# Navigating complex stakeholder expectations

Financial services leaders have faced increasing pressure from customers, employees, and the public at large to focus on environmental, social, and governance (ESG) issues in recent years. More public commitments and increased transparency have also generated greater scrutiny; claims of greenwashing and hypocrisy have increased as critics question the alignment between firms' public statements and commitments and their actions, including lobbying activities.

But ESG efforts have also faced significant backlash, particularly in the United States. Some state governments are pushing back against so-called "woke capitalism," threatening to pull pension fund investments and contracts from financial institutions that indicate intentions to reduce exposure to fossil fuels, for example, and some state attorneys general and members of Congress are threatening antitrust litigation.

Apart from the competing pressures from stakeholders, financial institutions need to assess the risks from climate change and how they can adapt approaches for markets already under stress, like Florida. Financial institution boards must balance a mix of difficult-to-measure political, reputational, and legal risks. Addressing these challenges requires concerted action within financial services, across sectors and industries, and with policymakers.

On March 2, 2023, board members and senior executives from leading financial institutions, investors, and other subject matter experts met in Coral Gables, Florida, to discuss evolving expectations around ESG, how their firms are responding, as well as what the stress in the Florida insurance market may foretell for other areas vulnerable to climate change. This *ViewPoints* summarizes the discussions. It focuses on two main themes:[1]

- **Repercussions of the politicization of the ESG agenda**
- **Lessons and warnings from the Florida insurance market**

## Repercussions of the politicization of the ESG agenda

In recent years, public interest in ESG issues has surged as investors, politicians, employees, and customers demand more of corporations and financial institutions. Having experienced a global pandemic, some of the warmest years on record, and the death of George Floyd, stakeholders of all kinds have been pushing banks and insurers to tackle environmental and social issues more aggressively. In response, senior industry leaders have dedicated more time and financial resources to addressing diversity, equity, and inclusion. They remain heavily invested in charting their paths to net-zero carbon, while also looking to capitalize on the trillions of dollars expected to flow into efforts to transition the global economy toward a greener future.

In early 2023, however, the "mood music" around the ESG agenda has changed. In the United States, prominent conservatives have increasingly challenged what they perceive as the progressive political agenda behind ESG. Florida Republican Governor Ron DeSantis, for example, has taken aim at "woke capital" and "elites" who exercise "ideological corporate power" at the expense of financial returns, and former Vice President Mike Pence has accused large investment managers of pursuing a "radical ESG agenda."[2]

### Financial institutions are facing pressures from many sides

The result is that large banks and insurers now face competing pressure from diverse sources. Participants identified the following areas of greatest concern:

- **Balancing opposing views on climate transition.** Combating the effects of climate change has become particularly contentious. Companies are caught between climate activists, some governments, and major institutional investors continuing to press for more aggressive actions to transition away from fossil fuels on the one hand, and some politicians who are threatening to blacklist any financial institutions that take even measured action on the other. A participant said, *"Companies can say they don't want to divest, that they want client engagement so that they can hit interim and long-term targets."* But politicians in states like Texas, Kentucky, and West Virginia view any transition planning as threats to local economies. These states have put many of the world's largest banks and asset managers on notice for "boycotting" fossil fuel companies; targeted entities face potential divestment from state pension plans and restrictions on bidding for new state business.[3] This clearly puts large firms in a bind.

*"A lot of the backlash is bluster. A lot of it is performative … but the trouble is in how it's become weaponized."*

– Participant

- **Confronting litigation risk from multiple directions.** Financial institutions face litigation threats from state attorneys general and others across the country. A participant remarked, *"A lot of the backlash is bluster. It's part of the culture war and anti-wokeness and all that. A lot of it is performative and doesn't have a whole lot to do with ESG, but the trouble is in how it's become weaponized."* Recent subpoenas sent from Republican attorneys general to financial institutions indicate the willingness of political leaders to start legal battles over ESG. One participant shared, *"Red-state attorneys general are asserting that participation in collective action schemes are antitrust violations, though mainstream law firms don't think there is weight to such allegations."* Right-leaning attorneys general may also accuse financial institutions of violating fiduciary duty by factoring ESG matters into investment and lending decisions at the expense of shareholder returns. Participants cautioned however, that legal risk over ESG could increasingly include attacks from the political left as well. Some expect fraud or consumer protection claims over issues like greenwashing from Democratic attorneys general to increase. Under pressure from investors and activists, firms have been making expansive ESG claims for years, but many have done so *"without enough thought about how they will get there. That will create liability on the blue-state side as well,"* according to one participant. Even if there is limited merit to the suits, companies risk reputational damage, distraction, and costs to litigate them.

*"It's not Larry Fink's letter driving our focus on climate transition; it is the central bank."*

– Board member

- **Meeting differing and evolving regulatory requirements.** Financial institutions not only have to deal with differences in ESG regulations across US states and the federal government, they must also take into account international regulations that will affect their global operations. A board member shared how central banks, as opposed to investors or entrepreneurial politicians, can be more relevant for large banks and insurers in Europe: *"It's not Larry Fink's letter driving our focus on climate transition; it is the central bank. It is the climate stress tests and analysis of the impact on pricing."* Lack of a harmonized regulatory regime for issues like climate risk creates additional complexity for global financial institutions. A director said, *"You are going to need to charge different rates for lending to different types of clients based upon their exposure to climate risk … The [European Central Bank] said, 'That's where we're going,' the [Federal Reserve] said, 'No, we are not doing that,' and the Bank of England said, 'We're in the middle.'"* The competitive implications are clear: *"If I'm a European bank having to charge higher rates because of the regulator, but JPMorgan doesn't have to, I can kiss my lending to fossil fuels goodbye."*

## Financial institutions and policymakers must respond strategically

> *"It's not even really an ESG decision; it's just economics."*
>
> – Participant

One director acknowledged that the result of efforts to strike this balance between competing pressures is leading to half measures: *"We keep landing at a spot of ESG-lite, which isn't great. It's more talk than action, but it's what we need to do. Not many people want to be out in front because of the backlash."* As a result, participants say their institutions are being more strategic in how they publicly address environmental and social issues. They also see the need for more coordinated policy to support private-sector efforts.

### Focusing on core business issues

Participants agreed that prioritizing issues core to their business allows firms to block out some of the noise and focus their efforts on key risks and opportunities. One participant said, *"There are so many things under the umbrella of ESG that If you focus on trying to do everything, you won't be generating revenue or profits."*

For some, aspects of ESG engagement are already part of the business. According to one participant, *"JPMorgan is a big fossil fuel lender, but is also the biggest lender to renewables. The exposure on the balance sheet is greater for renewables than for fossil fuels. It's not even really an ESG decision; it's just economics."* Another participant's financial institution has integrated funding climate transition into their purpose statement to demonstrate the scale of the opportunity.

### Identifying supportive policies

> *"If politicians are not willing to tackle an issue, it's very difficult for the industry to solve it on its own."*
>
> – Participant

Most participants believe governments need to put policies in place to help align ESG incentives across industries. One stated, *"A lot of things that need financing are nascent industries … If politicians are not willing to tackle an issue, it's very difficult for the industry to solve it on its own."* Another director remarked, *"Regulators are behind, but there are things that can be done … Governments can step in to create incentives. Right now, price mechanisms are part of the problem—they disincentivize."* In other cases, there is *"low-hanging fruit"* that could be addressed via regulatory requirements—for example, by requiring solar panels on large commercial buildings in places like Florida, Texas, and elsewhere where currently licensing or permitting requirements are creating barriers to investment in sustainable power generation.

### Carefully vetting public commitments and communications

A director asked, *"If we see more and more states taking different positions on [ESG] issues, should we rethink where we locate companies and do* *business? Will we see big moves based on this?"* Most do not foresee major business decisions driven by politics: *"I tend to think not; we won't see the US market split into blue-state asset managers and red-state asset managers,"* said one.

> *"You can be true to your values without going to the rooftop and shouting through a megaphone."*
>
> – Executive

For leaders of large banks and insurers, making public statements is now a perilous act, and navigating the minefield of potential reactions requires careful planning. An executive noted, *"Public companies are getting more thoughtful and intentional about ESG communications. The spat between Ron DeSantis and Disney led to a lot of this. You can be true to your values without going to the rooftop and shouting through a megaphone."* The executive added, *"Thinking about communications can be different from thinking about values."* The risks are such that many boards now expect the CEO and management team to clear any public statements on sensitive issues with the board.

In recent years, pressure from activists and investors prompted some CEOs to speak out on environmental and social issues, which one participant said contributed to greater scrutiny of disclosures: *"I never heard so many CEOs talk about systemic racism and related issues as following George Floyd's death. The response from investors was, 'Show us what's going on in your company; let investors get into the weeds and look at the raw data, not a pie chart or photos of employees building houses together.'"* Another said that regardless of how SEC and other regulatory reporting requirements evolve, *"The 10k cat is of out of the bag on these disclosures. Investors want data. Whether mandated or not, you will have to be doing this. Even if it is not in the 10k or the proxy statement, you can still be liable for those disclosures."*

As a result, an executive observed, *"Directors are pushing CEOs harder on communications strategies about ESG. CEOs are being pressed on intentionality; in turn, they are pressing on the organization below. Prior to this, it was often thought of as just marketing."* Another director reported *"spending more time looking at ESG reports"* than they used to and *"pressing companies on why they are disclosing data, what it accomplishes, and why it is relevant to us as a company. It used to be about putting out stuff to tell a story, but it wasn't really connected to how companies were thinking about enterprise risk management. It's part of the board's duty of oversight now."* Participants highlighted the need to create an internal controls framework around these communications so that public statements square with institutions' investing, underwriting, lending, lobbying, and other activities.

# Lessons and warnings from the Florida insurance market

Climate-related risks pose daunting future challenges for housing and insurance markets across the United States. In some regions, however, those risks are already reality—as is the case in Florida. Property insurers in Florida suffered net underwriting losses every year from 2017 to 2021,[4] including "a more than $1 billion underwriting loss in 2020 and again in 2021."[5] When Hurricane Ian hit the state in September 2022, it inflicted an estimated $60 billion in insured losses.[6] These mounting losses have transformed the insurance landscape. Since 2020, 15 property insurers in Florida have declared insolvency, and the reinsurers Swiss Re and Munich Re have reduced their capacity in the state "by as much as 80%."[7]

*"The rates are set way too low compared to the actual financial risk."*

– Executive

The stress in the insurance market is not limited to Florida. Insurance markets in places like Louisiana and California have also shown considerable signs of stress in recent years. An EY expert noted, *"In Louisiana, over 20 insurers went bankrupt in the past year, which accounts for around 20% of the market. It's getting harder and harder to find affordable insurance."* The insurance market turmoil continues to drive many more homeowners to state-run insurers of last resort, such as Citizens Property Insurance in Florida. Such last-resort insurers have quickly become market share leaders and often the only options for property owners.

## Several factors are driving the crisis

Commenting on the factors stressing the insurance market in Florida, a director suggested, *"We need to shift the focus to treat the disease and not the symptoms."* Participants discussed issues contributing to the dysfunction:

- **Despite high premiums, insurance is severely underpriced and coverage is inadequate.** Recent analyses found Florida residents pay nearly three times the national average for their homeowners policies.[8] Despite the high rates in Florida, participants noted that those premiums might actually need to be considerably higher to adequately price the risk. An executive opined, *"The rates are set way too low compared to the actual financial risk."* Another participant observed, *"The numbers are pretty striking: legal costs over $3 billion alone for insurance companies for Florida claims. Insurance companies had $4 billion in underwriting losses. Even with premiums going up, and rate* *adequacy going up, they are still losing money."* And a third affirmed, *"The pricing mechanism is out of whack."* This participant described the faulty pricing mechanism as *"the root of the disease"* in many distressed markets. One director said that the issue is not just that the rates are too low, but also that *"the coverage is … inadequate. The solution could be in the private market, but it's just not there now."*

> *"We now have more data telling us just how big we're failing."*
>
> – Participant

- **Widely used data is inaccurate or incomplete.** Data coming from government agencies like the Federal Emergency Management Agency (FEMA) and the National Oceanic and Atmospheric Administration (NOAA) may fail to accurately capture risks to properties. According to one executive, *"NOAA and FEMA do not have accurate data to go off of. A lot of insurance companies have staff to do this stuff, but it doesn't get out of the company."* This can be problematic: *"Six million homes have a one-in-a-hundred-year flood risk but don't know it because they're outside the current bounds"* of FEMA's flood maps, noted the same executive. As more sophisticated tools become available, the results can be sobering. A participant detailed, *"More and more data show inefficient rate adequacies and inefficient government action. We now have more data telling us just how big we're failing."*
- **Protection gaps are ultimately covered at a steep cost to taxpayers.** With insurance rates skyrocketing, uninsured or underinsured consumers often have no other options after a disaster but to rely on the government for support. An EY expert explained, *"Many Americans can't afford adequate homeowners' coverage, so they just don't get insurance. Then they get ruined by a disaster, FEMA comes in, and we all pay. In 2019 dollars, there was a 1 to 7 ratio of uninsured or underinsured dollar cost to taxpayer. That ratio could be 1 to 10 or 1 to 12 by now."* In other words, *"If the one dollar were paid through private enterprise, [and] the person had adequate coverage, it would have been one dollar. The inefficiency to get that dollar back to that homeowner means that for every dollar that could have been spent on insurance coverage, emergency government support is costing anywhere from 7 to 12 times as much. So, it's in everyone's best interest to close the protection gap."*
- **Key risks are often misperceived.** As the public continues to learn about the impact of climate change, there is often a fundamental misunderstanding and underestimation of the physical risks at play. A participant described how many homeowners across the country misperceive the risks most relevant to their properties, *"With wildfires,*

*for example, part of the problem is when people see a wildfire coming close to their town in places like California, they feel like they've experienced wildfire. So, they perceive a high risk, but their greatest risk might actually be from flood."* In addition, the participant noted, *"Major destruction from tropical storm systems actually comes from excess rainfall as opposed to storm surge or high winds, which is more commonly believed."* Misperceptions of risk can lead to suboptimal insurance decisions, resulting in financial consequences that extend well beyond the impacted property owners.

- **Climate change could greatly exacerbate these issues in the future.** Regarding climate change's impact in Florida, a participant predicted, *"It will get astronomically more expensive to live here,"* while another noted, *"This is going to spread as well. The Gulf Coast, East Coast, and California will face rising flood risk with rising sea levels."* An executive painted a bleak picture of the future: *"This is a ticking time bomb on a national scale. We can focus in on the problem now, but it is quantifiable, and it will get worse."*

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– Executive

## Solutions remain obscured by politics and market dynamics

Participants explored opportunities for both private business and government to improve conditions in distressed markets like Florida's, but they noted that several obstacles and trade-offs make progress challenging.

### Potential solutions often conflict with political realities

Participants observed that most pathways for assuaging stressed insurance markets hit a key sticking point: *"There's a persistent problem of politicians not wanting to raise rates"* or take other actions which could negatively impact their standing with voters. For example, public policy could force higher rates to ensure adequate coverage or could require that those with higher incomes and more expensive properties be charged more to help subsidize those who cannot afford coverage, but the *"politicians in Florida and in Congress do not want to raise rates on retirees,"* who live on fixed incomes and vote in large numbers. Implementing stricter building codes to ensure greater climate adaptation and resilience in new construction could bolster the market against future damages, something one participant said could *"get private money back in. Building codes work, but they are very expensive."* Lower-income residents may not be able to afford the incremental cost of stricter building codes, and those doing the building would also likely oppose the higher costs. Some suggested following

Europe's example and using stricter zoning codes, but one participant remarked, *"That's a nonstarter in most of the country."* An executive concluded, *"Private industry will have to get in to close the gap. Government will move too slowly."*

## Private-sector approaches may emerge over time

*"There is more to do on prevention, adaptation, and mitigation."*

– Director

Sounding a note of optimism, one participant said, *"Protection is still provided despite all the doom and gloom: is it nothing more than this is a hard market, and capital will find its way in? There have to be solutions about to emerge."* But another asserted, *"I don't think solutions will emerge of the size that is needed. We won't see a swell of capital that you might expect."*

But participants do believe the private sector can implement certain measures that could alleviate problems in the absence of more aggressive action from the public sector. Short of forcing people to move out of high-risk areas, *"there is more to do on prevention, adaptation, and mitigation,"* said one director. *"Banks and insurers could fund better infrastructure, for example."* Another participant suggested insurers could introduce more incentives, such as *"[reducing] insurance policy prices if you build with the right materials."*

*"If you have the data, you can build the business."*

– Participant

A director suggested the insurance market needs to embrace new methods of preventing losses and driving more efficiency in the claims process: *"When will mortgage providers allow parametric insurance to pay for wind damage claims? It could solve a number of problems. It could get money into the hands of the customers to mitigate losses. It would require no lawyers, no negotiation, and it's arguably 40% less expense to the customer. Mortgage providers need to allow it to be accepted as a type of homeowners insurance."* An executive suggested starting by improving risk measurement: *"At the bare minimum, we need to identify the problem that needs fixing. We need climate stress testing to get a good sense of the physical risk part of it all. We're still at that step in the process of just quantifying risks in order to accurately admit our problem."* Another participant observed, *"If you have the data, you can build the business."*

But with the data come questions around disclosure. For example, a participant said, *"Insurance companies are getting more sophisticated data around climate: what do you disclose, and when do you disclose it?"* A participant cautioned, *"If you're on an audit committee, you want to be pressing management on some of this. Does the way you disclose risks and how you are pricing them reflect your best knowledge in the company? Over time, insurance may be in the same spot as large pharma talking about access and affordability."*

Ultimately, financial institutions face an uncertain path forward in navigating markets under stress, but devising effective solutions could yield significant returns. A participant stated, *"If you can solve for Florida and maybe one other state, banks and insurers can come together and solve for how to approach these situations everywhere."*

## Appendix

The following individuals participated in these discussions:

**Participants**

- Marty Becker, Non-Executive Director, Axis Capital Holdings
- Marianne Brown, Non-Executive Director, Charles Schwab
- Jan Carendi, Non-Executive Director, Lombard International Assurance
- Howard Davies, Chair of the Board, NatWest Group
- John Fitzpatrick, Non-Executive Director, Assurely
- Tricia Guinn, Non-Executive Director, Reinsurance Group of America
- Sheila Hooda, Risk Committee Chair, Mutual of Omaha; Chair Nominating and Governance Committee, Enact Holdings
- Craig Isaacs, Vice President Operations, State Farm
- Ed Kearns, Chief Data Officer, First Street Foundation
- Senthil Kumar, Senior Executive Vice President and Chief Risk Officer, BNY Mellon
- Michael Littenberg, Senior Partner, Ropes & Gray
- Yumi Narita, Executive Director of Corporate Governance, Office of the New York City Comptroller
- Alessa Quane, Executive Vice President and Chief Insurance Officer, Oscar Insurance; Non-Executive Director, AXA XL
- Manolo Sánchez, Non-Executive Director, Fannie Mae
- Lex Suvanto, Chief Executive Officer, Edelman Smithfield
- Jane Tutoki, Non-Executive Director, Sedgwick
- Fred Zutel, President, Property and Casualty, Lockton Companies

**EY**

- Jan Bellens, Global Banking and Capital Markets Sector Leader
- Ed Majkowski, Americas Insurance Sector and Consulting Leader
- Isabelle Santenac, Global Insurance Leader
- Sophia Yen, Senior Partner/Principal Insurance Strategy and Innovation Leader

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- Dennis Andrade, Partner
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## About this document

This *ViewPoints* document is the output of Tapestry Networks' convening of financial services board members, executives, and stakeholders, together with other subject matter experts, with the goal of addressing pressing problems and enhancing trust in financial markets. The meeting was organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

*ViewPoints* is produced by Tapestry Networks to stimulate timely, substantive discussions about the choices confronting board members, management, and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

## About Tapestry Networks

Tapestry Networks is a privately held professional services firm. Its mission is to advance society's ability to govern and lead across the borders of sector, geography, and constituency. To do this, Tapestry forms multistakeholder collaborations that embrace the public and private sector, as well as civil society. The participants in these initiatives are leaders drawn from key stakeholder organizations who realize the status quo is neither desirable nor sustainable and are seeking a goal that transcends their own interests and benefits everyone. Tapestry has used this approach to address critical and complex challenges in corporate governance, financial services, and healthcare.

## About EY

EY is a global leader in assurance, tax, transaction, and advisory services to the financial services industry. The insights and quality services it delivers help build trust and confidence in the capital markets and in economies the world over. EY develops outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, EY plays a critical role in building a better working world for its people, for its clients, and for its communities. EY supports the convening of financial services stakeholders as part of its continuing commitment to board effectiveness and good governance in the financial services sector.

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## Endnotes

[1] *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby comments are not attributed to individuals or corporations. Quotations in italics are drawn from conversations with participants in connection with the meeting.

[2] Richard Vanderford, "Florida's DeSantis Takes Aim at 'Woke Capital,'" *Wall Street Journal,* July 28, 2022; Jeff Green and Saijel Kishan, "America's Political Right Has a New Enemy No. 1: ESG Investors," *Bloomberg*, May 20, 2022.

[3] Dan Ennis, "Kentucky Puts JPMorgan, Citi, BlackRock on Divestment List," *Banking Dive,* January 4, 2023.

[4] Insurance Information Institute, *Trends and Insights: Florida Homeowners' Insurance Crisis* (New York: Insurance Information Institute, 2022), 1.

[5] Shahid Hamad, "The Big Reason Florida Insurance Companies Are Failing Isn't Just Hurricane Risk – It's Fraud and Lawsuits," *FIU News,* October 5, 2022.

[6] Tom Sims and Alexander Hübner, "Hurricanes and Floods Bring $120 Billion in Insurance Losses in 2022," *Reuters,* January 10, 2023.

[7] Akshat Rathi, "Climate Is Forcing the Most Risk-Aware Industry to Reinvent Itself," *Bloomberg,* January 24, 2023.

[8] Stassy Olmos, "Florida Homeowners Pay Nearly 3x National Average for Homeowners Insurance," ABC Action News: WFTS Tampa Bay (Scripps Local Media), June 23, 2022.