# Rewriting the risk:

## Addressing the challenge of climate change

July 2022

Kennedys

# Contents





# Foreword

This report provides an overview of the multifaceted risk landscape that climate change poses to (re)insurers in terms of their business operations, investment decisions, and underwriting work.

Along with the corporations they insure, (re)insurers are under pressure to cut their environmental impact as more customers want green products. Customers also want to see those they do business with as responsible businesses. In light of the climate emergency, (re) insurers are also alive to the fact that the rapid acceleration of climate pledges, combined with the fragmentation of approaches, means that they must increase efforts to demonstrate real climate leadership.

To assist progress, (re)insurers already enjoy access to vast amounts of climate-related data, including trends in their own annual claims data. This is alongside multiple third-party sources of climate and wider environmental risk data used by (re)insurers to refine and better understand climate risks across their businesses, supply chains and client portfolios.

However, given the increased scrutiny of progress being made, additional credible information and data sources are of paramount importance. To that end, our insights draw upon the views of leading industry experts discussing how risk management approaches and underwriting practices are set to evolve to address the growing climate risks.

Moreover, this report provides an additional dimension to the analysis. Namely, by adding the voices of citizens alongside industry opinion leaders in setting out the key themes which shape the business, political and regulatory landscape, and unpacking what that means for the evolution of physical, transition and environmental liability risks associated with climate change.

Climate change is a key element to the first of the three pillars that make up environmental, social and governance (ESG) considerations. This is the first of three reports in a series that will address ESG considerations, with this report specifically focusing on environmental aspects that – together with climate action – include natural capital and environmental opportunities.

> Greening the economy should be the number one priority as climate change is the number one long-term risk for the global economy.[1]
>
> Jérôme Jean Haegeli,
> Group Chief Economist, Swiss Re

# Executive summary

Climate change presents a wide range of emerging risks which affect all businesses and households across all societies. When seeking to meet the challenge of climate risks, the global insurance industry has a key role to play. However, insurers cannot meet the challenges of climate change alone. Collaboration between all actors, including governments, is vital.

Climate change will play out in the form of physical, transition and liability risks. Following COP26 there is political commitment to help mitigate these risks, coming in the form of eye-catching pledges and new initiatives to support the transition towards net zero, such as the Glasgow Financial Alliance for Net Zero and the Global Coal to Clean Power Transition Statement.

However, the reality of tackling climate change is greater than top-down solutions from political leaders at global conferences. Instead, changes must ultimately be embedded bottom-up through the billions of everyday decisions made by businesses in conjunction with citizens around the world.

Within this climate space, (re)insurers will have a profound impact on achieving a positive outcome by helping to influence the behaviour of both businesses and households. That being said, the prerequisite to changing everyday decisions will be relevant regulatory and tax regimes that prompt change.

> **It's now or never, if we want to limit global warming to 1.5°C (2.7°F).** Without immediate and deep emissions reductions across all sectors, it will be impossible.
>
> Intergovernmental Panel on Climate Change

## Mobilising insurance markets

The industry has a central position in building wider understanding about climate-related risks and in mitigating against those risks, as a risk manager, risk carrier and as an institutional investor.

The insurance sector currently writes **US$6.3 trillion in annual premiums globally**, which accounts for around 8% of global GDP.

Specifically, risk transfer provided by the sector allows key parts of the economy to function, including agriculture and manufacturing.

The insurance sector is already taking steps in the right direction. (Re)insurers make up 12 of the 26 members of the UN-Convened Net-Zero Asset Owner Alliance (NZAOA), which has committed US$4.6 trillion of Assets Under Management (AUM) to be carbon neutral by 2050. Moreover, the Sustainable Markets Initiative (SMI) Insurance Task Force commits the insurance industry to support the global transition through providing climate-positive financing and risk management solutions.

But while progress is being made, there are a series of operational challenges that face (re)insurers as they fully realise the transition towards environmental sustainability. Overcoming such issues will be business critical.

## The value chain risks

There remains a wide-ranging set of challenges that (re)insurers face as they seek to factor climate risks into their business and a wider environmental risk assessment framework. These fall under the following:

- **Strengthening senior management:** senior (re)insurance business leaders will be expected to set the course in creating the right policies, incentives, and business culture for embedding climate risks.
- **Capital framework – embedding climate risks within solvency regimes:** the need to provide for future losses raises industry concerns that natural catastrophe modelling does not properly capture the climate risks within the existing capital requirements framework.
- **Underwriting emerging risks:** there is an inherent risk of mispricing natural catastrophe and transition risks as the underwriting models need to be recalibrated; moving from the use of historical backward-looking data to a more forward-looking approach to risk assessments.
- **Improving climate transparency and reporting:** risk assessments are only as good as the risk models and the data available. Emerging climate risks may represent unchartered waters for (re)insurers, and historical data may not be as relevant or useful as, for example, weather conditions become more severe and uncharacteristic of the past. As a result, data required to price transition and physical risks may often be incomplete.

While (re)insurance businesses now have greater clarity about their own climate disclosure requirements, when it comes to many of their corporate customers there is still scope to improve the underwriting process.

> Filling the data gaps, improving the data quality, and ensuring much more comprehensive levels of corporate climate disclosures across all enterprises of all sizes is a vital step in ensuring that underwriters can price climate risks effectively.

## Trends in climate litigation

The climate litigation landscape is already active and is set to continue to change rapidly. Civil action groups are becoming more organised, paving the way for climate litigation with potential consequences for changes in the law, as well as changes to policy wordings and coverage provided across all business lines.

There are three main types of climate litigation that we are currently seeing in the courts and which mainly bring Directors and Officers (D&O) and Errors and Omissions (E&O) insurance into focus:

1. Lawsuits targeting states challenging the adequacy of climate policies.
2. Lawsuits targeting companies over their emissions of carbon dioxide, alleging climate-related harms.
3. Other litigation tactics brought by activist shareholders and employees, including with regard to non-disclosure of climate-related risks.

> Civil action groups are becoming more organised, paving the way for climate litigation with potential consequences for changes in the law, as well as changes to policy wordings and coverage provided across all business lines.

Within this landscape, there are two notable developments we expand upon:

**1. Climate change 'duty of care'**
While establishing causation in claims against contributors to climate change is typically very difficult, the notion of a climate change duty of care is already being tested.



**2. External pressure on companies**
As with the 'duty of care', individuals and NGOs are increasingly using the court to try to achieve their objectives, including enforcing board responsibility with regard to corporate compliance with regulations, targets and broader environmental principles. Shareholder activism is a notable litigation risk that arises when minority shareholders use legal, strategic and publicity means to promote their climate change goals in listed companies. Most claims focus on climate risk disclosures.

For (re)insurers and businesses seeking to avoid being exposed to future climate liabilities amid claims of potential greenwashing against insureds, or otherwise, one of the key concerns is the lack of sufficient progress in improving the ESG regulatory framework.

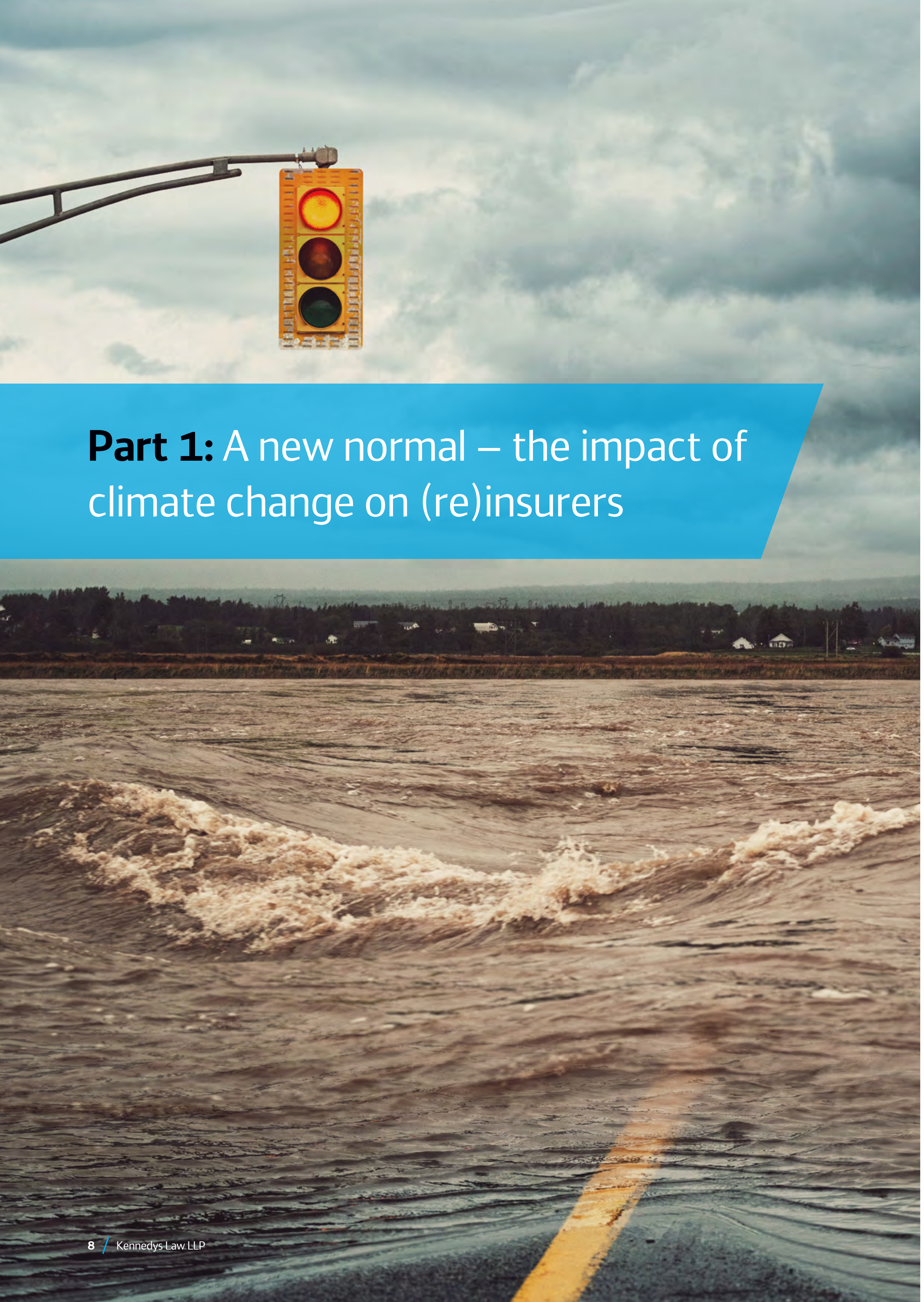
## Conclusion

The Intergovernmental Panel on Climate Change (IPCC) makes clear the urgency for all to act now. This report outlines the steps (re)insurers are taking to help their customers manage the risks of this transition. In addition, we look at those outstanding actions required by insurers to adapt and to help their insureds to adapt to net zero.

## Report methodology

In preparing this report, we undertook in-depth interviews with a range of industry leaders and opinion formers. These interviews covered emerging climate risks and the industry response to date including underwriting and investment practices, industry initiatives to adapt to net zero, as well as areas of innovation in products, customer services and community engagement.

Our research partner Cicero/amo undertook consumer research on a sample of 14,449 households across 13 countries globally. Within each country, the sample was representative of the age, gender and regional profile of that nation. The survey was conducted between 14-21 June 2021. The surveyed countries represent a wide range of markets when measured by their level of economic and political development, innovation, and adoption of digital technology, climate risk and sustainability issues.



# **Part 1:** A new normal – the impact of climate change on (re)insurers

Many of our (re)insurance clients have already identified climate risk as a significant business challenge.

According to R Street's review of 2021 earnings, climate change was highlighted as one of the top three challenges among the world's 15 largest publicly listed property and casualty (re)insurers.[2]

This came on the back of a string of natural catastrophes during 2021, including hurricanes Ida and Nicholas, and tropical storms Fred and Elsa. These events, and the related losses, have helped to further focus industry efforts to address this climate challenge.

In its 2022 Global Risks Report, the World Economic Forum (WEF) identified that environmental risks dominate the risk agenda, with climate-change related risks accounting for three of the top risks by severity over the next 10 years.[3] This includes climate action failure, extreme weather events and biodiversity loss according to the WEF Global Risks Perception Survey (GRPS). All of these risks have a direct and growing impact on (re)insurers and corporate insureds.

## Understanding the complex nature of climate risk

Climate change presents a wide range of emerging risks which affect all businesses and households across all societies. The insurance industry will help businesses and households manage the cost of future climate-related risks and liabilities.

(Re)insurers will help to transfer these risks from businesses and households to help cover the cost of future climate-related liabilities. (Re)insurers are also major institutional investors and will, over time, help channel private capital towards greener technologies and more sustainable business activities.

The main climate-related threats to the insurance industry and corporate clients are defined in Table 1.

**Table 1: Types of environmental risks facing (re)insurers and corporate clients**

| Risk type | Description |
|---|---|
| 1. **Physical risks** | These risks impact on a business's physical assets because of changing weather patterns, sea-level increases, temperature extremes and natural resource scarcity. Such events are becoming both more frequent and more severe, and manifest in physical damage from hurricanes, floods, forest fires and droughts. |
| 2. **Transition risks** | These arise from the mitigation challenges faced by businesses and societies as they adapt their operating models to meet carbon-reduction targets. They can be triggered in several ways including changes in public policy and regulation, new technologies and shifting investor and consumer preference. These risks could include a firm's failure to transition in line with agreed targets, or making false or misleading statements about the real nature of a firm's transition. |
| 3. **Environmental liability risks** | These are potential exposures to legal liability where a third party seeks compensation for losses because of the physical or transitional risks related to climate change. This could include a business's failure in respect of environmental clean-up. |

> We are seeing today changes globally in the frequency and severity of the perils such as tropical storms, wildfires and floods.[4]
>
> Evan Greenberg, Chairman and CEO, Chubb

As the effects of climate change intensify, so will the associated risks set out above, alongside the political imperative to tackle them. The political efforts to reduce long-term physical risks, such as the steps announced at COP26, will result in greater transition risks as countries move towards zero-emissions economies.

Physical risks are already producing more adverse weather events resulting in record losses for property and casualty insurance markets.

We can already see how public policies which aim to address the transition risks will impact on major emitting sectors the hardest, including transport, manufacturing, agriculture, and energy.

For example, governments around the world have ambitious commitments in place to ban the use of petrol and diesel-powered road vehicles, as soon as 2030 in some countries (including the UK). Emissions Trading Schemes have been put in place to help decarbonise heavy industry. Meanwhile, COP26 introduced a historic global commitment to phase down coal-powered energy sources.

Whilst certain sectors may find themselves in the forefront, no sector of the economy, no individual business, nor any government can ignore the need to meet carbon-reduction targets.

Maintaining a clean and sustainable environment will also ramp up pressures around how governments address environmental liabilities and the associated litigation for environmental polluters. This could also extend to businesses which stand accused of social dumping, the practice of locating business in countries where levels of pay and working conditions are lower than in the business's domestic market.

Many countries already have an environmental liability framework in place which adopts a 'polluter-pays' model, where those who are deemed to be responsible for damaging the environment are expected to cover any clean-up costs. These liabilities will likely grow (see Section 4) – along with the level of the fines – as the public demand ever higher environmental standards to protect the land, air, and water sources.

From a risk management perspective, business leaders and (re)insurers will require ever more detailed sources of information about the evolving nature of climate risk exposures and what that will mean for risk underwriting, insurance coverage, claims management and reputational damage.

> The political response to climate change translates to growing pressure on corporates from both the top-down and bottom-up.

The political challenge is now focused on how best to mitigate these risks. As the world's political leaders gathered in Glasgow to attend the UN COP26 in November 2021, much of the media focus was on eye-catching commitments and new initiatives to support the transition towards net zero.

**Table 2: Key COP26 measures adopted by the insurance and financial services industries**

| Initiative | Description |
|---|---|
| **Glasgow Financial Alliance for Net -Zero (GFANZ)** | Led by UN Special Envoy Mark Carney, the GFANZ represents a consortium of over 450 financial firms across 45 nations committed to align their own businesses, as well as their lending and investing practices, with net zero goals.[5] These businesses represent total assets of US$130 trillion. |
| **International Sustainability Standards Board (ISSB)** | As part of a new international framework, the International Financial Reporting Standards (IFRS) Foundation committed to consolidate the Climate Disclosure Standards Board and the Value Reporting Foundation by June 2022. The aim is to create institutional arrangements and lay the technical groundwork for a global sustainability disclosure standard for financial markets.[6] |
| **Global Coal to Clean Power Transition Statement** | Around 190 countries signed up to phase out coal as an energy source. The Global Coal to Clean Power Transition Statement commits these countries to end all investment in new coal power generation and to phase out coal power by the 2030s for major economies and 2040s for the rest of the world. |
| **Powering Past Coal Alliance (PPCA)** | As part of the discussions on coal, 28 new members signed up to the Powering Past Coal Alliance. Notably, this included Chile and Singapore. |
| **2030 Breakthroughs** | Major (re)insurers should set and achieve five-year (2025 and 2030) targets for net zero aligned investment and (re)insurance underwriting portfolios. The outcome will lead towards all investment and (re)insurance portfolios to become net zero by 2050.[7] |
| **Net Zero-aligned Financial Centre** | The UK Government announced several initiatives to make the UK the world's first 'Net Zero-aligned Financial Centre'. Given the implications this has for the London Market, the impact of this decision will be felt across the (re)insurance sector globally.<br>These changes will include the introduction of new climate reporting requirements on all financial institutions in the UK, including (re)insurers. These will require financial institutions to publish net zero transition plans by 2023, which will be assessed by an independent Transition Plan Taskforce to guard against greenwashing. |

We now explore in more detail the need to mobilise insurance markets and overcome the operational challenges which will be faced across the insurance value chain.

# Part 2: Mobilising insurance markets



As a key pillar of the global economy, the insurance industry has a central position in building wider understanding about climate-related risks and in mitigating against those risks.

By the nature of where the insurance industry operates and where it underwrites risks, written premiums are concentrated in major economies, which are among the heaviest carbon emitters (Table 3) and, consequently, where the need to transition is greatest.

Table 3 shows the major overlap between the countries which emit carbon and the countries where the insurance industry is heavily exposed. This demonstrates how critical the global insurance industry will be in the transition towards a resilient, net zero economy.

> The growth in sustainability and climate-related issues impacts on all insurance life-and non-life policies.

In addition to its risk management role, the industry is also a major institutional investor channelling funding into public and private sector investments around the world via global capital markets.

On one side of the equation, sovereigns and corporates act as major issuers of debt and equity. On the other side of the equation, insurers act as major buyside institutional investors facilitating billions of dollars of investment flows.

## Insurance market in numbers

- The insurance industry writes **US$6.3 trillion** in annual premiums globally.
- Accounting for around **8% of global GDP**, this risk transfer plays an integral role in helping vital parts of the global economy to function, including transport and logistics, agriculture and manufacturing.
- (Re)insurers find themselves in the front line in efforts to address climate-related physical and transitional risks – **the top five global insurance markets account for two-thirds of global premiums and half of global carbon emissions.**

**Table 3: Top five global insurance markets by annual written premiums and their global emissions ranking, 2020, US$[8]**

| Country | Global Insurance ranking | Annual premiums | % share of global premiums | Global emissions ranking | Annual emissions (tonnes per annum) | % share of global emissions |
|---|---|---|---|---|---|---|
| **US** | **1** | US$2.5tn | 40% | **2** | 5.011bn | 14% |
| **China** | **2** | US$655bn | 10% | **1** | 10.432bn | 29% |
| **Japan** | **3** | US$414bn | 7% | **5** | 1.239bn | 3% |
| **UK** | **4** | US$338bn | 5% | **17** | 367m | 1% |
| **Germany** | **5** | US$258bn | 4% | **6** | 776m | 2% |

**Table 4: Key action points for insurers**

| Stakeholder | Business activity | Description |
|---|---|---|
| 1. **Senior management** | **Governance frameworks** | Embed environmental assessments within risk frameworks and business strategy and ensure that the strategy is aligned with business culture, incentives, and operations. |
| | **Operational resilience** | Undertake risk assessment on the company's climate-related risks, carbon footprint, land-use and efforts to support climate action. This should include employee and supply chain impacts. |
| 2. **Client-side (business and consumer)** | **Underwriting** | Review underwriting portfolios and undertake climate adaptations to insurance products and services to help drive behaviour change through the customer base in support of climate action. |
| 3. **Capital markets** | **Investment** | Update investment strategies and targets to embed environmental considerations within asset management mandates. |
| 4. **Regulatory** | **Prudential risks** | Update prudential framework to capture stress tests for physical and transition risks. |
| | **Conduct risks** | Address the potential for conduct failures, particularly in respect of misleading 'green' claims and statements (greenwashing). |
| | **Climate reporting** | Create reporting systems for collating data and enhancing regulatory and public climate risk disclosures on what the company is doing (in line with current trend towards mandatory reporting). |

As Table 4 demonstrates, (re)insurers can also make an impact through improving management of their workforces, their supply chains, and contributing towards enhanced corporate climate reporting.

This relationship between insurance and the wider economy highlights how the ambition of creating green economies is wholly dependent upon creating green capital markets. This means taking steps to fully integrate environmental issues within the global insurance market in line with the commitments announced at COP26, such as the creation of the International Sustainability Standards Board and the new net zero strategies for financial institutions.

The insurance sector has a significant role to play in ensuring that investments which flow into business activities support green transition.



## Steps in the right direction

The insurance industry is already actively engaged in the process of adapting to climate change, and this commitment is seen through numerous initiatives.

The UN-Convened Net-Zero Asset Owner Alliance (NZAOA) is a coalition of institutional investors with US$4.6 trillion under management that are committed to making their portfolio emissions carbon neutral by 2050.[9]

(Re)insurers make up **12** of the **26** members of the UN-Convened Net-Zero Asset Owner Alliance.

Furthermore, the London Market has already initiated efforts to take this goal forward. The creation of the Sustainable Markets Initiative (SMI) Insurance Task Force commits the insurance industry to providing climate positive financing and risk management solutions (see case study).

Fully realising the transition towards a sustainable insurance market presents a range of operational and reputational challenges and opportunities.

Whilst the industry is taking steps in the right direction, like other sectors, it is far from its final destination. Overcoming these challenges will be business critical and this report explores this in greater detail in Part 3.

# Case study

### The London Market and the SMI Insurance Taskforce

The SMI Insurance Taskforce will set out how the insurance industry can support and encourage individuals and businesses around the world to accelerate their transition to a sustainable future.

Specific actions include adapting and expanding coverage for offshore wind projects in response to rapid growth and new technologies, alongside the implementation of 'build back better' claims clauses in home insurance policies to encourage customers to rebuild sustainably.

To support the rapid growth of green projects and innovation, the SMI Insurance Task Force will develop a framework to help unlock the more than US$30 trillion in assets under management, increasingly directing capital towards investments that drive climate-positive outcomes in both developed and developing nations.

The SMI Insurance Task Force demonstrates that the insurance industry is exceptionally well placed to understand the impact of climate change and the damage it can cause.

# Part 3: Value chain risks arising from climate risk

There is an array of issues facing (re)insurers as they look to embed climate risks within their businesses as part of their broader environmental risk assessment framework.

These issues run across the whole insurance value chain starting with senior management and flowing through financial management, underwriting, conduct, supply chain and claims management.

## Strengthening senior management accountability

Senior insurance business leaders will be expected to set the course in creating the right policies, incentives and business culture for embedding climate risks. As one of our industry interviewees commented:

> Senior leadership buy-in is the biggest deciding factor as to whether businesses will make progress on sustainability. You need your CEO on board. Creating a Chief Sustainability Officer will help too. You need to start with a holistic strategy. But you need to embed that strategy. You can have the best strategy in the world, but if the staff incentives and culture aren't aligned with the strategy, then you won't be successful. Culture eats strategy for breakfast.
>
> Colin Curtis, Managing Director, TBL Services and Founder, Support the Goals

From a governance perspective, the pressure to disinvest in carbon intense activities is a growing political and regulatory demand with corporate and insurance business leaders expected to expedite their transition from 'brown' to 'green' activities. It is for this reason that climate change should increasingly be seen as a D&O (directors and officers insurance) risk.

D&Os have always been required to assess the impact of their firm's operations on the community and the environment. However, D&Os face increased scrutiny, and in many cases, heightened regulation, in this area and must deal with climate risk at all levels and throughout all sectors.

Obviously, directors in carbon intense companies might face different duties than those in say financial institutions. The bottom line is, however, that new legislation and regulations mean new risks if D&Os fail to comply.

In future, the failure to transition at an appropriate speed may increase the likelihood of stranded business assets,[10] potentially higher physical climate risks, greater environmental liabilities, and potential investor losses. All such outcomes pose the prospect of potential litigation, including group actions and/or regulatory fines, as well as reputational damage. Most directors are already alive to the increased pressure to manage climate risks effectively. For example, in the UK, the Prudential Regulatory Authority (PRA) introduced powers in 2019 to make senior managers more accountable for addressing climate risks:

> The Board, at the highest level of executive management, should identify and allocate responsibility for identifying and managing financial risks from climate change to the relevant existing Senior Management Function(s) (SMF(s)) most appropriate within the firm's organisational structure and risk profile, and ensure that these responsibilities are included in the SMF(s).
>
> Prudential Regulatory Authority[11]

This shift in senior managers' responsibilities has parallel impacts on investment portfolio construction, with investment mandates stressing the need to achieve environmental objectives. The concept of shareholder primacy comes under threat as managers' liabilities grow to cover a broadening list of business stakeholders. This creates the potential for new and more expansive regulatory standards on senior managers, asset managers, financial intermediaries, and professional service providers such as lawyers and accountants, as a wide set of social and environmental stakeholders are taken into consideration.

> The powers introduced by the PRA to make senior managers more accountable for climate risks could be viewed as the thin end of the wedge as other regulators around the world adopt the same approach.

Supply chains represent a significant new frontier in terms of assessing senior management responsibilities. Our research indicates broad public support for companies giving a higher regard to the environmental impacts across their supply chain. This is particularly true in emerging markets where communities may find themselves subject to environmental dumping (the shipment of waste between countries to benefit from more relaxed environmental laws) by multinational companies.

Regulators are already creating new requirements for senior managers to better understand the operational risks across their business supply chain. This is pushing businesses to adopt environmental requirements within their procurement processes – such as requiring minimum standards on environmental impacts – as well as being able to monitor suppliers to ensure that businesses are not unwittingly partaking in environmental dumping. This means (re)insurers must have a clearer understanding of the true nature of any climate-related supply chain risks with companies who they insure or invest in and procure services from.

As one of our industry interviewees commented:

> "The problem with supply chain risks is not so much around regulation. It is about being able to define what good behaviour looks like and having clear benchmarks by which to measure your progress. We still struggle to define ESG. It's not just about asking suppliers to fill out sustainability questionnaires. Ultimately it's about educating your suppliers and bringing them with you.
>
> Colin Curtis, Managing Director, TBL Services and Founder, Support the Goals

Decarbonising the whole supply chain benefits those procuring the services as their scope 3 emissions will be reduced. (Scope 3 emissions are the result of activities from assets not owned or controlled by the primary reporting organisation, but that the organisation indirectly impacts in its supply chain).

Asking for policyholders to provide details of their scope 1, 2 and 3 emissions will incentivise them to look at their supply chain. In doing so, it will help insureds to identify those risks that may lead to greenwashing claims. The EU defines greenwashing as companies giving a false impression of their environmental impact or benefits.

> Insurers, asset managers and corporate clients are all increasingly liable for potential environmental dumping where it takes place within their supply chain.



A recent market-leading report published by ClimateWise highlights a five-stage framework to help (re)insurers incorporate transition and liability risks into their stress testing and scenario planning.[12]

Specifically the 'Climate Transition Pathways' principle outlines the need for:

- Target setting
- Pathway identification
- Credible goals
- An assessment of current and expected technologies to decarbonize and
- Ongoing measurement of operating metrics.

## Capital framework: embedding climate risks within solvency regimes

The need to make provision for future losses raises industry concerns that natural catastrophe modelling does not properly capture the climate risks within the existing capital requirements framework.

As 'one-in-100-year' events become more frequent, (re)insurers' capital provisions will need to respond accordingly.

Environmental stress tests are being embedded within the insurance solvency regime in multiple countries. However, while nobody would contest that climate risks will hit (re)insurers, currently only a minority of firms assess climate change risks as part of their Own Risk and Solvency Assessment (ORSA) using scenario analysis.

Perhaps unsurprisingly, regulators have therefore raised two primary concerns:

**1. Time horizons**
Climate risk assessments are usually limited to a short-term time horizon. To address this issue, the European Union insurance regulator (EIOPA) is adapting solvency rules to foster a forward-looking management of these risks to ensure the long-term solvency and viability of the industry.[13]

This followed industry consultation in 2020, which recommended moving beyond one year time horizons for considering the impact of climate risks on insurers' balance sheets.[14]

**2. To address a full risk taxonomy**
Climate risk assessments often focus on physical risks at the expense of transition and liability risks. This is partly explained by the industry's reliance on backward-looking data such as historical claims data.

As stated, EIOPA, and indeed other regulators, are now exploring how the industry moves towards a more forward-looking and longer-term approach.

## Underwriting emerging risks

From an underwriting perspective, one of the key challenges will be to establish the right price for the level of risk. There is an inherent risk of mispricing natural catastrophe risks as the underwriting models need to be recalibrated; moving from the use of historical backward-looking data to a more forward-looking approach to risk assessments.

> Our industry interviews broadly concluded that at present, the level of premiums is inadequate for the level of risk that insurers and reinsurers are taking.

A consequence of mispricing is that over the last five years, most (re)insurers have made losses underwriting natural catastrophe business, particularly those who are writing global programmes. This is part of a decades long trend, where weather-related losses have increased since 1970 (see Figure 1).

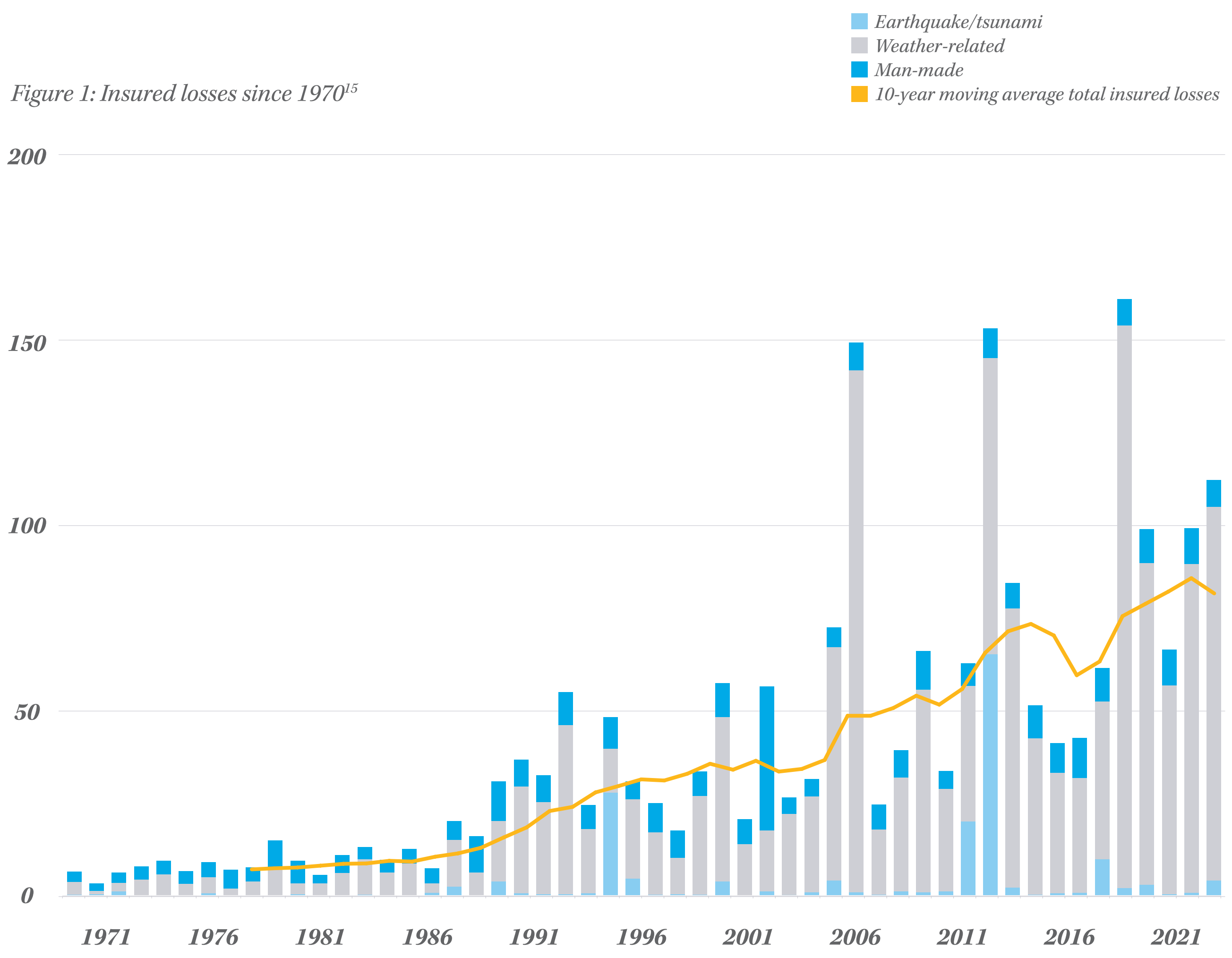
Changes in underwriting practices will be required to price climate risks more accurately in future years. To date, climate change has not been part of mainstream underwriting, but this is quickly evolving. Changing underwriting practices have explored the dimensions of climate change in terms of perils, time horizons and confidence levels.

Securing adequate premiums requires both forward and backward-looking analysis to address historical bias in claims data. Establishing accurate pricing requires an evolution in insurance products to limit the prospect of unsustainable losses and extend coverage to address new and evolving risks. This means adapting (re)insurance policy terms and conditions with the changing character of climate events.

Pricing considerations also mean applying new technologies and data solutions to provide new and innovative solutions such as those listed in Table 6. One growing area of insurance that is particularly benefiting from these new data solutions is parametric insurance. Parametric insurance provides cover when certain objective criteria, such as wind speed or flood water depth, for example, are met.

Initially, parametric insurance products focused on providing protection gap solutions in collaboration with supranational banks and non-governmental organisations. Increasingly, this is becoming a competitive alternative for policyholders otherwise facing significant premiums for certain perils, such as floods and hurricane damage. We expect that both the number of parametric insurance products and the take up of this cover by policyholders will continue to grow over the coming years.

*Figure 1: Insured losses since 1970*[15]




> FloodFlash is a new type of rapid-payout flood insurance. When the client's sensor detects a flood at their agreed trigger depth, it sends the data to us via wireless networks. We validate the data from their sensor and organise the payout... Most cases take less than 48 hours... There is no loss adjustment and no excess.

Ola Jacob Raji, Broker Success Manager, Parametric insurer, Floodflash Ltd

We are also seeing much greater interest in innovative policy wordings aimed at encouraging good behaviour. These are currently focused on 'build back better' clauses, which provide increased cover for the implementation of loss resistant/resilient measures.

Other clauses encourage climate risk assessments, transition planning and reductions in greenhouse gas (GHG) emissions. This is coupled with a growth in risk management services provided by insurers to utilise the wealth of knowledge and experience they have to help insureds avoid/mitigate losses.

Pricing risk accurately also requires a stable and coherent approach to developing legal and regulatory frameworks by government policymakers. Retrospective action by courts and policymakers can result in drastic changes to the scope of policy coverage, leading to underwriters making potentially large unanticipated losses.

Examples include New Zealand, where the government changed the building construction standards to reduce the risk of property damage and loss of life in earthquakes. The changes had the effect of extending the coverage of property insurance policies increasing potential losses for insurers.

**Table 6: Climate innovation within the insurance market**

| (Re)insurer | Innovation |
|---|---|
| **Tokio Marine & Nichido Fire Insurance Co. Ltd. (TMNF)**[16] | TMNF's Mega-Solar Package Program combines insurance coverage across property, liability, and warranty, with risk consulting services, for solar power plant facilities. This packaged protection within the insurance sector programme provides confidence throughout the lifecycle of renewable technology, from development, testing and commissioning, construction, distribution, and operation, to support their scaling. |
| **Swiss Re**[17] | The reinsurer has developed customised, index-triggered protection products for wind and solar energy that safeguard against loss of income due to adverse high or low wind conditions, lack of solar irradiation or variations in water levels. The Solar Irradiation Index, an annual insurance product, provides protection for photovoltaic plant operators, should levels of solar irradiation fall below that expected. |
| **Blockchain Climate Risk Crop Insurance** | Provides a digital platform where insurance policies are plugged into smart contracts on a blockchain and indexed to local weather patterns. The project aims to increase penetration of crop insurance for smallholder farmers in Africa, which currently stands at just 3%. |

During the COVID-19 pandemic the UK regulator, the Financial Conduct Authority (FCA), took the decision to utilise its powers under the financial markets test case scheme to go to court to seek clarification on the definition of what was captured under the policy wording on pandemic risks in business interruption policies. The Supreme Court's ruling in January 2021 retrospectively extended the scope of policies to include pandemic losses. As our industry interviewees commented:

> If you look at the litigation relating to the COVID-19 pandemic, things like government lockdowns were not anticipated because of infectious diseases when the business was being written. Recent court judgments, in some jurisdictions, indicate that it is now covered.
>
> Cedric Lobo, Senior Vice-President, Transatlantic Reinsurance

Similar retrospective decisions could arise in the context of climate change litigation. The climate litigation landscape is already active and is set to continue to change rapidly, which we explore in greater detail in section 4.

> As climate change litigation grows, its complexity does also. Another legal approach that has gained considerable traction especially in Europe recently have been lawsuits against governments and corporations seeking injunctions ordering alignment with the Paris Agreement. These are increasing the risk that states and corporations can be found negligent in their duty to protect the public from the harmful effects of climate change.
>
> Martin Massey, Managing Director, OneRisk Consulting and RM Chair, Climate Change SIG

## Improving climate transparency and reporting

The risk of mispricing insurance policies highlights the central need to improve risk assessments by (re)insurers and their corporate clients. Risk assessments are only as good as the risk models and the data available.

Emerging climate risks may represent unchartered waters for (re)insurers due to the lack of historical claims data. As a result, data required to price transition and physical risks may often be incomplete or unavailable. To help fill these data voids, climate reporting by corporates has improved following the introduction of the Taskforce on Climate-related Financial Disclosures (TCFD).

The objectives of the TCFD are broadly supported by citizens in our global survey:

- Globally, 43% of citizens believe that companies should be more transparent about the climate impact of their business by publishing an annual sustainability report that accounts for the firm's carbon impact.
- Currently, corporate disclosure of environmental impacts is greatest in Europe and North America.

In the UK mandatory climate-related financial disclosures are concentrated among large firms in exposed sectors such as utilities and financial services, but remain voluntary in other jurisdictions. Nonetheless, major (re)insurers have been quick to adapt to, and move beyond, these voluntary arrangements.

Underwriters including AXA, Allianz, Aviva, Generali, Swiss Re and Zurich are amongst 15 of the world's leading (re)insurers who have committed to transition their underwriting and investment portfolios to net zero greenhouse gas (GHG) emissions by 2050 as part of the UN Net Zero Insurance Alliance (NZIA). This reflects the industry's desire to lead by example, and not ask of real economy companies what they are not asking of themselves.

However, what this means in practice is that while (re)insurance companies now have greater clarity about their own climate disclosure requirements, there are still challenges in identifying and harnessing ESG data when pricing risk during the underwriting process, and in particular for smaller and medium-sized businesses.

The EU is introducing a statutory reporting code in most jurisdictions. Other jurisdictions, such as the UK, are similarly heading in the same direction. This includes having first published the Roadmap to Sustainable Investing in October 2021 which provided that commercial companies with a UK premium listing become subject to TCFD-aligned reporting for accounting periods beginning on or after 1 January 2021. The first annual reports including mandatory TCFD disclosures came into effect in spring of 2022. The next phase of roll out in the UK applies to large businesses and will apply for accounting periods beginning on or after 6 April 2022.

> TCFD moves us towards greater disclosures, but you can only disclose what you know. And if brokers aren't brought along, and if there isn't a clear standard of transparency, then it makes it incredibly difficult for (re) insurers to meet external disclosures.
>
> Cedric Lobo, Senior Vice-President, Transatlantic Reinsurance

## Case study

### Climate data and small business risks

One of the significant issues facing (re)insurers and investors will be the need to understand climate risks among smaller and medium-sized enterprises (SMEs).

Current public policies reinforce this slow rate of progress. The OECD's (Organisation for Economic Co-operation and Development) SME and Entrepreneurship Outlook for 2021 reveals a policy focus among national governments on post-COVID-19 recovery, with measures to boost digitisation and financial resilience.[19]

Few governments are actively promoting climate mitigation among SMEs. However, as we saw during the pandemic, SMEs can often find themselves highly exposed when faced with unexpected ESG business risks.

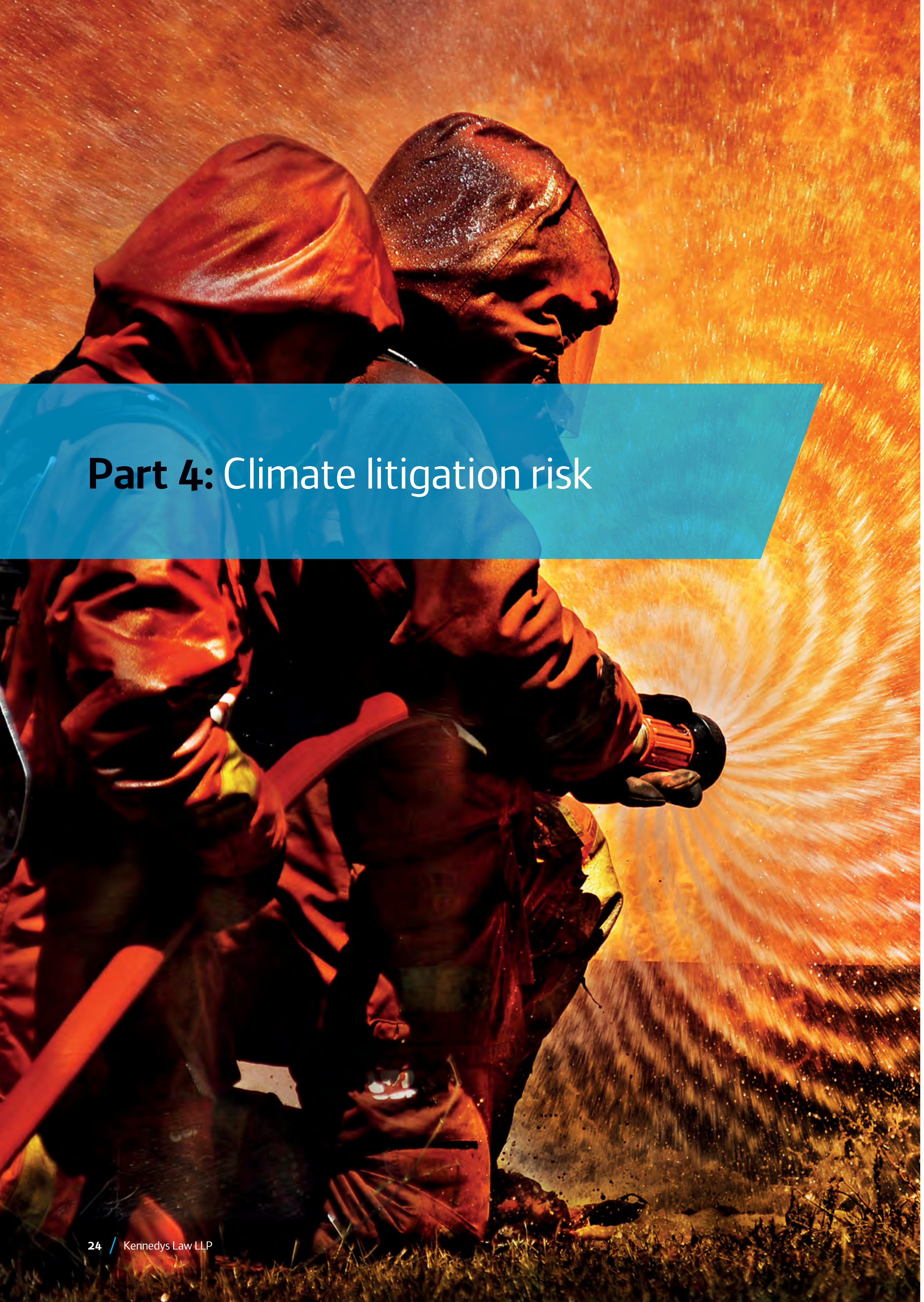
With limited onus on climate disclosures, it will become increasingly difficult for SME business managers to fully understand the nature of climate and broader ESG risks within their business. This could leave owners of SMEs being more exposed to climate-related litigation in future years, for example, by failing to:

- Comply with possible future changes to legal standards on product liability and waste disposal.
- Identify climate risks across their supply chains
- Identify or manage their CO2 emissions.
- Put in place policies on water usage, energy consumption and waste management.

Without robust data, insurers will find it harder to price climate risks among SMEs leading to potential gaps in insurance coverage or even increases in premiums. It will also become harder for investors to gauge the impact of climate change on SMEs. This has the potential to reduce the flow of investment capital to innovative businesses at the start-up and scale-up stages in their development.

Focusing efforts on developing cost-effective legal frameworks that enhance climate disclosures will be a prerequisite in helping SMEs to not only manage transition risks, but in doing so, continue to maintain access to wholesale insurance and investment markets.

Given the gap in post-pandemic public policies to support green transition among SMEs, the insurance sector, which already holds vast amounts of risk data on SMEs, can form a big part of the solution. (Re) insurers can do this by making disclosures more affordable through developing data platforms and risk dashboards for SME clients.



# Part 4: Climate litigation risk



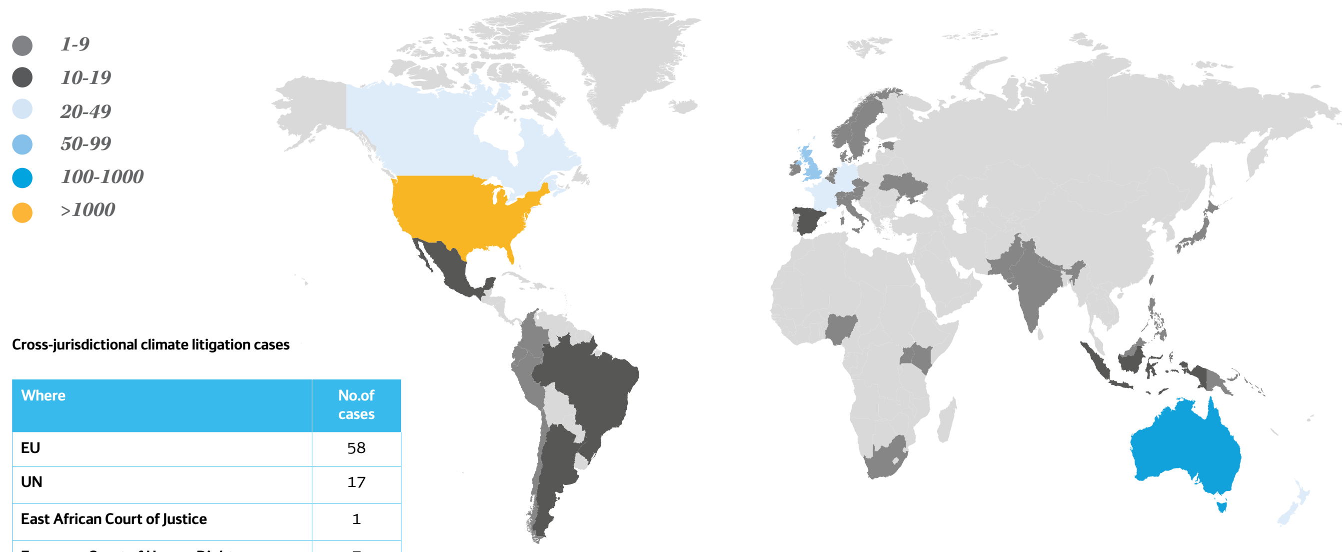
The climate litigation landscape is already active and is set to continue to change rapidly. There are over 1,900 global climate cases ongoing and concluded as of May 2022. Of this number, the vast majority are filed in the US, followed by Australia.[20]

Market practitioners have started comparing climate litigation to tobacco litigation in the 1980s and 1990s. Civil action groups are becoming more organised, paving the way for climate litigation with potential consequences for changes in the law, as well as changes to policy wording and coverage across all business lines. Not all litigation is about securing financial compensation for past environmental damage, climate-related harms or misleading investors. For some, it is about exerting pressure on companies to implement change in order to prevent future environmental damage.

The climate litigation picture is being driven by a shift in public expectation about responsible business and a new range of claimants who have access to litigation funding, law firms, social media and other platforms. While some claimants want to pursue court action, there is a shift towards those individuals, NGOs and groups who want to agitate and make their views known. There are three broad types of climate litigation: claims against states, claims against companies and other types of litigation tactics. Such claims and activity bring Directors and Officers (D&O) and Errors and Omissions (E&O) insurance into focus, in particular.

In turn, central to the disputes landscape are two overriding concepts: direct contribution to climate change and 'greenwashing'. We consider each in turn in the next two sub-sections.

*Kennedys Climate Litigation Heatmap: Powered by climate litigation cases according to the Sabin Center for Climate Change Law as of 12 May 2022*[22]




**Cross-jurisdictional climate litigation cases**

| Where | No.of cases |
|---|---|
| EU | 58 |
| UN | 17 |
| East African Court of Justice | 1 |
| European Court of Human Rights | 7 |
| European Committee on Social Rights | 1 |
| Inter-American System of Human Rights | 5 |
| International Centre for Settlement of Investment Disputes | 9 |
| International Courts & Tribunals | 3 |
| Permanent Court of Arbitration | 1 |
| Stockholm Chamber of Commerce | 3 |
| WTO | 3 |

## Claims against contributors to climate change

Related to such claims is the notion of a 'climate change duty of care'. This places the onus on public and private actors to exercise their powers to prevent harm to a population that can be directly linked to climate hazards resultant from the actors' actions or activities.

In Australia, the 2021 decision in *Sharma v Minister for the Environment* found that a novel duty of care is owed by the Minister for the Environment to Australian children who might suffer potential "catastrophic harm" from her approval to expand a coal mine.

On 15 March 2022, the earlier decision in *Sharma* was overturned, finding that the Minister for the Environment had no duty of care to Australian children to exercise her powers to approve the coal mine expansion so as to avoid the harmful effects of climate change. Despite the outcome in *Sharma*, the case illustrates the impact of climate and ESG issues on government decision-making.

The focus on decision-makers' environmental choices and profiles remains sharp, as illustrated by the pending case of *Pabai v Commonwealth of Australia* [2021]. Here, a group of Torres Strait Islanders claim the government has a duty to protect them, their culture and way of life from the rising sea levels associated with climate change.

Elsewhere in the Netherlands, the District Court of the Hague found that Royal Dutch Shell must reduce its carbon dioxide emissions by 45% by 2030 (against 2019 levels). The claim was brought by seven environmental associations and NGOs acting as co-claimants (*Milieudefensie v Royal Dutch Shell* [2021]).

The Dutch Court determined that Shell owed an "unwritten duty of care" to residents and the inhabitants of the Wadden region to take sufficient action to curb contributions to climate change.

More recently in March 2022, ClientEarth has started legal action against the Board of Directors of Shell, arguing that their failure to properly prepare the company for net zero puts them in breach of their duties under UK company law.

If proceedings are issued, Shell will be one of the first companies to have its ESG credentials tested in the English courts. Further, if proceedings are successful and a finding that the directors have acted in breach of their statutory duties is made, 'greenwashing' claims brought by Shell's shareholders could follow. We discuss greenwashing in more detail later in this chapter.

> A key development in the ongoing trend of climate litigation is the notion of a 'climate change duty of care' owed by public and private actors.

Establishing causation in climate change claims is currently difficult. If properties are flooded because of climate change, it is challenging to attribute the damage from one-off events to past GHG emissions. However, the cost of defending a company against such claims can be financially prohibitive. This will naturally impact on the cost of insuring against future climate-related defence costs. The extent to which premiums have to rise to cover this cost will depend on how volatile the situation becomes.

# Case study

## Leading litigation cases against contributors to climate change

***Massachusetts v Environmental Protection Agency* [2007] (USA)**
The first successful climate change case in which the Supreme Court recognised that greenhouse gases are air pollutants that could endanger public health or welfare.

***Friends of the Irish Environment v The Government of Ireland & Ors* [2020] (Ireland)**
The Irish Supreme Court determined that Ireland's National Mitigation Plan falls short of specificity because a reader of the plan would not understand how Ireland will achieve its 2050 goals. However, the Court found that the claimant lacked standing to bring its claims under the constitution or the European Convention of Human Rights (ECHR).

***Sharma v Minister for the Environment* [2021] (AUS)**
First Instance decision that the environment minister has a duty to take reasonable care to avoid causing personal injury to Australian children when deciding to approve the extension project for a coal mine. Overturned on appeal by the Full Federal Court.

## Cases to monitor

***Lliuya v RWE* (commenced in 2015) (The Hague)**
The claimant, a Peruvian farmer, experienced an increased risk of flooding due to melting ice caps, allegedly caused by greenhouse gas (GHG) emissions partly produced by German utility company, RWE. The claimant seeks payment of RWE's pro-rated share of global emissions to build flood defences.

***Juliana v USA* (commenced in 2015, awaiting appeal) (USA)**
The claimants allege the government's practices of encouraging and permitting the combustion of fossil fuels violates the governments public trust-related obligations and the claimants' due process rights.

***Kim Yujin et al. v South Korea* (filed in March 2020) (South Korea)**
The claimants argue that climate target for reducing GHGs in the Framework Act on Low Carbon Green Growth is too low and not sufficiently specific and is in breach of the ECHR.

***Pabai v Commonwealth of Australia* (filed on 22 October 2021) (Australia)**
Applicants allege the Australian government has breached a duty to protect them from rising sea levels by failing to adopt climate targets consistent with the best available science.

***ClientEarth v UK Government* (filed on 20 January 2022) (UK)**
The claimant alleges that the UK net zero strategy is in breach of the Climate Act 2008 for failing to set out credible policies to tackle climate change.

## Greenwashing claims

Although some representations may be partly true, companies are said to be engaging in greenwashing when their representations are exaggerated and made to mislead environmentally conscious consumers or investors.

In response, NGOs and individuals, including a company's shareholders and employees, are deploying the threat of litigation in order to drive corporate change. The claim typically arises from climate-related management decisions and non-disclosure of climate related business risks.

While the link between shareholder resolutions and corporate behaviour may be an inexact science, the trend towards a new breed of activists is likely to drive a change in corporate behaviour to ensure that climate change is treated as a serious issue – not least as corporates recognise the associated reputational risk.

(Re)insurers know they too must treat climate change as a serious issue, strive to meet their own targets and accurately report their progress on cutting their environmental impact. They will be required to make greater use of ESG data, as part of their ongoing efforts to price insurable risks and assess investment risks as part of their ESG risk assessments. Failure to do so may leave (re)insurers exposed to the risk of 'greenwashing'.

> Greenwashing misleads market actors and does not give due advantage to those companies that are making the effort to green their products and activities.
>
> European Commission,
> Initiative on substantiating green claims[23]

With the advent of consumer and investor action groups, crowd funding and claimant law firms, individuals are accessing climate justice in new and novel ways – including by forcing companies to comply with their sustainability policies.

> Forcing companies to adhere to their sustainability policies, and live by public statements, is set to become a key growth area for future litigation.

This aspect of climate justice is evidenced by the Dutch activist group, Milieudefensie, which won the landmark case against Royal Dutch Shell in 2021 (as considered above). In January 2022, the group targeted 30 large companies with legal bases in the Netherlands (including insurers Aegon and NNGroup) and demanded they publish their net zero plans, in order to avoid legal action.

Similarly in Australia, by way of a foretaste of future trends, the Commonwealth Bank of Australia was faced with litigation in August 2021 over shareholder concerns that the bank's investment portfolio ran contrary to the bank's own 2019 Social and Environmental Framework and Environmental and Social Policy. Whilst the shareholders then withdrew their action, they applied for and were granted pre-action disclosure in November 2021 to inspect the bank's internal documents relating to seven oil and gas projects. This was the first successful pre-action disclosure application of its kind.

It is increasingly likely that the number of organisations targeted will be widened to include financial institutions, mining companies, airlines, producers of single-use plastic or organisations that have made unsubstantiated representations regarding their green credentials.

Without insurance, most of these organisations would be unable to function. As a result, insurers are seen as financial enablers, and with the perception that they have deep pockets, they too could be the focus of litigation if they continue to insure those policyholders who refuse to put in place and implement robust decarbonisation plans.

> For (re)insurers and businesses seeking to avoid future climate liabilities amid claims of potential greenwashing, one of the key concerns is the lack of sufficient progress in improving the ESG regulatory framework.

# Case study

### Greenwashing claims in the United States

In the US, there are two main potential areas of concern in relation to greenwashing as indicated by the cases filed to date:

1. **Public representations:** any company that is readily identified as being in a carbon intensive industry could be the subject of civil or regulatory investigations based on the representations it makes to the public. Here, we have traditionally seen investigations and claims made against suppliers of fossil fuels. However, we are also starting to see the same type of claims against users of fossil fuels (e.g. the transport industry).

   With the new proposed rule from the Securities Exchange Commission (SEC) described below, even more public companies and different industries may be subject to higher scrutiny. For example, product manufacturers have already begun to see litigation arising from representations they make about the climate-friendly attributes of their products. It is also possible that financial institutions could see litigation with respect to representations they make about the climate-friendly attributes of their investments.

2. **Public nuisance:** a growing number of lawsuits are being filed against energy companies under a state law-based 'public nuisance' theory. In these types of actions, state and local entities may seek to hold companies liable for their negative impacts on the environment.

If such litigation is successful and liability is established against these companies, the financial consequences to investors could be substantial. Moreover, this could lead to separate derivative and securities class actions against companies for failing to address the issues or making misrepresentations about their company's impact on the environment. In turn, these types of cases could negatively impact a company's D&O insurers.

In March 2022, the US SEC intervened to help combat greenwashing and make more companies further transparent about their impacts on the environment. The Commission announced its proposed rule on the 'Enhancement and standardisation of climate-related disclosures for investors'. The proposed rule is intended to require "consistent, comparable, and decision-useful information" on climate-related disclosures.

If the rule is enacted and adequate internal processes are not used to comply with the proposed disclosure requirements, shareholder or derivative actions against a much broader group of industries are indicated. In addition, we may see a potential increase in enforcement actions by government regulators, including the SEC's newly constituted Climate and ESG Task Force. The disclosures could further cause a wave of litigation brought by private litigants in connection with a variety of state laws.

## A global green taxonomy

Business leaders – including (re)insurers – require a clear taxonomy for sustainable activities that offers a classification system to clarify which investments are environmentally sustainable. The EU Commission was first to show its hand with its taxonomy regulation published in June 2020 in the context of the European Green Deal. The regulation established six environmental objectives, including climate change mitigation and the protection of biodiversity, for which the Commission had to come up with the actual list of sustainable activities by defining technical screening criteria for each objective.

In October 2021, the UK released 'A Roadmap to Sustainable Investing' which includes a section on how the UK will develop its own Green Taxonomy. Elsewhere, other jurisdictions have yet to follow suit, including in the US where market practitioners deem such a move to be unlikely among US regulators.

Where regulatory certainty is lacking and is instead largely voluntary, grey areas are created for interpretation. If businesses do not have a clear regulatory framework in which to judge what is green and what is not, the potential for legal action and reputational damage is compounded.

Business leaders will be alive to being retrospectively judged by investors, customers, and other stakeholders to have issued misleading statements about the true nature of ESG-related risks in their public statements, advertising, or social media.

Filling the data gaps, improving the data quality, and ensuring much more comprehensive levels of corporate climate disclosures across all enterprise sizes is a vital step in ensuring that underwriters can price climate risks effectively, and asset managers can properly assess ESG-related investment risks. Until this is in place, and until there is clarity, consistency and transparency of data, climate risks and reporting obligations, we will continue to see an increase in the number of claims, especially those that impact D&O and E&O insurance.
Overall, insurers can expect to see more claims from their customers across a range of activities including:

- Misleading statements in annual reports.
- False or misleading claims in advertising.
- Deceptive conduct and breaches in governance.
- Non-disclosure.
- Regulatory breaches.
- Discovery requests.

# Case study

## Leading greenwashing cases

***People of the State of New York v Exxon Mobile Corporation* [2018] (USA)**
The case was allowed to proceed to trial based on theories concerning Exxon's representations to shareholders regarding its knowledge of the financial consequences of climate change. The Supreme Court found the plaintiff had failed to establish that Exxon had made material misrepresentations about potential future costs related to climate change that misled investors.

***Stoyas v Toshiba Corporation* [2020] (USA)**
The court held that a non-US issuer making alleged misrepresentations about climate change activities to the public may be held liable in US courts where the misrepresentation relates to the company's ADRs (American Depository Receipts).

***McVeigh v Retail Employees Superannuation Trust* [2020] (AUS)**
The claimant, a pension fund member, filed suit against his pension fund, alleging that the fund violated the Corporations Act 2001 by failing to provide information related to climate change business risks and any plans to address those risks. A settlement agreement was reached between the parties.

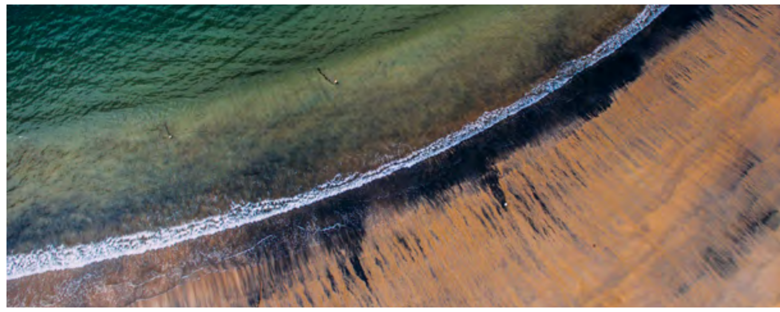
***Abrahams v Commonwealth Bank of Australia* [2021] (AUS)**
The claimant, a CBA shareholder, brought an application for access to certain documents pertaining to the funding of oil and gas projects. The claimant's concern was that the projects might be contrary to CBA's own 2019 Social and Environmental Framework and Environmental and Social Policy.

In a decision described as the first of its kind, the Federal Court granted access to the documents which potentially exposes CBA to future litigation.

## Current cases to monitor:

***Australasian Centre for Corporate Responsibility v Santos* [commenced in 2021] (AUS)**
ACCR alleges Santos engaged in misleading and deceptive conduct when it made statements to the effect that:

- The natural gas it produces is a "clean fuel" and provides "clean energy".
- It has a "clear and credible" plan to achieve net zero scope 1 and 2 greenhouse gas emissions by 2040.



# Conclusion and recommendations

Against the backdrop of increasing climate litigation risk and value chain risks outlined in this report, senior managers must act quickly and with conviction to address the scale of the risk. As they attempt to address climate risks, senior managers can and should adopt a range of strategies to identify and stay ahead of potential exposure including reputational harm.

## 1. Embed climate mitigation within governance changes and senior leadership

Regulators are already setting clear expectations regarding the need for senior managers to fully understand climate risks within their business and to take responsibility for managing those risks across the business value chain.

This could result in Senior Managers Regimes (SMRs) requiring the board appointment of a Chief Sustainability Officer as an SMR function to improve alignment between corporate strategies and business operations.

## 2. Enhanced disclosure

The onus is already on (re)insurers and their corporate clients to disclose full details of their climate emissions on an annual basis. This should be accompanied by a breakdown of the data to specific emission sources (including scope 1, 2 and 3 emissions and other emissions), along with the presentation of historical data for each emission source.

Enhanced disclosure will, in time, widen to include biodiversity risks. This year, the Task Force on Nature-Related Financial Disclosures (TNFD) is expected to launch a framework for organisations to report and act on nature-related risks.

## 3. Develop net zero plans

Over time, senior managers will be expected to set specific emission reduction targets as part of their net zero plans. This requirement will start to roll out on a statutory basis from 2022-23 in some jurisdictions (such as the EU and the UK), with other jurisdictions looking to maintain a voluntary approach (such as the US and Australia).

Developing net zero plans will need to consider climate impacts across the business value chain, including supply chains. Firms must build a better understanding of how third-party resources are sourced through the development of sustainable procurement policies or risk claims against them for greenwashing. Insurers can help their customers mitigate claims and reputational risk by educating them on resilient net zero plans.

## 4. Reduce emissions across the value chain

Implement decarbonisation measures and disclose details of those measures. Integrate those measures within procurement and supply chains to ensure that externally sourced inputs (including energy supplies) are sustainable and aligned with business sustainability targets. Businesses should disclose the full details of that procurement.

Again and as stated above, working with their customers and the investor community, (re)insurers can play a vital role in identifying and mitigating climate risks within the wider corporate market through education.

> By using their market position – as an underwriter and investor – (re)insurers are well-placed to bring about positive change across the wider economy.

For example, (re)insurers can and are designing new products and amending traditional products to cover new technologies which will drive the transition to a greener economy.

## 5. Take steps to ensure conduct is fully compliant with objectives

Avoid misleading claims and pledges; ensure full alignment between all corporate statements and internal practices. With businesses rushing to adopt new sustainability targets, the risk is that business operations cannot keep pace with the rapidly changing expectations of clients, investors, and regulators.

Businesses must adopt an approach where climate impacts are properly measured and realistic targets are put in place. This means fully reviewing all consumer literature across all products and services to ensure that it is compliant with current business practice.

Regulatory reporting requirements will also mean businesses must develop processes for gathering timely and accurate climate impact data. The failure to properly disclose climate impacts will result in heavy regulatory fines, sanctions and reputational damage.

## 6. Seize the opportunities

Climate change cannot be ignored. Those businesses that are at the forefront of the green revolution are much more likely to succeed; like those who were at the forefront of the industrial revolution and the move to a digital economy.

With challenge comes opportunity and businesses have the chance to drive and benefit from environmental opportunities, which include opportunities in green technology, green building and renewable energy. Indeed, it has been estimated that the benefit to UK manufacturing alone in producing zero carbon-compatible equipment could be more than £200 billion between now and 2030.

The quicker organisations in all sectors of the economy can work to understand how climate risk is likely to affect them, identify opportunities and adaptations and transition to net zero, the more likely they are to survive and thrive.

> Collective action of businesses will increase the chances of countries meeting the Paris Agreement goals and avoiding the very worst effects of global warming.

As we have outlined in this report, underwriting and pricing is set to be overhauled due to climate risks. However, insurers have a clear oppurtunity to evolve their business models so that the primary emphasis is on helping to build deeper resilience and risk mitigation among their customers. Compensating policyholders then becomes the secondary aim.

Moreover, (re)insurers have a role to play in driving resilience in the climate-vulnerable parts of the world. By collaborating with businesses, national governments and local authorities, insurers can provide guidance on where assets should and should not be developed, how infrastructure should be designed, and to what standards. In this sense, the insurance industry could work actively with businesses to reduce risk from the equation, rather than just transferring it.

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- Katie Lennon, Head of ESG, UK & Lloyd's at AXA XL and Vice-Chair of the IUA Climate Committee
- Colin Curtis, Managing Director at TBL Services and Founder of Support the Goals
- Harry Wright, CEO and Founder of Bright Tide
- Martin Massey, Chairman at the Institute of Risk Management (IRM), Managing Director of One Risk Consulting, and Strategic Risk and Climate Change Consultant at Milliman

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**cicero-group.com**

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21. **Directors' and Officers' liability insurance:** also known as D&O insurance – covers the cost of compensation claims made against business's directors and key managers (officers) for alleged wrongful acts. Wrongful acts include, breach of trust, breach of duty, neglect, error, misleading statements, wrongful trading.
    **Errors and Omissions insurance (E&O):** a form of professional liability insurance, is designed to protect employees and employers against clients' claims of negligence or inadequate work.
22. Columbia Climate School Sabin Centre for Climate Change Law, May 2022 Updates to the Climate Case Charts, May 2022
23. European Commission, Initiative on substantiating green claims, accessed 26 May 2022

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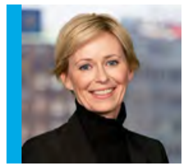

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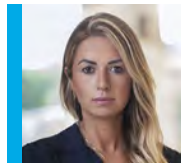

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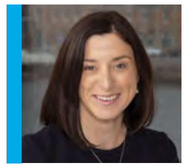

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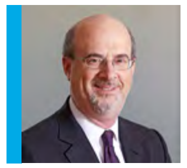

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This report does not represent the views of Kennedys Law LLP. The report is based on interviews with eight academics and experts across the key subject areas discussed and the views of 14,449 households in 13 surveyed countries. The report seeks to present a balanced snapshot on key topic areas based on the interviews and research conducted. Kennedys Law LLP is not aligned with any campaign group, nor does this report seek to make recommendations or endeavour to support any political outcome or aim.

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