FORUM OF INSURANCE LAWYERS

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Can Reinsurers Encourage Environmentally Sustainable Underwriting?

IN BRIEF

A panel of experts discussed the extent to which reinsurers are able to influence and drive good ESG practices on both a national and global basis.

This roundtable event held on 24th January and was hosted by London FOIL.

The event commenced with a panel discussion led by **Mark Huxley (MH).** MH noted that the last reinsurance renewal round had been 'challenging', particularly in relation to property. Does this reflect the beginning of a period when reinsurers will adopt a more cautious approach to what they are prepared to underwrite: a warning shot to the primary market?

Leo Barran (LB) from RenaissanceRe felt that with ESG in mind, there will be drivers or enablers of the role of reinsurers in the reinsurance market. One of them is going to be the question of whether the commercial desire is matched with the commercial power. As the industry emerges from a soft market, the bargaining position of the reinsurer is going to limit the ability of the reinsurer to achieve its objectives, particularly where an objective is seen as ancillary to or separate from the overall commercial objective of writing profitable business. It may be too early to say whether this is a blip or whether, when the dust settles, it will be seen that reinsurers have used their bargaining power to take steps, for example to enable the transition to net zero.

The speaker felt that we are probably still in the thought leadership phase. The principles of sustainable insurance are still expressed in aspirational terms and are general in their drafting. The industry is discovering what is possible: after the pain of soft market conditions, there is a move to ameliorate that pain. The future will see more grip in transition towards sustainable underwriting and reinsurers having a role.

Guy Dormer (GD) from the LMA offered a perspective from the Lloyds market. The last round of renewals demonstrated that the market can drive change. This round was less about ESG than market corrections. It has yet to be seen if reinsurers can drive their own ESG/net zero agenda. However, it must be recognised that this is a long-term issue and this is merely the start of a cycle. The hardening market may be a good time to drive ESG but it may be naïve not to accept that there will be a return to a softer market long before we see 2050..

The reinsurance market can have an impact but whether reinsurers will capitalise on their better position remains to be seen.

Nigel Brook (NB) of Clyde & Co confirmed that he had seen a correction through terms and conditions and bargaining power. He agreed that this hard market has been driven by non-ESG factors: the triple blow of Covid; Russia; and then Hurricane Ian. There was an environmental aspect to the third of these and a number of reinsurers are backing-off property catastrophe. It remains to be seen whether the fact that the market has hardened for unrelated reasons will encourage reinsurers to push their own ESG agendas.

The relevance of the Net Zero Insurers Alliance, of which a number of the reinsurance heavyweights are already members, is reflected in Munich Re's decision to pull out of writing and investing in new oil and gas fields and infrastructure.

What has not come through as yet, is what other aspects of the E, the S and the G are really important to insurers. The E is bigger than climate change and the S is large and disparate. ESG is here to stay but there is no consensus yet on the specific components and how much weight will be given to the each of them.

MH suggested that the panel should 'war game' the future and what carrots and sticks reinsurers might use. Reinsurers could refuse cover, or impose terms and conditions; they could penalise or incentivise.

LB felt it was down to how good behaviour could be enforced. Past experience showed that factors included fear of the risk; regulatory imperative; or commercial imperative. Reinsurers can apply a stick where they have a fear of the risk. Reinsurers are aggregators of risk and if there is sufficient fear of an unknown then they start to adopt a herd mentality and impose certain conditions. An example was the Y2K exclusion that came in against a risk that was perceived to be unknowable and unquantifiable.

Fear is a driver in the current, harder market with a lack of confidence in the current models and whether they are adequately allowing for climate change. That is constraining capital.

One of the ways in which reinsurers can encourage good behaviour is in driving the conversations about enhancing the models and the data needed for those models. Part of the speaker's company's strategy to enable the transition to net zero is to integrate risk, working with industry partners to enhance their management of climate related risk. That is to do with data quality and working on models and is a carrot in that it informs clients' views of risk.

Reinsurers need to stay close to the regulators, so that the regulators can understand the extent to which reinsurers are able to act on the requirements that may be imposed on them. There is a tendency to see insurance and reinsurance as a pressure point that can be used to achieve objectives, e.g., cut off the supply of insurance and that could stop the export of oil and gas by Russia. This demonstrates a lack of understanding as to how the reinsurance industry works and the commercial factors at play. Regulation can be a stick used against reinsurers and there must be communication with regulators before any requirements are imposed.

NB agreed that the interaction with regulators is very important, as over the next few years we are likely to see some convergence of standards around the world. the EU has taken a lead by producing a raft of measures, some of which are the subject of lobbying from interest groups to make them more user-friendly. Elsewhere, such as the USA, coordinated policies are not emerging so rapidly.

Some insurers and reinsurers are worried about competition law: not being seen to work too closely together, e.g., all stating at the same time that they would not underwrite new oil and gas. Competition regulators in the EU and the UK are aware of similar concerns in various industry sectors and have been seeking to give reassurance.

GD felt that public sentiment should not be ignored and had been experienced at Lloyds. Similarly, reinsurers have stakeholder who may have views. Investors may look for greener alternatives. The voices of employees are increasingly becoming relevant.

There is also the commercial reality that there will be huge opportunities as a result of this transition, e.g., the renewables sector. GD also felt that clients will develop ESG policies and will wish to see these reflected in their insurers/reinsurers. There are also regulations coming into the supply chain that need to be taken into account. The speaker agreed that there are negative factors through regulation but that the positives are important.

MH asked if insurance/reinsurance needs to become global (not just global collaboration) and is that achievable?

GD agreed that it is undeniable that this is a global problem and requires a global solution. The reinsurance industry is not in a position to alone drive the global development of the legislation. It is not realistic to expect there to be a level playing field across the globe, certainly in the short or even medium term. What can be hoped for is coalescence around reporting and regulatory standards, so that everyone can follow a single course, rather than operating in a fragmented landscape. For some time to come, it is likely that reinsurers will need to develop their own agendas and fit them as best they can into different parts of the world.

NB observed that if there is a rise of 2.5 degrees or worse, large parts of the world will become uninsurable. It is in the insurance industry's collective interest to avert that. That can only be done collectively: insurers and reinsurers need to be part of the solution and regulators have a role to play as well. There is no local solution: it has to be global. Global reinsurers have a major part to play, as they reinsure a large proportion of the world's risks. If they move, or signal movement in a particular direction, that will effect change over a period.

LB was of the view that the thinking has to be multifaceted. Where the industry can safely work together (insurers, reinsurers, regulators, clients, modelling agencies) it should do that. One area of collaboration should be data standards. Improving data standards would improve the view of the risks. It would then be possible to evaluate the impact of steps taken and measures put in place. That would be vital in determining how successful reinsurers were in their efforts to move to net zero and protect the environment.

A further factor is the alignment between commercial considerations and enabling the transition towards net zero. There are commercial opportunities and that means that competition should be maintained, as otherwise, commercial opportunities may not be discovered. Areas of insurance that become less fashionable need to be discussed on a broad basis (including regulators and the government), so that transition can be managed, including the financial risks associated with them.

MH asked what the risk is of players taking the opportunity to exploit this situation in an unethical way.

GD felt that due to the relatively limited number of reinsurers and therefore their broad reach into the primary market, the reinsurer market could probably ensure that a primary writer would not offer a coverage that could be viewed from the point of view of society as unacceptable. It would be very difficult to underwrite if no reinsurer would not provide cover. This would not prevent self-insurance to an extent (although most captives do utilise reinsurance to some extent) and the reinsurance market must be wary of taking itself out of the conversation with any blanket refusal to provide cover, driving cover out of the mainstream market. Insurers and reinsurers need to work with clients to try to achieve the best outcome, wherever possible.

A delegate commented that those insurers/reinsurers who continue to insure risks that society dislikes will come under activist shareholder pressure to stop and face challenges on their ESG statements. **LB** agreed that the concern we should all have as an industry is in the binary disclosures we are required to provide and the complex nature of the portfolios that are reinsured. If a reinsurer says it has no carbon intensive risks in its portfolio it is totally dependent on the quality of the data it receives from its clients. How the reinsurer responds to pressure from shareholders and other interested parties is a challenge. In some quarters, there is a backlash against ESG. This drives efforts towards better data quality and may also drive the fragmentation of portfolios of different types of risk, e.g., more carbon intensive and less carbon intensive portfolios. That in turn could drive new tools to assist in the transition towards net zero, in those carbon intensive portfolios, arising from greater focus on particular areas of the risk.

The same delegate was interested in how to support the transition from a risk that society generally does not wish the industry to insure, without just walking away from the client. On the one hand there is no desire to leave the client to its own devices, but on the other, how far should the primary insurer go? If declining to insure oil extractors, should the insurer refuse also to insure carriers of oil? The delegate's company is concerned with clients' ESG policies and the extent to which they will be challenged about what they say ('greenwashing'). The delegate agreed that such insureds should not be driven to the dark recesses of the market. His company is currently assisting a peat extractor to transition to become a wind energy company, using the same land. Insurers can assist with transition through applying their knowledge gained through other risks.

LB agreed that it is difficult for an insurer to see down the supply chain. There is still a plurality of views within insurers and capital providers but reinsurers need to be having the conversations. Climate change is here and is a threat. Reinsurers on their own cannot affect change within the supply chain. In a hard market they can impact at certain points but hard markets do not last. Other stakeholders have to be involved who can apply pressure throughout that distribution chain. So, insurers can only drive the conversations; work with other agencies; and improve disclosure, with the attendant risk of greenwashing.

On the topic of collaboration, **MH** asked whether given its importance, the (financial) City of London should be doing more.

A delegate expressed concern about how the city then remains competitive. Any influence it exerts can only be by carrot and not stick, as the work done in the city can effectively now be done anywhere. **MH** clarified his point by asking whether a single entity could be created within the city, as a centre of excellence, driving global change.

GD observed that it is not possible to step away from a carbon economy immediately. The sustainable transition must be supported and significant commercial opportunities will arise.

Shareholder activism creates its own issues. Calls for action must be measured against allegations of greenwashing. All in the absence of consistent, quality data..

Q&A

A delegate noted that a lot had been said about the importance of data. She assumed that involved not only disclosure at inception but also throughout the life of the portfolio. In the light of that is there any scope for standardising the collection of data for reinsurers, or is that merely aspirational, given the global nature of the market?

LB responded that there is already a huge amount of data out there. A large number of products have an environmental rating and increasingly, the impact of our activities is measured. The challenge is bringing that together and standardising it, so that it can be used. The speaker felt that insurance and reinsurance could only have a limited impact in that standardisation. There are no common data standards at present, even for day-to-day purposes.

However, companies are trying to gauge the quality of a given ESG portfolio and that depends on data, for rating purposes.

GD added that there had been some movement in this direction but the standardisation of ESG data is challenging for both client and insurer. Lloyd's can and will drive that conversation within its own market.

Another delegate reported that there had been a recent article on concerns about the lack of standardisation and that brokers and insurers are concerned that there is no consistency in what questions are asked and regulators need to standardise systems globally.

GD added that the links between ESG data and ESG behaviour and underwriting performance have yet to be proven, making conversations about the benefits to clients of providing ESG data challenging.

FOIL CEO **Laurence Besemer (CEO)** observed that when tendering to provide legal services, law firms are being questioned about what their ESG policies are and about their supply chains.

A lawyer delegate confirmed that his firm had been asked about Scope III and about transporting and commuting routines, for which data was having to be collected. Scope III opens up a very wide area.

Another delegate felt that whether a firm deselected a supplier based on its ESG performance would depend on what public statements had been made about the policy and being seen to follow them through.

CEO felt that with its huge experience of industries, the insurance industry has a massive part to play in assisting existing companies to transition to greener options or even completely new activities but using existing assets, not only as reinsurers and insurers but also as employers and investors.

LB observed that no link in the chain owns the solution to the question posed by this event. Everybody, including reinsurers has a role to play. Reinsurers, nevertheless are particularly well positioned in some cases to influence change, for example by sourcing capital to support innovation.

CEO listed the risks of UK insurers walking away from an activity as:

1. That industry collapses with wider economic consequences;

2. It becomes insured by a less reputable entity elsewhere;

3. That industry loses the expertise available in the UK market to assist in managing risk.

It was felt that as this discussion had taken place in the face of a hardening market, it will be worthwhile reviewing the situation in a year's time.