Informing Progress - Shaping the Future

FOIL UPDATE 4th May 2022

Understanding Your Clients' Universe

This event, hosted by FOIL London, took place on 24th March 2022 and was led by **Mark Huxley** of **Insure Scale UP**.

The panel:

Nigel Brook – Clyde & Co who heads the firm's UK reinsurance team and leads the firm's Resilience and Climate Change Risk practice . Nigel is a member of the FOIL London Energy SFT.

Tony Rooke – Willis Towers Watson - Director of Climate Transition Risk in the company's Climate and Resilience Hub

Olly Bain – Senior Consultant at **Carbon Intelligence London**

Panel session

Tony Rooke - what is the client universe, what does managing climate risk really mean and how do we avoid a 'so what' attitude?

The speaker's clients come from a wide range of corporate entities: insurers, banks and financial institutions. He also has a pro-bono client, which never actually manifests itself in meetings: how can we decarbonise the economy and reduce the huge risks that are going to manifest themselves on the pathway we are on? The route we are on at the moment could spell the end of the insurance industry because the world on the current pathway is virtually uninsurable in the latter half of this century.

Within this corporate client base the issues are how do they decarbonise; how do they continue to get insurance, whilst doing the right thing; and will they not get insurance if they do not do the right thing around climate change? Insurers have to decide how to manage a portfolio with a climate risk lens on, whilst recognising opportunities. Also, society at large must recognise that this is not about saving the planet (a rock) but saving our society from its own folly.

Nigel Brook -A legal perspective, with the risk in mind of measures being seen as anti-competitive.

Competition law has had a chilling effect on some of the more ambitious collaborations. There has been a tremendous shift across the board to achieve net zero by 2050. Whole new economies need to be built: a hydrogen economy, batteries at scale, continuing the drive for wind and solar, carbon capture, transforming agriculture, etc. All of this requires some degree of collaboration to speed it up and someone needs to take the lead. There is a need to share best practice, and improve supply chains but that is where competition law can become a problem. Collaboration could produce detriments for consumers, e.g., prices increasing, and the law requires evidence that they will benefit in some way.

Competition law is an inhibitor and the regulators are being pressed to provide guidance on how to strike the balance. This month, the European Commission had launched a consultation on some reasonably helpful proposed guidelines. This was followed by a consultation by the UK Competition and Markets Authority to see if any legislative change is required. The existing UK legislation provides some exceptions for 'progress', which *might* apply to sustainability. The view has been expressed that case law could evolve effectively in the UK but a sustainability task force will be looking into the issue more generally.

The speaker suggested that insurers might set out for the regulators how they are trying to balance consumer detriment with the drive for sustainability and secure comfort from the regulators.

Olly Bain - A broad view of the issues

Sustainability has moved on a long way in the last five years. When it first came in it was focused on rudimentary targets around direct energy and emissions (Scope 1 and 2, which are relatively easy to measure). The last five to seven years have seen a huge transition to an emphasis on the complete value chain, which for the legal sector produces 90% of their emissions (Scope 3, which is a totally different beast). To address this, it is first necessary to understand the data behind it and gathering that data is a hugely complex area.

The methodology around Scope 3 is still evolving. A basic model is looking at spend and then trying to estimate the associated carbon emissions. This is a starting point for finding a base-line. The next challenge is to try to improve that data. This invariably means engaging with a company's key suppliers to see where emissions can be reduced, without impacting efficiency.

The speaker's initial set of clients were those who wanted to lead the process. The clients now are those who are being pressed by those early players, who are questioning those in their supply chains.

Further observations by speakers

The point was made that an industry like insurance is hundreds of years old but is now being required to address this issue in a very short space of time. How do we avoid short-term tokenism?

Tony Rooke cited the jerk reaction of insurers and banks to reduce the funding for coal. What that has driven from some is a set of exclusionary policies for which there seems to be no scientific basis. It also suggests that there will be funding only for those who are already green. The better approach would be to ask 'how do we get those who are really black/brown to green'? This recognises that limiting the supply chain does not necessarily drive change. Change may be better influenced by collaboration.

Lawyers looking at their clients should be asking what they are assisting them to enable. Are you helping them to enable change to a low carbon economy? Are you enabling them to allow the high carbon economy to continue?

Olly Bain

Lawyers are in the early stages of this journey. As previously mentioned, with financial services firms, it is very difficult to gather and analyse the necessary data. More robust methodology is needed. Trying to overcome the problem immediately with early changes is not always appropriate. For example, there is a desire to move to electric vehicles but the infrastructure does not yet exist.

A definition of net zero is a 90% reduction in operational emissions by 2050 at the latest: no company in the world is ready for that. But companies are looking to develop a long-term strategy to achieve that but they are restrained by current law and regulation. Government support and backing is needed.

Nigel Brook

There are a number of stakeholders here. Investors have to decide whether or not to invest and what attitude to adopt to a brown investment.

There is more litigation against companies such as Shell, pushing them to move faster. However, the incumbents cannot readily be replaced by 100% green entities, particularly in the energy sector, where they are plugged-in to the world economy. They must be encouraged to move as quickly as possible towards green.

There is also increasing litigation that alleges greenwashing, where a company overstates its green credentials.

Open session

A delegate commented that a number of his clients were looking at their supply chains (portfolio alignment) and some would change the suppliers they dealt with. The problem was the point at which they elected no longer to deal with that supplier. What did the panel think?

Tony Rooke uses a process of engagement with his clients. What is it they are trying to achieve? There should be meetings with suppliers (current or prospective) to show them what the goals are and how they can assist. The supplier should be asked for their solution. They can also be asked to consider how this could be revenue earning for them as well. There must then be a matrix for judging performance and how that feeds back into the client's performance. This process tends to lead to suppliers making suggestions of their own. Suppliers that miss out invariably then up their game.

The delegate was concerned about the decision-making process. Procurement would run the process but ultimately there would be a strategic decision about one or more suppliers and then tracking performance against a wide range of other criteria. Who makes the final call?

Tony Rooke thought this depended on where this policy sits. If it only sits in one team (e.g., sustainability) it will not work. It has to be written into the strategy, with the values of the company aligned around that (sitting with the company's culture). Governance is very important.

Another delegate agreed with this approach, as he was concerned that this would be seen as a compliance matter. His company had engaged consultants to calculate emissions, which had then been published in the accounts. This was an accounts led initiative which senior management knew nothing about. This illustrated the importance of cultural change.

The question was asked whether insurers are coming under pressure from other groups, such as employees and/or consumers to change their business model in anyway.

An insurer responded that his company was looking at 'what is the full set of stakeholders'? Employees want to see certain things, including appropriate wording in policies covering concerns about the environment. But these were not yet driving forces and there is little internal pressure, which could be potent if it occurred.

On this issue, **Tony Rooke** had seen insurers engage with and exchange ideas with large groups of others, with whom they would not normally meet. These discussed the issues being faced and how they are being addressed: looking at practical steps. There are market drivers (e.g., from Lloyds), from clients and from staff. What is more important is the steps the insurers take.

Mark Huxley asked if there is enough encouragement from central government, the City of London, etc.

Olly Bain observed that not only are client companies looking at net zero strategies, but they are being questioned about sustainability in tender questionnaires. One such client was being asked to make a 3.2% year on year reduction in their carbon footprint (over five years) as part of the tender process. This sort of thing gets the attention of senior management.

Tony Rooke noted that the Bank of England had produced a supervisory statement in 2019, asking who in the financial industry was responsible for climate change/climate risk. There is increasing evidence of this approach in financial regulation in both the UK and the EU. But to work, there has to be compliance, strategy and risk management. In the USA there is a shift to mandatory disclosure. All of this is pushing the change. Lloyds of London and the banks are producing statements, building the momentum.

The question was put whether suppliers will be looking at what their customers/clients are doing and be brave enough not to do business in some cases.

An insurer was of the view that insurers will often be seen as suppliers and the whole value chain is looking at this.

An energy underwriter was aware of energy companies asking climate related questions but it had not yet become a major issue. She asked about the claims side and whether that could be used to influence behaviour.

Tony Rooke felt there was little that could be done at the claims stage: it should be when the risk is being underwritten. New underwriting terms need to build in those components. The policy could perhaps allow for ‘build back better’ but that has to be factored into the premium.

Nigel Brook spoke about resilience, where building back better is key. Some insurers are looking to replace on a ‘green’ basis, with for example white goods being replaced with a greener alternative. There are also parametric solutions.

Another delegate asked whether we are looking at a situation where it will become survival of the fittest, with those leading on this issue seeing off the others and thus presenting an opportunity to such companies.

Olly Bain

The opportunities thrown-up by these situations are often overlooked. Showing the necessary credentials in a supply chain offers up opportunities, when others may push back. This could include proving climate resilience in the short, medium and long term (where their infrastructure is sited; risks from drought, fire, etc).

Another delegate was less upbeat. He felt that being at the cutting edge as an insurer rarely worked out. There is no data for the past; the premium set tends not to be attractive; and the insurer finishes up funding R&D for the insured. He thought there was no incentive to go first in moving from oil and gas into renewable energy. It is okay for a broker but the underwriter has to explain why they went into something new, incurring losses.

Renewables do not fall into the Lloyds PIF, as they are not considered sufficiently innovative. Lloyds could perhaps provide more encouragement.

Tony Rooke agreed. There will be transitions in every industry and there will be a need to insure those products, but there is no legacy because there is so much innovation. Insurers will not underwrite risks that they cannot measure. The official sector needs to step in to help bridge that innovation gap.

A delegate from a sustainability consultants’ firm said that they had developed an ESG impact measurement tool, which includes an investor dashboard. This enables the company to communicate all aspects of its ESG to a variety of stakeholders.

Nigel Brook commented on just how fast things are changing. What seemed extreme positions five years ago are now mainstream and that will keep happening. The transition is proceeding rapidly and for businesses, waiting is not an option.

By way of follow-up on what had been said, a delegate made the point that he had been involved in looking at net zero underwriting. It is highly strategic, with portfolio alignment. A real challenge is insuring physical risks, such as properties in known flood risk areas, which are not sustainable in the long term. Insurers around the world are pulling out of various forms of physical insurance because of climate change.

Tony Rooke remarked that this is a key issue, along with transitional risk around the globe. Developing economies are likely to be hit by both the physical risks and by the collapse of their industries (a major percentage of GDP) when there is no more call for fossil fuels. It is vital that there is a managed transition.

As far as physical risks are concerned, it is difficult to factor in the medium to long term effects of climate change. If insurers cannot do it, the burden will fall on government.

The point was made that there is also conflict in some situations between the sustainable solution and how it is achieved, e.g., a Tesla car and mining the lithium for the battery. Who should make the decision about whether one outweighed the other?

An insurer thought this was an unanswerable question but the risk was ‘analysis/paralysis’, with nothing happening. This can lead to no decision or a bad decision. Leaders need to try to stop people over thinking for the time being.

Tony Rooke felt that the answer lies in what you value. The easiest step is to do/buy less/share more. But to do this the existential risks must be fully understood, to weigh-up the relative risks. These include climate change and bio-diversity, with the impact particularly on food supply. He fears that much of the thinking at the moment is short term. There has been gross under investment.

Nigel Brook observed that coal, oil and gas are extracted and consumed once, and we must move to recycling and the repurposing of items like batteries. A more circular economy is a must. Reducing the use of fossil fuels (and the vessels used to transport them) will also reduce air pollution and its impact on human health.