ACTUARIES DRIVING ESG INNOVATION

INTRODUCTION

Environmental, Social and Governance (ESG) is a framework used to evaluate an entity's business practices, governance, reporting and performance on sustainability issues. ESG criteria evaluates the social responsibilities, governance procedures that an entity follows and the kind of impact the entity has on the environment. Outside of the market, it assesses a business' transparency, ethics and governance across different sectors. ESG is increasingly weighing on the minds of investors in terms of financial decisions. In contrast to traditional investing which was largely centered on financial rewards, modern investors are typically in search of sustainable investment options that align with ESG principles.

The three main pillars of ESG are :

1. Environmental
2. Social
3. Governance

Environmental

This pillar considers the environmental impact of enterprises. It involves carbon emissions, resource management, water usage, pollution control and climate change. It focuses on how businesses are rated on sustainability and the footprint that they produce.

Social

The social pillar of ESG refers to how an entity interacts with its customers, vendors, partners, employees and the local community. Key considerations include human rights, inclusion, working environment, diversity, equity and employee relations. Businesses that excel in this domain foster inclusive, safe and equitable work environments with a positive social impact.

Governance

The governance pillar involves formal elements such as the role of management, ethics, transparency, leadership and shareholder rights. It focuses on how businesses are implementing their pledge of ethics, corruption free operations and being responsible towards the interest of stakeholders. Sound governance processes underpin the long-term reputation and trust of the entity.

CHALLENGES FACED UNDER ESG

Despite the growing significance of ESG practices, businesses encounter a number of obstacles when attempting to successfully apply and disclose these standards:

1. **Lack of Standardization** : There is no universal standard outlining specific ESG metrics or reporting frameworks. As a result, each entity relies on unique identifiers and different methodologies which ultimately makes it difficult for investors as well as stakeholders to get comparable ESG performance of entities.
2. **Complex Regulatory Compliance** : ESG-related regulations vary by region and industry, creating complexities in compliance. Many entities struggle to navigate these multifaceted requirements, which can be time-consuming and costly to implement.
3. **Green washing** : This occurs when an entity pretends to care about ESG, bragging about the practice or measuring in an exaggerated positive light with no meaningful actions being taken. This misrepresentation undermines the real ESG initiatives that are taking place and can also betray consumer and investor trust.
4. **Data Availability and Quality** : To accurately assess the ESG performance of an organization, detailed and comprehensive data is needed. Many entities experience issues around finding, confirming and disclosing trustworthy ESG data due to inconsistent or low-quality data.
5. **Defining and Quantifying ESG Risks** : Pinning down and measuring ESG risks can be a challenge. Including environmental and social risks in corporate strategy is more complicated because it is more difficult to measure these risks the same way you would quantify the normal financial risks.
6. **Stakeholder Engagement** : Some stakeholders may not be committed to ESG practices like others, especially when those measures may not lead to immediate financial returns. Potential conflicts may arise with investors or board directors who may want to prioritize long-term sustainability over short-term profits.
7. **Lack of Clear Metrics** : Entities frequently lack reliable, definite benchmarks to assess their ESG performance. This may lead to unclear reporting, which makes it difficult for investors and firms to monitor developments or hold each other accountable.

ROLE OF ACTUARIES IN ESG

Actuaries' knowledge of risk management, data analytics and financial modeling can be quite helpful in advancing ESG and sustainability. Below are some ways actuaries may contribute to advancing ESG principles:

- **Data Analytics** : The analysis of data using tools uniquely available to actuaries could help extract valuable insights into ESG performance. By analyzing trends and patterns regarding environmental impact, social responsibility and governance, actuaries can help firms to identify areas that have more room for improvement in regards to ESG.
- **Measuring the Impact of ESG on Companies** : From this perspective, actuaries can play an important role in helping enterprises to quantify the financial impact of ESG considerations. Actuaries may be valuable advisors to boards and management in the integration of ESG factors in strategic planning by assessing how the risks and opportunities associated with these areas can impact an entity's long-term financial viability.
- **Integration of ESG Risks into Financial Models** : Actuaries are in a good position to include social risks, legislative changes and climate change-related concerns into financial models. This can help businesses become more resilient and manage risks by assisting them in understanding and preparing for the possible financial repercussions of these risks.
- **Assisting with Regulatory Compliance and Formulation** : By providing risk modeling and regulatory support, amongst others, actuaries can help firms stay abreast of the changing landscape of regulations. Actuaries can work together with governments and regulatory bodies to help establish regulatory frameworks by proposing how ESG risks should be measured and reported on.

- **Scenario Analysis for Climate Risks** : To evaluate the effects of climate change on firms, actuaries could create scenario simulations. They can assist businesses in better preparation for climate-related risks by simulating a variety of future climate scenarios, including extreme weather occurrences and changes to regulations pertaining to carbon emissions.
- **Sustainable Investment Strategies** : Investment teams and actuaries can collaborate closely to create sustainable investment plans that follow ESG guidelines. By quantifying risk and return on ESG-focused investments, actuaries can assist investors in making informed decisions as well as identifying potential areas for long-term sustainable investment opportunities.
- **Long-Term Risk Management** : ESG factors often impact entities over periods of decades. As the experts in long-term risk assessment, actuaries can aid entities in producing forward-thinking risk management frameworks encompassing ESG within their longer-range planning. This would ensure that, over the longer term, ESG opportunities and risks are embedded in the strategic decision making process.
- **Employee Benefit Schemes and ESG** : Actuaries have a part to play in making sure that ESG goals are met by employee benefit plans. To support sustainability and employee well-being, they could, for example, assist in creating pension funds or retirement plans that prioritize investments that adhere to ESG standards.

CONCLUSION

As ESG principles are becoming more central to investing and corporate strategy, actuaries are uniquely situated to address the challenges ESG presents and drive meaningful change, through their risk management, financial modeling and data analytics experience and knowledge. Actuaries can guide organizations with regulatory compliance and reporting metrics. Due to their important function, actuaries are well placed to help ensure there is ethical governance and long term sustainability in today's world of business.

For enquiries about the information contained in this research report, please contact us on the address below:

CONTACT US

Insurance Research Team,
Actuarial Services (EA) Ltd,
1113 Kayahwe Rd, Off Galana Rd, Kilimani,
P. O. Box 10472 - 00100 Nairobi, Kenya.
Tel: +254 202710028 || Fax: +254 202726844
Mobile (Office): +254 708710028 || +254 786710028
Email: insurance_team@actserv-africa.com || Website: www.actserv.co.ke