SBTi)

A credible net zero strategy means eliminating sources of emissions in the value chain at a pace and scale consistent with limiting global warming to 1.5 °C as far as possible, and after this point removing any residual emissions that remain unfeasible to eliminate through the permanent removal of CO_2. It is recommended that all interventions adhere to strict social and environmental safeguards, and that those with strong social and environmental co-benefits are prioritized. A foundational guide for the science-based assessment of corporate net zero targets has been provided by the Science-Based Targets initiative (SBTi).

The SBTi provides companies with the world's first blueprint, as well as a robust definition of how to set short and long-term net zero targets in line with the latest climate science. The initiative is a collaboration between the Carbon Disclosure Project (CDP), the United Nations Global Compact, the World Wide Fund for Nature (WWF) and the World Resources Institute (WRI). Of the 1155 companies in total that submitted their targets, 127 are financial institutions, and of these, more than ten are insurance companies.

The initiative allows financial institutions to set science-based targets, align their financial and operational activities with the Paris Agreement and ultimately to reconcile financial flows with the path towards climate-resilient development and low GHG emissions. Beyond the company's own ambitions, partners and customers should be encouraged to set their own targets and reduce emissions. In order to understand the concept of science-based targets and to set organizational boundaries, it is important to distinguish between three scopes of GHG emissions as defined by the GHG Protocol Corporate Standards:

- Scope 1: Direct GHG emissions from company-owned or controlled sources (for example fuel combustion, company vehicles, company facilities etc.)
- Scope 2: Indirect GHG emissions from the generation of purchased electricity, steam, heating and cooling
- Scope 3: All additional indirect GHG emissions that occur in the company's value chain (for example investments, business travel, purchased goods and services etc.)

Insurers may be large real estate owners with direct control over GHG emissions. Other insurance companies (asset owners) may only exercise limited direct control over the carbon footprint, although they play a strong enabling role when it comes to shaping sustainable finance. Consequently, the submission to SBTi includes scope 1 and 2 targets as well as scope 3 portfolio targets, whose criteria have been specifically designed for the financial sector. The focus lies on trackable activities in the financial sector, which include:

- transition and physical risk assessment,
- measurement of emissions based on the GHG Protocol Corporate Standards,
- tracking of mitigation actions and performance,
- transparent disclosure, and
- communicating targets to investors, customers, and other key stakeholders.

By showcasing companies that have established their targets, the initiative succeeds in highlighting regulatory uncertainties, profitability and competitiveness, strengthened investor confidence, and innovations.

Example for Net Zero Commitments

More than 2400 companies are already taking actions towards net zero. As outlined above, 1155 of those global enterprises have developed science-based targets which commit to the 1.5 °C target. Those pioneering companies will lead the way to a world aligned with the Paris Agreement, and empower peers, suppliers, and customers alike to follow their lead.

In 2020, Swiss Re, the largest Swiss reinsurer, committed to reaching net zero with its own operations by 2030. Innovative strategies have been implemented to reduce their carbon footprint where possible as well as removing any remaining emissions using carbon removal technologies.

Internally, a carbon price has been set at USD 100 per ton of carbon dioxide (CO_2) as of 2021, which will gradually increase to USD 200 per ton of CO_2 by 2030. Additionally, all the energy for its operations has come from renewable sources since 2020. For all residual emissions, Swiss Re strives to apply direct air capture technologies. Direct air capture and storage is one of many negative emissions technologies which enables CO_2 to be captured directly from air and stored underground, where the CO_2 mineralizes and turns into stone. The company has entered into a ten-year carbon removal purchase agreement with the Swiss-based negative emissions technology company Climeworks. This pioneering partnership sets a statement for committing to net zero and leveraging this innovative technology.

To transform their asset management towards net zero, which should be reached by 2050, Swiss Re became a founding member of the Net Zero Asset Owner Alliance. It has set itself ambitious targets for transforming its portfolio, such as phasing out coal-based assets by 2030.

Swiss Re and other insurance companies, such as the Zurich Group, are also redesigning their underwriting procedure for the purpose of reaching net zero. While Swiss Re is tightening its coal policy, Zurich is selectively excluding investment activities in companies which are related to coal, oil sands and oil shale.

All founding companies of the NZIA have acknowledged the importance of tackling climate change, and others have and will follow their lead. Innovative technology, science-based solutions as well as new collaborations, partnerships and business transformation efforts will be at the forefront of the race to net zero.

How to Start the Net Zero Journey

In order to deliver on their net zero commitments, insurers will need to undertake an end-to-end business transformation. This includes understanding the implications of net zero for a company's growth strategy and operating model and embedding net zero across all business functions, from governance to value chains, finance, and innovation.

To support companies on their net zero journeys, PwC has prepared a checklist with nine defined key actions that companies need to consider for their net zero transformation. These key actions are based on PwC's own journey to net zero and its experience with net zero client projects. They include:

- Ambition: Aim to achieve global net zero by no later than 2050 and limit global warming to 1.5 °C
- Governance: Define accountability driven from the top
- Strategy: Embed and align net zero into the company strategy
- Enterprise transformation: Consider the key operating model changes in support of transformation
- Supply chain: Transform the net zero value chain
- Innovation: Develop the innovation and technologies to deliver net zero
- Finance: Consider the financing of the net zero transformation
- Transparency: Communication action
- Engagement and influence: Enhance the pace and scale of net zero action

Net zero is not a standalone project. It requires a holistic view across an ecosystem that includes government, businesses, customers, and communities. Transforming at pace for a changing world requires skilled people, innovative thinking, and smart technologies – a community of solvers working together to build trust across the net zero ecosystem to deliver sustained out-comes which will make a positive difference to our world. To reach net zero, organizations need to identify and prioritize their climate risks and opportunities. This means understanding where they are today, where they want to go and what strategies will get them there.

Notes

1 See https://www.unepfi.org/net-zero-insurance/.
2 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32021R1119.
3 See https://www.bafu.admin.ch/dam/bafu/de/dokumente/klima/fachinfo-daten/langfristige-klimastrategie-der-schweiz.pdf.
4 See https://www.newsd.admin.ch/newsd/message/attachments/69727.pdf.
5 See https://www.efrag.org/Activities/2105191406363055/Sustainability-reporting-standards-interim-draft.
6 See https://www.admin.ch/gov/de/start/dokumentation/medienmitteilungen.msg-id-84741.html.
7 See https://www.finma.ch/en/news/2021/11/20211103-finma-aufsichtsmitteilung-05-21/.

Authors

Armando Hammer
is Manager Sustainability & Strategic Regulatory Services at PwC Switzerland.

Larissa Ruprecht
is Senior Associate ESG Transformation at PwC Switzerland.

Theresa Ertl
is Senior Associate Sustainability & Climate Change at PwC Switzerland.

Keira Spinner
is Associate Sustainability & Climate Change at PwC Switzerland.