Climate Change and the Insurance Sector

Issue 5, June 2021

Welcome to our latest bulletin, providing you with the latest updates on climate change developments as relevant to the insurance market.

We hope you find this bulletin useful, and please do get in touch if there are any areas you would like to discuss in more detail.

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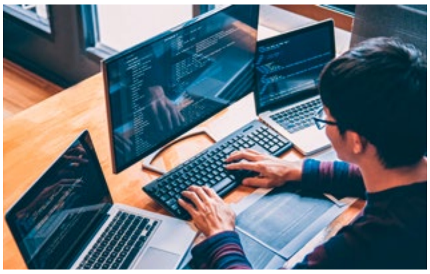
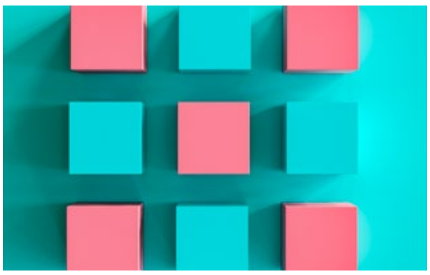
Hot off the press



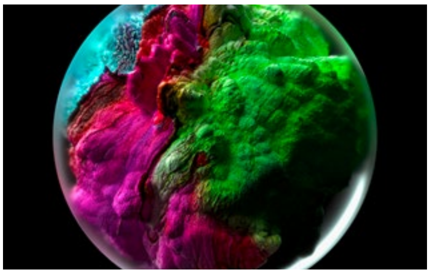
Lloyd's launches 'Futureset' - a platform to build resilience to systemic risks
In February 2021, Lloyd's of London announced that it was launching a global platform called 'Futureset'. The principal purpose of the platform is to help the government and businesses to prepare for the effect of future systemic risks. It is hoped that preparation for, and understanding of, systemic risks will ensure greater economic resilience in the event of subsequent systemic failure, as witnessed by the effects of the Covid-19 pandemic.

'Futureset' will publish 'masterclass' webinars and panel discussions with experts, academics and government officials. Lloyd's have confirmed that topics will include: the growing risks exhibited by climate change; understanding the definition and effects of systemic insurance risk; and reviewing the global response to the Covid-19 pandemic.



RMS to launch new Climate Change Models to help businesses with strategic planning
RMS, a catastrophe risk modelling company, has confirmed that it will launch its new Climate Change Models in June 2021. RMS believe the models will help companies profile and assess the short and long-term risks ensuing from climate change by combining financial data with climate science.

RMS believe the tool will help business leaders identify climate-change risks and use this knowledge to make more informed decisions to benefit the company. The aim is for this knowledge to then enhance organisations' strategic planning and long-term investments, leading to a more sustainable business industry.



Insurance Industry calls for climate change regulation

Industry concerns over the uncertainty posed by climate change risk have led Moody's to call for regulators to impose additional rules on the insurance industry. The introduction of mandatory regulations on climate change reporting would necessitate insurers improving their evaluation of climate change threats and developments. Additionally, Brandon Holmes (Senior Credit Officer at Moody's) maintains that legislation:

"Will also encourage them [insurers] to consider climate risk and sustainability more rigorously in their investing and underwriting decisions, improving their overall risk management."

This recommendation comes as the UK prepares to impose mandatory climate-related financial disclosures on insurance firms by April 2022, in line with TCFD recommendations.

New Zealand becomes the first country to introduce climate change law for insurance companies

New Zealand has announced it will become the first country to introduce an enforceable law requiring insurance companies to report on climate-change risk.

From 2023, companies will have to disclose how they manage climate-change risk, and report on their mitigation strategy, in line with TCFD recommendations. These obligations will affect any insurer managing more than NZ $1 billion of assets. The government has defended the introduction of mandatory climate-change reporting as part of its attempt to meet its 'Net Zero carbon' target by 2050. It believes that these changes will ensure that climate change risks are placed *"at the heart of financial and business decision-making*".

The Insurance Council of New Zealand (ICNZ) has welcomed the plans for mandatory disclosure of climate-related risks. However, it warned that there were major challenges for the insurance industry in implementing these disclosures. Principally, ICNZ said that insurers face three types of climate-related risks (physical, investment and liability risks) and disclosure against all 3 types of risk would clearly increase insurers' regulatory burden. ICNZ also called for clear reporting standards to be introduced to provide clarity to the insurance industry, and to streamline the disclosure process.

Australian Lenders announce plans to stop lending to coal companies by 2030

Lenders in Australia have caused controversy by announcing plans to cease all lending to coal companies by 2030. The Small Business Ombudsman has responded to complaints by proposing powers which would enable the government to reverse decisions made by banks or insurers to refuse to provide their services to entities, where the refusal was based on climate change concerns or on meeting climate-related targets. This proposal stems from widespread concerns that coal companies are increasingly unable to attain funding, and as a consequence cannot obtain the insurance policies required by their contracts, since insurers view their financial positions as too precarious and do not want further exposure to climate risk.

The banks have defended their position on three grounds. Firstly, that investors are demanding that banks actively manage climate risk and transition to greener investments. Secondly, that they are simply complying with domestic and international guidance or regulations, including the Paris Agreement, which Australia became a signatory to in 2016. Lastly, lenders contend that trading partners, such as the UK, are demanding that Australia initiate positive steps to reduce climate change and mitigate climate risk.

In recognition of the enhanced importance of the consideration of climate risks in decision-making, the Insurance Council of Australia recently established the 'Climate Change Action Committee'. It expects the Committee to raise awareness of climate-related threats and opportunities.

Swiss Re stress test reveals global GDP could decrease by 18% from climate change if no action taken

In April 2021, Swiss Re conducted a Climate Economies Index stress test in order to consider how climate change will impact 48 countries that represent 90% of the world economy.

The impact on global GDP by 2050 is as follows:

— Global GDP is expected to decrease by 18% if no mitigating actions are taken (3.2°C increase);

— Global GDP is expected to decrease by 14% if some mitigating actions are taken (2.6°C increase);

— Global GDP is expected to decrease by 11% if further mitigating actions are taken (2°C increase);

— Global GDP is expected to decrease by 4% if Paris Agreement targets are met (below 2°C increase).

The stress-test expects that, in the most extreme scenario of a 3.2°C temperate increase, the greatest impact would be to Asia's economies (China's GDP could decrease by 24%), with the US, Canada and the UK each decreasing by c. 10% and Europe by c. 11%. If the Paris Agreement targets are met, the impact will be lessened with an expected GDP decrease of 4% globally.

Swiss Re's Group chief economist said "*Our analysis shows the benefit of investing in a net-zero economy. For example, adding just 10% to the $6.3tr of annual global infrastructure investments would limit the average temperature increase to below 2°C. This is just a fraction of the loss in global GDP that we face if we don't take appropriate action*".

UN environment programme | finance initiative

Principles for Sustainable Insurance

Association of British Insurers backs sustainable insurance initiative

The Association of British Insurers (ABI), which represents over 200 member companies, has joined the UN Environment Programme's Principles for Sustainable Insurance (PSI) Initiative. The move demonstrates the trend towards climate action ahead of the UK hosting COP26, which will take place in Glasgow later this year.

The PSI was launched as a collaboration between the UN and the insurance industry in 2012 and is a global framework for the insurance industry to address ESG risk and opportunities. By joining the initiative, the ABI has agreed to the following sustainability measures:

— embed ESG issues in decision-making;

— work with clients and business partners to raise awareness of ESG issues, manage risk and develop solutions;

— work with governments, regulators and other key stakeholders to promote widespread action across society on ESG issues; and

— demonstrate accountability and transparency in regularly disclosing publicly progress in implementing the Principles.

Huw Evans, director general added "*By working together with the PSI, we can ensure that the UK industry can join with our international partners to amplify the PSI's agenda-setting work on sustainability, from implementing the TCFD (Task Force on Climate-related Financial Disclosures) recommendations to supporting the development of the Net-Zero Insurance Alliance it is establishing. There is strength in numbers*".

Bank of England tells banks and insurers to quantify climate risks
On 18 May, Sara Breeden (executive director of Bank of England) gave a speech on how financial service firms can act as stewards in the move to a 'net zero' economy. Breeden said that insurers and banks are underestimating the potential impact of climate change on their business, and believes it is critical that financial firms run climate scenarios as part of BAU risk management and quantify risks from targeting 'net zero' by 2050. She considers sudden market shifts are likely until risk management greatly improves. The Bank of England is due to launch its first climate-related stress test of insurers in June.

Guidance/Consultations

European Insurance and Occupational Pensions Authority

EIOPA issues Opinion on the supervision of the use of climate change risk scenarios in ORSA
The European Insurance and Occupational Pensions Authority (EIOPA) has issued an Opinion on the supervision of the integration of climate change scenarios in the Own Risk and Solvency Assessment (ORSA).

A previous information request revealed that a small minority of ORSAs assessed climate change risk using scenario analysis, with those who performed such assessments taking a short-term approach. EIOPA considers a forward-looking approach is essential, and that insurers should assess climate change risks in both the short and long term (next 80 years) using scenario analysis to inform strategic planning and business strategy. In particular, the following two long-term climate scenarios should be considered where appropriate:

— A scenario where global temperature increase remains below 2°C (in line with EU commitments); and

— A scenario where global temperature increases above 2°C

EIOPA expects national supervisors to perform a supervisory review of the analysis in the ORSA by collecting qualitative and quantitative data. EIOPA will start monitoring application of the Opinion by national supervisory authorities two years after publication (i.e. from April 2023).

Claims

We have picked out a selection of cases to update you on below, and will revise this monthly, updating on key cases as they progress. When speaking with Insurers and Insureds on the topic of climate change, we often note that the strategy of climate change litigation differs significantly from other forms of litigation. Climate change litigation, especially of the type we are now seeing, is often 'agenda' setting litigation, meaning that the goal of the plaintiffs is to change patterns of behaviour, such that seeking any monetary form of settlement is often not feasible. These cases demonstrate that approach, and it is important that Insurers bear this in mind, should their Insured be on the receiving end of any such claim.

US Supreme Court rules in favour of industry in procedural decision, avoiding merits decision on whether fossil fuel companies are liable for climate change impact
We have previously reported how, in January of this year, the US Supreme Court heard arguments in *Mayor & City Council of Baltimore v BP plc*, a claim brought by the city of Baltimore which is seeking to hold fossil fuel companies liable for climate change impacts. The claimant alleged that the companies misled the public about the climate threat of burning oil and gas and that the city faces large costs to protect residents, business and infrastructure against the impacts of climate change such as rising sea-levels.

Although only a narrow jurisdictional question was considered, the court held that the Fourth Circuit Court did not correctly analyse whether the case could be heard in federal court and only focussed on a narrow issue, rather than all of the industry's arguments. The case will therefore be sent back to the Fourth Circuit Court where the defendants will have another opportunity to ensure the litigation is heard in federal court, which is often viewed by corporates as a more favourable venue, rather than the state court. The ruling will likely impact other similar ongoing cases in the US.

German Climate Protection Act held to be partly unconstitutional
In a historic ruling, on 29 April 2021, Germany's supreme constitutional court held that the country's Climate Protection Act (CPA) is partly unconstitutional. Under the CPA, Germany must cut greenhouse gas emissions by 55% by 2030 (compared to 1990 levels) and to net zero by 2050.

As has been the case with many recent climate change suits, the claim was brought by young environmental activists. The claimants alleged that the CPA did not go far enough and encroached on a number of their constitutional rights such as a right to life and physical integrity, and a right to property. The judge held that "*that the provisions of the Federal Climate Change Act … governing national climate targets and the allowed annual emission are incompatible with fundamental rights insofar as they lack sufficient specifications for further emission reductions from 2031 onwards*".

The German government has until the end of 2022 to improve the CPA in order to reduce greenhouse gas emissions. The ministry of finance has already published plans to amend the targets to a 65% (instead of 55%) reduction by 2030 and net zero by 2040 (instead of 2050).

Dutch Court orders Shell to cut carbon dioxide emissions by 45% by 2030
The Hague District Court has handed down its judgment in the case of *Milieudefensie et al v. Royal Dutch Shell plc*. In a landmark decision, the Dutch Court has ordered Shell to cut its global carbon dioxide emissions by 45% by 2030, compared to its 2019 carbon emission levels. The judge affirmed that Shell held a duty of care to reduce its carbon emissions, and those of its suppliers, in line with the climate change targets set out in the Paris Climate Agreement. This is the first occasion on which a multinational company has been held to possess a legal responsibility to comply with the Paris Climate Agreement, effectively imposing a responsibility on a private company to meet internationally-agreed climate change targets.

The decision must be met with caution, since the judgment is only binding in the Netherlands. However, the verdict is likely to act as a persuasive authority to judges in the 1,300 similar ongoing cases which are currently being brought by environmental groups in foreign jurisdictions. As a result, the judgment has the potential to significantly impact the fossil fuel industry and its participants.

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