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Climate change and the insurance and reinsurance industry

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This note sets out key considerations for the insurance and reinsurance industry in relation to climate change. It explains, among other things, the financial impact of climate change on the industry, the main regulatory obligations on insurers and the key risks and changes that are occurring in different lines of insurance.

Scope of this note

This note sets out key considerations for the insurance and reinsurance industry relating to climate change. In particular:

- It considers the impact of climate change on the industry, including the economic and financial impact on both insureds and insurers.
- It considers the industry memberships and organisations working to tackle climate change.
- It outlines the main regulatory obligations insurers are facing, as well as the key risks and changes that are occurring in different lines of insurance (such as, financial lines, property and construction, marine and motor insurance).
- It identifies new insurance products and innovations that are being developed to deal with climate change.

For information on materials on climate change, see Climate change toolkit.

Impact of climate change on the industry

Growing protection gap

Climate change is having a significant impact on the insurance and reinsurance industry. In a press release from March 2023, Swiss Re reported that, globally, the natural catastrophes of 2022 resulted in an estimated US$125 billion of insured losses for that year, far exceeding the 10-year average of US$81 billion. The total of both insured and uninsured losses is estimated to be US$275 billion, highlighting the growing protection gap between those who are able to access insurance and those who are either unable to afford the insurance available or cannot access any insurance cover at all.

Steps are being taken to address the protection gap in certain areas. By way of example, in the UK, Flood Re was set up to provide affordable access to insurance cover for homeowners living in areas at risk of flooding. Despite this aim, following the 2019 South Yorkshire floods, a government backed independent flood insurance review by Amanda Blanc still found that 45% of tenants did not have contents insurance and, therefore, cover for alternative accommodation when their properties flooded (see GOV.UK: Flood insurance review 2020: Doncaster, 14 April 2020).

Industry resilience

In 2022, the Bank of England (BoE) published its findings following the Climate Biennial Exploratory Scenario (CBES) it set for seven banks, five life insurers, six general insurers and ten Lloyd's syndicates (UK entities only) (see BoE, Results of the 2021 Climate Biennial Exploratory Scenario (CBES), 24 May 2022). The CBES was an exploratory exercise considering how UK insurers and banks could be affected by certain climate risk scenarios. The BoE asked firms to consider their exposure to physical risks (arising from higher global temperatures) and transition risks (arising from the move from a carbon-intensive economy to net zero emissions) in three scenarios: early, delayed or no action to achieve net zero by 2050. The BoE found that climate risks will affect profitability but the transition to net zero is not likely to result in firms' insolvency. However, while recognising the lack of available data, it also found that firms had underestimated the physical risks of climate change and there was much more work to do to in managing their exposure to climate risks. For more information on the CBES, see Practice note, Stress tests and scenario analysis:

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implications for banks and insurers: Climate biennial exploratory scenario.

These findings are reflected in other lines of business. The marine insurance market, for instance, is undoubtedly one of the lines of business that is more exposed to climate-related physical risks and extreme weathers. The frequency of weather-related losses has increased, which will only serve to drive up premiums and may even leave some assets uninsurable. For more information, see Exposure to climate risk.

In addition, these unforeseen higher value claims will add strain on insurers' underwriting and liquidity risks, putting pressure on capital. This pressure is also likely to be felt by reinsurers covering these risks.

It is likely that the transport and logistics sector will be impacted significantly by the transition towards decarbonisation. In particular, the movement towards the adoption of alternative fuel sources, such as electric and wind-powered transportation and use of natural gases, will invariably lead to new risks and different claims. For more information, see Exposure to climate risk and Electric vehicle technology: claims escalation?.

Increasing claims

It is important to note that, increasingly, there are "hidden" climate-related claims in addition to the more obvious natural catastrophe events. For example, Birgit Vosper, Head of Global Practice Group Liability for Allianz Global Corporate & Specialty, reports claims arising from melting bitumen that Allianz had not seen in the past, commenting:

> "While these may not be specifically labelled as climate-related claims, this is exactly what they are because the materials are melting as a result of the extreme temperatures. It may be impossible to properly capture all the claims that are attributable to the impacts of climate change".

In the financial lines (FL) space, the current legislative and regulatory framework is driving companies to implement environmentally sustainable business practices and greater transparency in their financial reporting. If companies fail to do this, or fail to do it competently, there could be a rise in the number of professional indemnity (PI) and directors and officers (D&O) claims and notifications from companies and their D&Os, as well as their professional advisers, such as solicitors, accountants, auditors and ESG consultants, for failing to properly advise their clients. For more information, see Impact of climate change litigation on FL insurers.

Prior to policy inception, insurers will be increasingly interested in ascertaining a policyholder's exposure to climate change and how it is protecting itself against these increased and varied claims risks. Once a claim is made, insurers will be considering the policyholder's duty of fair presentation under the insurance policy and whether all material circumstances have been properly disclosed. For information on this duty, see Practice note, Insurance: the pre-contractual duty of fair presentation under the Insurance Act 2015.

The payment of regulatory fines will be subject to the terms and conditions of the policy and will require careful coverage consideration, as well as the applicability of environmental and pollution exclusions. Causation will continue to be a difficult legal principle to overcome in such claims: for example, what is really driving the change in share price? (For an overview of the law on causation in insurance contract law, see Practice note, Insurance contract law: causation.)

Outsourcing risks

A further consideration is insurers' use of managing general agents (MGAs) to underwrite business on their behalf. This business model has many advantages and cost savings. However, outsourcing work in this way presents challenges from a climate risk perspective. Insurers may not have sufficient oversight of the types of business the MGAs underwrite. Consequently, to meet their own regulatory requirements, insurers will need to consider appropriate controls and measures to effectively assess the policyholder's exposure to climate change (see Insurers' regulatory obligations).

Rise in litigation

Given the exponential rise in climate-related litigation in recent years, it seems inevitable that claimants' attention will turn to insurers. The insurance broker, Marsh, has come under significant pressure, with various non-governmental organisations (NGOs) lodging a formal complaint with the US government, due to its involvement in placing insurance for a large oil pipeline. This is an oil project which has critical environmental impacts on nature reserves in Uganda and Tanzania, forcing thousands of villagers to leave their homes. 33 million tons of carbon emissions are expected to be generated per year from this pipeline. This case outlines the growing scrutiny on companies in the insurance industry to act ethically in relation to social and environmental issues. For information on materials on the impact of environmental, social and governance (ESG) factors, used to encapsulate the ethical corporate behaviour and social responsibility of an organisation, see Toolkit, Environmental, social and governance (ESG) toolkit: UK.

Litigation could arise from insurers' own shareholders resulting from investment decisions; from activists, critical of the practice of insuring high carbon-emitting

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companies or from policyholders for insurance cover for climate-related claims. In relation to the latter category, there has not yet been any such litigation in the UK, though it is likely to be a case of when, rather than if, this litigation is pursued.

For more information on climate change litigation, see Practice note, Climate change litigation.

Insurers' membership of organisations tackling climate change

As financial institutions, insurers do not themselves **directly** generate (that is, through scope 1 and 2 emissions) a significant proportion of greenhouse gas (GHG) emissions. However, as insurers are also asset managers (managing £1.8 trillion of investments in the UK, around 25% of the UK's net worth), the GHG emissions from their investments are captured within their scope 3 emissions.

For more information on scope 1, 2 and 3 emissions, see Practice note, Climate change terminology (UK): Scope 1, 2 and 3 emissions.

Partnership for Carbon Accounting Financials

The Partnership for Carbon Accounting Financials (PCAF) has developed the first global standard to measure and disclose emissions attributable to insurance underwriting portfolios, referred to as "insurance associated emissions". This standard was launched in November 2022. At that time, the PCAF acknowledged the significant limitations of gathering data about scope 3 emissions, stating:

> "The comparability, coverage, transparency, and reliability of scope 3 data varies greatly per sector and data source. Furthermore, scope 3 data will be collected by a mixture of sources that vary per re/insurer. The basis of collating, processing and publishing these figures will also vary by re/insurer, and methodologies must be developed in a way that best suits the internal capabilities of each re/insurer".

See Partnership for Carbon Accounting Financials: PCAF launches the Global GHG Accounting and Reporting Standard for Insurance-Associated Emissions, 16 November 2022.

Net-Zero Insurance Alliance

The UN-convened Net-Zero Insurance Alliance (NZIA), part of the Glasgow Financial Alliance for Net Zero, comprises insurers and reinsurers that have committed to transition their (re)insurance underwriting portfolios to net zero GHG emissions by 2050, consistent with a maximum temperature rise of 1.5°C above pre-industrial levels by 2100, in line with the Paris Agreement. The NZIA, which is accredited by the UN Race to Zero campaign, had 29 members at the start of April 2023, representing approximately 15% of global premium volume. However, as of September 2023, this had reduced to 11 members with a number of withdrawing members citing competition infringement concerns. As a result, the NZIA has relaxed its membership rules. It no longer requires new members to set or publish targets, but has asked members to "be responsible and publicly accountable for any targets they set".

Net Zero Asset Owner Alliance

The UN-convened Net Zero Asset Owner Alliance (NZAOA) is a member-led initiative of institutional investors committed to transitioning their investment portfolios to net-zero GHG emissions by 2050. Members must set five-year interim targets within 12 months of joining. However, critics have asserted that this transition is not taking place quickly enough. Research from the University of Edinburgh and SDG Labs found that seven members of NZAOA owned more fossil fuel company bonds than Vanguard (an average market benchmark without any climate considerations).

ClimateWise

ClimateWise, part of the University of Cambridge's Centre for Sustainable Finance, has 40 members, comprising insurers, reinsurers, brokers and loss adjusters, that are required to disclose annually against the ClimateWise Principles framework. They also undertake research and have produced reports relating to transition risk, net zero underwriting and climate product innovation, among others. ClimateWise focus on four key areas:

- Measuring and reporting on carbon footprint.
- Integrating climate risk into underwriting and investment decisions.
- Developing sustainable insurance products.
- Engaging with stakeholders to promote climate change action.

The ClimateWise Principles Independent Review 2022 has shown that insurance firms have made progress in their disclosures and response to climate change. Neena Seega, the Director of Sustainable Finance at the Cambridge Institute for Sustainability Leadership (CISL) has highlighted the focus for the industry, which "needs to move to insurers, reinsurers and brokers

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becoming… enablers of enhanced climate financing, climate resilience building and climate solutions". (See University of Cambridge: Cambridge Institute for Sustainability Leadership, ClimateWise Principles Review 2022 press release, 20 January 2023.)

Insurers' regulatory obligations

This section outlines some of the key regulatory obligations insurers and reinsurers have to comply with.

For more information on applicable regulatory requirements, see Practice note, Hot topics: UK regulation of sustainable finance.

Task Force on Climate-related Financial Disclosures

Set up by the G20's Financial Stability Board (FSB) in 2015, the Task Force on Climate-related Financial Disclosures (TCFD) issued recommendations for better climate-related financial disclosures on carbon-related assets and exposure to climate-related risks and opportunities.

It became mandatory for UK insurers with over £500 million of turnover and over 500 employees, from April 2022, under the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 (SI 2022/31) (CFD Regulation), to disclose this information in their annual report. For more information, see Practice note, Strategic report: non-financial and sustainability information statement: financial years beginning on or after 6 April 2022: Companies legislation on NFSI statement.

More broadly, engagement by insurers with the TCFD is on the rise. The 2022 TCFD Status Report found that 58% of 118 large insurance companies disclosed information aligned with risks and opportunities for strategy on climate change (see Financial Stability Board: 2022 TCFD Status Report: Task Force on Climate-related Financial Disclosures, 13 October 2022). Between 2019 and 2021, the number of insurance companies reporting information increased by 20%.

For more information on the TCFD recommendations, see Practice note, Task Force on Climate-related Financial Disclosures (TCFD): recommendations.

Financial Conduct Authority requirements

The Financial Conduct Authority (FCA) issued amendments to its Listing Rules (LR) introducing climate-related disclosure requirements in 2020 (see LR 9.8.6R(8)) and extended these requirements to certain issuers of standard listed equity shares in 2021.

Insurers caught by these rules must declare whether they have made disclosures consistent with the TCFD's recommendations in their annual report or explain why not. The FCA issued further non-binding guidance in February 2022 on the climate details to include in a company's strategic report or a limited liability partnership directors' report.

For more information on these requirements, see Practice note, TCFD recommendations: climate-related financial disclosures for premium listed and standard listed companies (LR 9.8.6R(8) and LR 14.3.27R).

Prudential Regulation Authority requirements

The Prudential Regulation Authority (PRA) (the regulatory arm of the Bank of England (BoE), which also regulates UK authorised insurers), published its latest climate risk report in March 2023. It expects firms to "develop and embed effective risk management processes to manage their climate risks".

For more information on the PRA's expectations, and the applicable regulatory requirements in this area, see Practice note, Managing climate-related financial risks: PRA requirements and expectations.

Enforcement action

To date, no enforcement action has been taken. However, the regulators are facing mounting criticism for not sufficiently addressing the quality of climate-related financial disclosures and, more generally, not using their powers to effect a greater reduction in climate change (specifically for not doing enough to support the UK economy towards net zero emissions).

For information on materials on investigations and enforcement, see Practice note, A guide to key resources: financial services investigations and enforcement materials.

Climate Change Act 2008

Underwriting high carbon emitting entities: divestment versus engagement

Under the Climate Change Act 2008, the UK government has committed the UK economy to have net zero greenhouse gas emissions by 2050 (see Practice note, Climate Change Act 2008). While established high carbon industries are still highly attractive insurance risks (in terms of profit and claims), the last few years have seen a significant divestment in insurers' underwriting of coal, tar sands and Arctic drilling and exploration. According to Insure our Future (a global campaign group of NGOs and others who monitor the

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insurance industry in terms of its actions in relation to climate change), as of October 2022, 41 insurance companies around the world have adopted coal exit policies representing 39.3% of the insurance market and 62.1% of the reinsurance market (see Insure our Future: The Sixth Annual Scorecard on Insurance, Fossil Fuels and the Climate Emergency).

Increasingly, insurers are placing cover with environmentally sustainable or low carbon companies at preferential rates and increasing premiums for those that do not have a clear net zero transition plan in place, in an effort to incentivise better practice.

The insurance market generally considers oil and gas fuels to be transition fuels, of vital importance in the short- to medium-term and is, therefore, focused on engagement rather than divestment in this area. This means that insurers will offer coverage to these high carbon emitting policyholders, but may then require those policyholders to put in place transition plans (to net zero) or carbon reduction targets.

In its 2023 Climate and Biodiversity Report, AXA, for example, stated that the "AXA Group no longer underwrites greenfield oil exploration projects. Exemptions may be granted to companies with the most far-reaching and credible transition plans, based on a case-by-case review. Restrictions will take effect with a 12-month grace period ending on January 1, 2024" (see AXA.com: 2023 Climate and Biodiversity Report, 29 June 2023).

Insurance lines of business

Climate change has an impact on a number of insurance lines (types) of business/policies provided by insurers, some of which are examined below.

Financial lines policies

FL insurance generally provides the following policies for various policyholders, including financial institutions:

- D&O liability.
- Employment practices liability.
- Corporate crime.
- Professional indemnity (PI).
- Cyber liability.

PI is used to describe liability cover for professional services provided by traditional professionals; for example, solicitors, accountants, surveyors and architects, as well as emerging professionals, such as ESG consultants. For more information on PI insurance, see Practice note, Professional indemnity insurance: an overview and Checklist, What to look for in a professional indemnity insurance policy. For information on D&O insurance, see Practice note, Directors' and officers' liability insurance and Checklist, What to look for in a directors' and officers' liability insurance policy. For an overview of cyber insurance, see Practice note, Cyber insurance: an overview.

Regulatory requirements

See Insurers' regulatory obligations for some of the key existing law and regulation on climate change that may affect FL insurers. In addition to this, and of particular importance to FL risk and exposure, are the requirements outlined in the sections below.

Net zero regulations. One of the recommendations made by the Advisory Group on Finance for the UK's Climate Change Committee in its 2020 report was that net zero targets and plans should be made mandatory for financial institutions, including insurers.

In a bid to tackle the inconsistencies in the disclosure of climate transition plans, HM Treasury launched the Transition Plan Taskforce (TPT) in April 2022. Following a consultation that concluded in February 2023, the TPT is expected to publish its Final Disclosure Framework and Implementation Guidance in autumn 2023. This may make the disclosure of standardised transition plans a requirement, which the UK government and FCA will likely draw on.

This would no doubt increase the regulatory burden on both insurers and their policyholders. However, it could also be of great assistance to insurers since it will enable them to assess policyholders' transition plans and improve their ability to review their entire underwriting portfolio.

For more information, see Practice note, Net zero transition plans for UK companies.

FCA proposed sustainability disclosure requirements (SDR). The SDR proposals will apply to all FCA regulated companies and will take effect as early as Q4 2023. The proposals include further mandatory disclosure, an anti-greenwashing rule and the option for firms to attach sustainable investment labels to products (if they meet the proposed criteria). The new SDR will expose companies to increased regulatory risk. Consequently, D&O insurers should expect to see a greater number of claims under policies for the costs of responding to these investigations.

For more information on the SDR, see Practice note, Hot topics: proposed FCA sustainability disclosure requirements (SDR) and labelling regime.

Financial Services and Markets Act 2000 (FSMA) reform. FSMA sets the framework for the UK financial services regulatory regime. The Financial Services

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and Markets Act 2023 (FSMA 2023) makes significant amendments to FSMA, with a view to giving the UK the chance to create a more competitive financial services sector post-Brexit. The key measures include:

- The introduction of a regulatory principle for the FCA and PRA recognising the net zero target as set out under the Climate Change Act 2008 and environmental targets, replacing the existing sustainable growth principle.
- Requiring HM Treasury to carry out a review of forest risk commodities, assessing whether UK regulation is adequate for eliminating the financing of the use of prohibited forest risk commodities or products derived from these commodities, the use of which is prohibited by paragraph 2 of Schedule 17 to the Environment Act 2021.

For more information, see Practice note, Financial Services and Markets Act 2023.

Climate change litigation. The current legislative and regulatory framework is driving companies to implement environmentally sustainable business practices and greater transparency in their financial reporting. If companies fail to do this, or fail to do it competently, the number of claims and notifications will continue to rise.

For FL insurers, there is a greater risk of third party claims against companies and directors (under management liability or D&O policies) as a result of:

- **Incomplete or incorrect disclosures of climate risks or a failure to address and mitigate such risks.** Overstating a company's commitment to climate change is where "greenwashing" comes into play. This has been referred to in ClientEarth's claim against Shell (*ClientEarth v Shell Plc and others [2023] EWHC 1137 (Ch)*) where it alleged the board failed to implement a climate strategy to achieve net zero emissions by 2050 (see Legal update, ClientEarth refused permission for derivative claim against Shell on directors' approach to energy transition and climate risk at oral hearing). Also, the High Court claim of *McGaughey v Universities Superannuation Scheme Ltd [2022] EWHC 1233 (Ch)* included a claim against directors of a pension fund for not having plans to divest from investment in fossil fuels. The claim was unsuccessful on the basis that the claimants had not demonstrated they had suffered a quantifiable financial loss. Difficulties proving causation and loss is a commonly occurring theme in these civil actions. *McGaughey* was appealed to the Court of Appeal, but was also unsuccessful. Nevertheless, these cases can have significant negative repercussions for businesses and their insurers in terms of adverse publicity, reputational damage and defence costs (with its consequential impact on insurance premiums), even if policyholders (and their insurers) are ultimately successful in defeating the claim. What is important, however, is that while climate related disclosures are new, financial reporting is not and the same legal principles apply for corporates and their D&Os.
- **Shareholder activism.** Corporates, their D&Os and their insurers are well versed with shareholders using their shareholder rights to effect change within an organisation. This is not set to change. However, what is being seen now is NGOs purchasing shares for this very purpose: ClientEarth being a key example with shareholdings in Shell and also Enea (see ClientEarth: Court win in world-first climate risk case puts future of Ostroleka C coal plant in question, 1 August 2019).
- **Regulatory action.** An increased regulatory framework paves the way for more regulatory investigation and claims against corporates and their D&Os and, as FL insurers are aware, investigation costs are not insignificant. The number of notifications and claims are also likely to increase due to a broad and widely held public expectation that financial businesses should be leading the force for positive environmental change.
- **Loss to third parties.** There is also the ongoing question of whether corporates should face responsibility for ongoing costs associated with climate change and loss caused to third parties. This is seen already with the German case, *Lliuya v RWE AG*, ((2015), Case No 2 O 285/15 Essen Regional Court) in which a Peruvian farmer is claiming the German energy company RWE has an obligation to protect the farmer's nearby hometown from a swollen glacier lake at risk of overflowing from melting snow and ice.

For more information on the key issues, trends and cases in climate change litigation globally, see Practice note, Climate change litigation.

Increased risk of third party claims

For PI insurers in particular, there is a greater risk of third party claims against the professions outlined in the sections below.

Auditors and accountants The Financial Reporting Council (FRC) has consulted on its corporate governance code. The version of the draft code consulted on recommends that companies should report on the sustainability of their business model and how environmental and social matters are taken into account in the delivery of their strategy, including their climate ambitions and transition planning. Accountants and auditors face a greater risk of PI claims and notifications if they fail to advise their professional clients on these financial reporting recommendations, particularly if they become mandatory.

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PI insurers will also see more notifications where finance professionals are involved in providing strategic advice that accounts for climate risk, as well as those preparing prospectuses, annual reports and other communications with investors and customers, in the event that untrue or misleading statements are included in those communications.

When it is finally tabled, the Audit Reform Bill will propose wide-reaching reform of audit and corporate reporting and to rename the FRC the Audit, Reporting and Governance Authority (ARGA). The FRC's three-year plan (dated March 2023) suggested that ARGA is now unlikely to be created by legislation before April 2024. However, once implemented, it is anticipated that it will impose stricter reporting regulations that will, in time, extend to climate change and sustainability, with greater sanctions for failing to comply.

For more information on the FRC's proposed reforms and the changes being introduced by the Audit Reform Bill, see Practice note, Audit reforms: proposals, impact and implementation of the Kingman, CMA and Brydon reviews and BEIS reforms.

Solicitors. Lawyers can expect to face claims for breach of duty to warn their clients about potential climate risks, for example, in property transactions where there is a risk of flooding. There could also be claims brought against lawyers advising clients on achieving B Corp status (that is, companies verified by B Lab to meet high standards of ESG performance). In guidance published in April 2023, the Law Society considers the impact of climate change on solicitors' professional duties and highlights the increased risk of regulatory investigations and claims in failing to do so.

For more information on B Corp status, see Article, Law firms and the B Corp movement: good corp, B Corp. For information on the law relating to claims against professionals, see Practice note, Professional negligence.

Valuers. Valuers will face claims if they fail to take into account the impact of ESG factors on value. According to media reports in May 2023, property professionals are seeing a trend for buyers down-sizing and an appetite for more energy-efficient new-build homes. Inevitably, this demand will increase the value of this type of property (with a corresponding decrease in the value of older, less cost-efficient homes). Valuation Practice Guidance Applications (VPGA) 8 section 2.6(c) requires valuers to have a working knowledge of the impact on value of sustainability and ESG issues in the short, medium and longer term. Those valuing properties or advising on geo-technical risks (valuers as well as architects, surveyors, solicitors or geo-technical experts) can expect to face more claims when property damage and consequent losses arise from issues which they failed to identify or claims that properties have been over-valued because a valuation figure did not take into account a specific climate risk.

For more information on VPGA, see Practice note, Property valuations under Rule 29 of the Takeover Code: The RICS valuation standards.

ESG consultants. There is a growing trend for hiring specialist ESG consultants as third party experts to advise and design ESG strategies. They can offer advice across the whole spectrum of ESG themes including:

- Helping to build and maintain ESG policies and procedures.
- Developing and monitoring key performance indicators (KPIs).
- Creating statements of corporate values and behaviour.
- Performing due diligence reviews and risk assessments of targets, investors or supply chains.
- Helping with ESG disclosure reporting.
- Peer benchmarking.
- Undertaking culture audits.
- Anticipating developing ESG regulatory obligations.
- Performing carbon footprint assessments.
- Developing crisis response strategies.

In turn, this is likely to give rise to a greater exposure to PI claims, given the specialist nature of their role and increasing climate change risks.

Construction professionals. Construction professionals, such as architects, face claims for failing to design and construct buildings and products that can withstand the extreme fluctuations in weather and temperature that are becoming increasingly common in the UK. They are also facing new risks created by new green products and sustainable methodologies in areas such as drainage, solar and wind loads.

For more information on climate change issues in the construction industry, see Sector note, Climate change and the construction industry.

Climate change exclusions

In terms of policy coverage, liability is often limited by "acts of God"' or *"force majeure"* clauses (that is, events beyond human control such as natural disasters, earthquakes, hurricanes or floods). As climate change continues to contribute to the rise in extreme weather events, there is a debate as to whether these events are influenced by human activity, no longer rendering

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them as an act of God. This is something for FL insurers to consider moving forward. FL policies may or may not specifically exclude coverage for losses caused by climate change and this depends on the specific wording of the policy.

Public liability and casualty policies

While climate-related liability for property damage and personal injury is often not specifically excluded from many public liability covers, it is highly likely that if a policyholder sought cover for this, it would be declined by the insurer on the basis that the damage is not "'accidental'" or that it fell within an exclusion of cover for pollution or contamination. Indeed, in the US claim *Aloha Petroleum v National Union Fire Insurance (Docket number 1:22-cv-00372)*, the insurer has rejected a claim by its fossil fuel policyholder for coverage to defend claims it is facing by two Hawaiian cities for climate-related damage citing the "pollution" exclusion under the policy.

To clarify the position, in November 2021, the Lloyd's Market Association published LMA5570, which is a model climate change exclusion for use on liability policies where a policyholder has caused or contributed to climate change or its consequences. This exclusion is being increasingly used, particularly in liability policies issued to policyholders in the fossil fuel sector.

Potentially providing a solution to this, and working in partnership with The Chancery Lane Project (TCLP), the authors have developed two clauses which, for the first time, will allow insurers to offer their commercial clients liability cover for climate-related injury or property damage claims. Seb & Abby's Clause provides climate-related liability cover and works in conjunction with Connor's Clause, requiring policyholders to put in place a robust net zero transition plan, including emissions reduction targets, before the commencement of cover (see The Chancery Lane Project: Climate-related liability cover (commercial insureds); Seb & Abby's clause, 11 April 2023 and Condition to liability cover for climate-related claims (commercial insureds); Connor's clause, 1 September 2020).

Given the scale of the physical impacts (for both people and property) of climate change, it seems highly likely that litigation for climate-related damage will become a major part of the legal landscape in the future, with the result that high carbon emitters are likely to seek risk transfer solutions to protect themselves against these claims.

The payment of regulatory fines will be subject to the terms and conditions of the policy but are often excluded under liability policies. (Regulated financial institutions are prohibited from using insurance to indemnify themselves against financial penalties imposed by the FCA or PRA (see rule 7.3, General Provisions Part, PRA Rulebook and rule 6.1.5, General Provisions, FCA Handbook).) For information on the typical scope of cover of a public liability insurance policy see Practice note, Public liability insurance: an overview.

Property and construction policies

Increased physical risks

Climate change has led (and will continue to lead) to an upsurge in the occurrence of severe weather events, or events previously uncharacteristic for certain jurisdictions (for example, property damage caused by wildfires in the UK). The impact of extreme weather events caused or exacerbated by climate change on insurers cannot be overstated. A rise in these climate-related extreme weather events has led to increased numbers of property damage insurance claims. For example, increased flood claims as well as claims arising from wildfires, are risks insurers will need to become increasingly aware of over the coming years and which, in affected parts of the US, have made a number of homes uninsurable. There has also been a rise in the number of subsidence claims. The UK summer of 2022 was the hottest on record for over 40 years, leading to a surge in subsidence claims. Analysts estimated that more than 7.65 million properties in Great Britain could be exposed to medium or high risk of soil subsidence by the 2080s.

As stated in Growing protection gap, this can result in a growing protection gap where premiums are either too high or no longer available for a particular property. This not only affects property owners, but construction companies as well.

Green building methods

The drive to greener methods of construction, building standards (such as Building Research Establishment Environmental Assessment Method (BREEAM) and Leadership in Energy and Environmental Design (LEED)) and methods to save energy, are certainly welcomed by the insurance industry. However, they undoubtedly create new risks for insurers of contractors and construction projects.

For more information on BREEAM and LEED, see Practice note, Energy issues for property lawyers: BREEAM and LEED.

Innovation risks

The Allianz PI claims insights 2023 Report ranks construction innovation among the second highest claims risk group for professionals in 2023/24. According to Allianz, the drivers of risk are twofold:

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- New methods of working that require revised and untested contract terms.
- The requirement for new standard profession-wide approaches to design and specification that are yet to be developed.

Specifically in relation to renewable energies, the key areas of risk liability include:

- **Wind projects.** The positioning of subsea cables for offshore windfarms, workmanship in the manufacturer of key parts, and completed projects not meeting forecast output levels.
- **Waste to energy plants**. Ensuring these plants meet the highest possible environmental and efficiency standards will protect these policyholders against litigation concerning their green credentials.
- **Solar projects.** Despite their increasing popularity, solar projects represent a major area of potential liability (predominantly fire damage). This is particularly so with residential construction projects where liability arises at the installation and "use" phases.

Insurers therefore ought to ensure their policyholders are giving careful consideration to design and build contracts to check that contractual obligations are understood and fall as intended, as this could have a knock-on effect for insurance coverage.

Where emerging, sustainable technologies are not being covered, the construction industry is turning to new insurance solutions, such as parametric insurance (see Parametric insurance). This can smooth out volatility and establish more comprehensive protection where, for example, there is lack of sun or too much, or too little, wind for electricity generation.

Role of insurers in public policy

Insurers have a long history of collaborating with governments and lobbying them for change in the construction and climate arena. The Flood Re Scheme is testament to this relationship. (For more information, see Practice note, Flood Risk Searches: Flood Re.)

In December 2022, over 40 construction experts (including insurers) called on the Department for Levelling Up, Housing and Communities for mandatory sustainable drainage systems (SuDs or SUDS) in new developments. SuDs are a solution to reduce the risk of surface water flooding, incidents of which are growing in number and severity due to climate change, causing insurers and the UK economy millions of pounds worth of damage. (For more information, see Practice note, Sustainable drainage systems (SUDS).)

The call to action resulted in the enactment of Schedule 3 of the Flood and Water Management Act 2010, to be enforced in 2024. Schedule 3 will provide a framework for the approval and adoption of SuDs for the lifetime of a property or construction development.

For more information on Schedule 3, see Practice note, Sustainable drainage systems (SUDS): Government approach to SUDS in England.

Climate litigation

The case of *MT Højgaard A/S v E.On Climate and Renewables UK Robin Rigg East Ltd [2017] UKSC 59* is one of the most high profile claims against those involved in the renewable energy space and concerned new wind turbine technologies. An incorrect formula in an international standard for the design of offshore wind turbines resulted in EUR26 million in costs for remedial works and subsequent litigation to decide who was liable for the risk and costs of the design error. The contract between the parties provided a "fitness for purpose" obligation and the requirement that the design life of the wind turbines would be 20 years. The Supreme Court decided MT Højgaard, which was engaged by E.On to design, manufacture and install the foundation structures for the wind turbines, owed a contractual duty to ensure the design life of 20 years and had breached that duty, notwithstanding that the international standard relied on did not provide for this length of time (see Legal update, Liability when international standard is incorrect (Supreme Court)).

The case demonstrates the issues facing construction professionals, particularly those who have to rely on new and relatively untested technologies.

Recent significant developments in climate attribution science, and cases currently pending before the courts, may in future enable property insurers to recover some or all of their potential outlay from those responsible for causing extreme weather events.

Scientists at the climate science research initiative, World Weather Attribution (WWA), concluded that the 40-degree temperatures experienced in the UK in July 2022 would have been extremely unlikely without human-caused climate change. For insurers, this means that their outlay for the destruction of homes by wildfires occurred as a result of conditions created by climate change. In the case *Lliuya v RWE AG* (*(2015), Case No 2 O 285/15 Essen Regional Court*), which is proceeding through the German courts, Mr Lliuya alleges that RWE has contributed an estimated 0.47% to global emissions, so it should therefore be liable to pay 0.47% of the cost of the works required to protect the town where he lives from being engulfed by melting glacier water. If this claim succeeds (experts have recently visited the lake, a trip that had been severely delayed by the pandemic), it will set a significant precedent for the apportionment of liability.

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The fact that extreme weather events can be causally connected to climate change, and those that have emitted the greenhouse gases may be proportionately liable, raises the prospect of claims by those impacted, including actions by insurers to recover their outlay. This may in turn enable insurers to continue to provide cover to those living in areas most at risk from natural catastrophes.

For more information, see Sector note, Climate change and the construction industry and Practice note, Climate change litigation.

Marine policies

Exposure to climate risk

Climate risk analysis provider, XDI, and insurance broker, Marsh, have indicated in a recent study that rising temperatures are leading to an increase in the desert storms which caused a ship, the Ever Given, to run aground in the Suez Canal in 2021, blocking it and preventing other ships from passing through the canal for six days. The Lloyd's List shipping journal estimated that the ship was holding up an estimated US$9.6 billion of trade. Marsh have suggested that if climate change is not tackled accordingly, similar events could happen in the future.

Shipping regulation

The shipping industry has historically lagged behind many industries in reducing its carbon footprint. In response, the global marine sector has turned to international regulation to clean up the industry and go green.

Shipowners have had to comply with the Energy Efficiency Design Index (EEDI) and the Ship Energy Efficiency and Management Plan (SEEMP) Regulations since 2013. The EEDI, similar to the more recent EEXI Regulations (referred to below), is designed to ensure that new ships are built to efficient standards and are, therefore, sufficiently seaworthy for insurance purposes (see Legal update, IMO announces first mandatory measures to reduce GHG emissions from international shipping).

The SEEMP is an operational measure which was developed and implemented by shipowners to reduce overall fuel consumption.

It is now mandatory for ships to calculate their EEXI (Energy Efficiency Ship Index). This will measure the energy efficiency of a ship's design, construction and technical features to ensure the ship meets a minimum energy efficiency standard. On 1 January 2026, the International Maritime Organization (IMO) intends (under MARPOL Annex VI Regulation 25.3) to review the EEXI measures with a view to assessing their effectiveness.

For more information on MARPOL, see Practice note, Plastics waste: summary : International Convention for the Prevention of Pollution from Ships (MARPOL).

Additionally, owners of vessels over 5,000 gross tonnage (GT) are now required to document their carbon intensity indicator (CII) and verify it against the required annual CII to determine their vessel's operational carbon intensity rating. The first annual reporting will be completed in 2023 and so initial CII ratings will be given in 2024.

In terms of impending new regulation, the 2023 IMO Strategy on Reduction of GHG Emissions from Ships includes the ambitious aim to achieve net zero GHG emissions from international shipping by 2050, and a commitment to ensure uptake of alternative zero and near-zero GHG fuels by 2030. The regulation expands the design efficiencies to all existing vessels in addition to applying carbon reduction factors to vessels.

"Indicative checkpoints" were also announced, to ensure the goal to reach net zero by 2050 is reached. These checkpoints are for a 20 to 30% reduction of GHG emissions by 2030 and a reduction of 70 to 80% by 2040.

Understanding the potential impact of all these regulations remains to be seen. However, it is likely that a vessel with a bad CII rating will be less attractive to charterers and insurers alike. Insurers may increase their premiums and charterers will likely face commercial pressure by consumers who will opt for more efficient ships.

For more information, see Practice note, Regulation of air emissions from shipping: summary.

Potential impacts of low-sulphur fuels

The sudden increase by the world's tonnage in using compliant, low-sulphur fuel could potentially cause engine problems due to the change in viscosity, instability or incompatibility of blended fuels. Damage to an engine can give rise to a number of salvage, general average, and potential unseaworthiness, arguments under an insurance policy. It will also result in delays, possibly giving rise to cargo claims.

In addition, the costs incurred in ensuring vessels are compliant may result in costs being cut in other places, especially in the current economic conditions, such as maintenance of the vessel and crew training. This could result in engine failures causing delays in scheduled arrivals time, resulting in business interruption (BI) and cargo claims, as well as allegations of unseaworthiness.

It is already evident that low-sulphur fuels are just an interim solution and, ultimately, the industry will need to invest in cleaner vessels. The improvised retrofitting of current vessels to adapt to new alternative fuels will also create new risks, many of which are not yet known.

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Insurers' role in transitioning to net zero

As outlined in Insurers' regulatory obligations, insurers and other financial institutions are increasingly subject to ESG reporting requirements, which will require insurers to incorporate ESG principles and the green credentials of vessels into their underwriting practices.

A good example is the Poseidon Principles for Marine Insurance (PPMI), a global framework launched in 2021 for assessing and disclosing the climate alignment of financial institutions' shipping portfolios. Signatories are required to measure the carbon intensity of their hull and machinery portfolio and their scores are published annually. It is likely that the information and data collected by this group will feedback into, and shape, the marine insurance market in the move towards net zero.

Motor insurance policies

Electric vehicle technology: claims escalation?

The UK government plans to cease the sale of all petrol and diesel motor cars by 2035 (pushed back from 2030). They hope sales of new motor vehicles will be electric vehicles (EVs) only by that deadline.

With a relatively small percentage of cars on the road currently being EVs, motor insurers are still getting to grips with underwriting the associated costs and risks.

The escalating move to EVs from combustion vehicles also carries with it some significant supply chain issues. In the first place, EVs require specialist repair technicians, specialist tools and equipment, and cannot be stored or towed in the same manner as traditional combustion motor cars. Motor insurers are struggling to replace damaged third party EVs with a like-for-like EV and there are far more frequent commercial write-off claims (if high voltage (HV) batteries are scratched, a replacement battery is required). This situation is being exploited by the credit hire market that is offering replacement EVs at a much higher daily rate and for a longer period of hire: a significantly increased cost for the motor insurer.

In the sphere of employer liability, EVs give rise to potential manual handling claims (due to the weight and nature of the HV batteries), safe workplace claims (due to potential HV battery explosions and fires, and high voltage electric cabling among other things) and even potential longer-term industrial disease claims (due to particulates from batteries when they are installed, damaged or replaced, and electromagnetic fields).

Public liability insurers face managing down many of the same risks and the costs of establishing proper systems of inspection and maintenance for public charging points.

There are also cyber risks and the risk of breaches of data security, both in the use of EVs and of smart charging points.

For more information on motor insurance, see Practice note, Motor insurance: an overview. For information on electric vehicles, see Practice note, Electric vehicles and charging infrastructure. For an overview of public liability insurance, cyber insurance and employers' liability insurance, see Practice notes, Public liability insurance: an overview, Cyber insurance: an overview and Employers' liability insurance: an overview.

Insurance product innovation and InsurTech

Parametric insurance

Parametric insurance (also called "index-based insurance") is gaining traction among leading insurers. Parametric insurance provides cover when certain objective criteria, such as wind speed or flood water depth, for example, are met. This means it pays out a pre-defined amount based on a specified trigger event. This is in contrast to a traditional policy that addresses specific loss or physical damage.

Initially, parametric insurance products focused on providing protection gap solutions in collaboration with supranational banks and NGOs. Increasingly, this is becoming a competitive alternative for policyholders otherwise facing significant premiums for certain perils, such as floods and hurricane damage. By way of example, Ola Jacob Raji, Commercial Director UK & Ireland at Descartes Underwriting, has said:

> "Descartes provides a new type of data-driven, rapid payout insurance called parametric, covering the full spectrum of climate risks and natural catastrophic perils. For example, when public or private sensors detect a flood at a pre-agreed trigger depth, we validate the data and swiftly organise the payout process...Most cases take less than a few days or weeks...with no loss adjustment and no excess".

It is likely 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.

Insuring the transition

Many insurers are creating products to insure the transition to a net zero economy. An example is insurance for the emerging voluntary carbon market. New insurers such as OKA and Kita offer cover to those

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that have purchased carbon credits thereby providing security and, it is hoped, increasing investment.

Other new products include those that facilitate the use of renewable materials or energies and the use of alternative building practices in construction. Examples of such products include eco-friendly replacement materials endorsements, broad coverage for alternative energy sources and premium discounts for LEED certified homes (issued by the US Green Building Council).

For more information on LEED, see Article, Green Buildings: Laws and Practices: LEED Certification.

Policy wordings

Sustainable insurance clauses are designed to increase communication between insurers and policyholders, put climate change on the agenda and promote sustainable practices in line with a net zero future. Ten insurers have now joined Flood Re's Build Back Better scheme, which provides an extra £10,000 of cover after flood damage to install flood-resistant and resilient measures.

Catastrophe bonds

Catastrophe bonds (CAT Bonds), a type of insurance-linked security (ILS), are fixed income instruments issued by insurers and reinsurers to transfer to investors' exposures from potentially large insured losses associated with natural catastrophes, as well as other "perils"' such as terrorism and cyber risk. These bonds provide a form of reinsurance so that the insurer's liabilities are covered, and they can afford to settle in full and aid recovery. In return, investors in CAT Bonds get paid a fixed rate of interest, just like a regular bond. The challenge is to calculate each CAT Bond's true risk and identify the opportunities with the most attractive yields.

For more information on ILS, see Practice note, Insurance linked securities (ILS) regime. For information on InsurTech developments, see Sector notes, Pinsent Masons' InsurTech column and Smart contracts and their application in the insurance sector.

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