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13 December 2021

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The Society of Lloyd's and the Council of Lloyd's

For the attention of Bruce Carnegie-Brown, John Neal, Patrick Tiernan, David Sansom and Rebekah Clement

By email

Dear Society of Lloyd's and Council of Lloyd's,

Lloyd's of London Environmental, Social and Governance Guidance

Summary

1. The Society of Lloyd's (the "**Society**") environmental, social and governance guidance for Lloyd's managing agents (the "**Guidance**") has now been published online.[1] The Society has publicly committed to transition the Lloyd's market (the "**Market**") to net-zero emissions by 2050, but the detail of the Guidance shows that, in reality, it is not taking meaningful action to achieve that.

2. This letter sets out why the Guidance is wholly inadequate to set the Market on a science-based transition to net-zero, or to mitigate the Market's climate risks and impacts – which puts the Society and Lloyd's Council (the "**Council**") members at risk of breaching their legal duties in relation to climate change. The main problems with the Guidance's position on climate change are:

   a. *Not binding*: The Guidance is not binding on managing agents, so they are free to disregard both the Guidance and the Society's stated net-zero ambition.

   b. *Lack of transparency*: The Guidance does not provide for any public disclosure of individual managing agents' or syndicates' environmental targets, nor for any disclosure of their individual progress towards those targets (in particular through disclosure of underwriting and investment portfolio emissions). They therefore will not be held publicly accountable if they fail to take action to transition to net-zero.

   c. *Unclear long-term emissions target*: The Guidance does not clearly stipulate that managing agents should target net-zero emissions in their syndicates' underwriting and investment portfolios by 2050.

   d. *No short or medium-term emissions targets*: The Guidance does not set any targets, standards or guidance for short or medium-term emissions reduction, on a science-based pathway to net-zero emissions by 2050. In particular, it does not ask managing agents to align with limiting warming with 1.5°C (in line with the goals of the Paris Agreement[2] and the UK Government's

[1] See Insure Our Future's website.

[2] In particular, Article 2.1.a of the Paris Agreement under the United Nations Framework Convention on Climate Change sets the goal of *"Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels"* and Article 2.1.c sets the goal of *"Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development"*.

emission reduction commitments[3]). Managing agents may therefore decide to take little or no meaningful action on climate change in the short to medium-term.

e. *No fossil fuel phase out*: There is no guidance on (or targets for) phasing out fossil fuels. In fact, the Guidance rows back from the Society's previous commitments in relation to phasing out coal, tar sands and Arctic oil set out in its ESG Report 2020 (the "**Fuel Targets**"). Managing agents and syndicates may therefore continue to underwrite fossil fuel projects that are incompatible with a science-based pathway towards net-zero emissions.

3. As a result, the Guidance does not set up an effective framework for managing agents or syndicates to embark on a science-based transition to net-zero, and is unlikely to lead to any significant change in the underwriting activity of Lloyd's syndicates in the near future. In particular, it does not ensure that the Market transitions away from underwriting fossil fuels (and other carbon-intensive activities) in line with climate science. Ultimately, the Guidance is a step backwards, as it no longer sets any clear expectations for managing agents to stop underwriting the most harmful fossil fuels. In this crucial decade for climate action, the Society is rowing back from previous commitments that were themselves inadequate.

4. The Society and Council members are under legal duties to mitigate the risks Lloyd's members face from a warming world by reducing the Market's contribution to climate change, as set out in our letter dated 14 June 2021 (our "**First Letter**"). As the Guidance is ineffective to mitigate the Market's impact on climate change (for the reasons summarised above), the Society and Council members are at risk of breaching these legal duties.

5. In addition, as the Guidance is so ineffectual, Lloyd's risks misleading the public and policyholders as to the climate action it is taking. The Society's public commitments regarding the Market transitioning to net-zero suggest that the Society is taking meaningful action to meet those commitments. But the detail of the Guidance reveals that it is not. This risks putting the Society and Council members in breach of their legal duties not to mislead, as set out in our letter dated 3 November 2021 (our "**Second Letter**").

6. We call on the Society to address these problems by issuing binding directions to managing agents requiring them to adopt a science-based pathway towards net-zero underwriting and investment emissions, including phasing out cover for fossil fuels in line with climate science.

7. In this letter, we:

   a. summarise the five key problems with the Guidance's position on climate change, as listed at paragraph 2(a) to (e) above (see paragraph 8);

   b. explain that, as a result of these problems, the Society and Council members are at risk of breaching their legal duties (see paragraph 31); and

   c. outline how the Society can address these problems and comply with its legal duties by issuing further directions to managing agents on climate change (see paragraph 35).

[3] The UK Government has committed to reducing territorial emissions (compared to 1990 levels) by 68% by 2030 (see the Government's 'UK Nationally Determined Contribution' (2020)) and by 78% by 2035 (see the Carbon Budget Order 2021), and to reduce to net-zero emissions by 2050 (see section 1 of the Climate Change Act 2008).

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Problems with the Guidance position on climate change

Not binding

8. The Guidance is not binding on managing agents. In our First Letter, we set out the Society's and the Council's legal powers to issue binding directions to Lloyd's members to comply with climate targets. However, you have chosen not to use those powers.

9. Instead, the Guidance states that the Society has merely *"asked"* managing agents to submit an appropriate ESG strategy and *"encouraged"* them to identify an appropriate policy on sustainable insurance. There is nothing to prevent managing agents disregarding these asks entirely.

10. The Society's press release on 28 October 2021 suggested that the Society's new expectations for net-zero plans would at least be built into Lloyd's business planning cycles in a meaningful way.[4] However, in reality the Society is not doing so. The Guidance states that managing agents will be asked to submit their ESG strategy as part of the 2023 business planning process, but makes clear that the Society will not take any formal action in relation to those strategies. The only action it intends to take is to review the ESG strategies and *"provide thematic feedback for consideration"*. Again, there is nothing to prevent managing agents disregarding any feedback.

Lack of transparency

11. There is a concerning lack of provision for transparency in the Guidance. In particular, there will be no disclosure of individual managing agents' or syndicates' climate policies or targets, nor any disclosure of their individual progress towards those targets (which should include disclosure of the emissions associated with their individual underwriting and investment portfolios). The only public disclosure under the Guidance will consist of aggregated data for the whole Market.[5]

12. This lack of transparency, coupled with the fact that the Guidance is not binding, means that managing agents and syndicates are free to take no action to mitigate climate change or reduce their underwriting emissions. They will face no action from the Society (except receiving thematic feedback) and will not be held publicly accountable (given the lack of transparency on their individual climate action).

Unclear long-term target

13. The Guidance does not directly ask managing agents to transition to net-zero emissions by 2050. Instead, it states: *"Managing agents are encouraged to identify an appropriate policy on sustainable insurance that considers ESG integration and which supports Lloyd's ambition for the market's overall transition towards net zero"*.

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[4] Lloyd's press release, 'Lloyd's joins the Net-Zero Insurance Alliance and becomes part of the Glasgow Financial Alliance for Net Zero' (28 October 2021), which states: *"These new formal expectations will be embedded into the Lloyd's market oversight framework, putting climate action at the heart of annual business planning cycles with syndicates."*

[5] The Guidance states that Lloyd's will develop a climate transition measurement methodology and disclose aggregated data on the overall market's progress as part of its *"Sustainability Transparency and Reporting regime"*. The Guidance contains little detail on the nature of this measurement methodology, but we infer that it will be based on a carbon intensity metric (rather than absolute emissions) as the Guidance states that it will identify *"current carbon intensity hotspots in underwriting portfolios"*.

14. This language appears to be deliberately vague. It is unclear what supporting Lloyd's net-zero ambitions involves. For example, it is unclear whether it requires the managing agent to actually target net-zero emissions itself. In addition, it does not state what the scope of any emissions target should be (e.g. whether it includes the scopes 1-3 emissions associated with both underwriting and investment portfolios). Furthermore, it does not set a date for achieving net-zero.

15. Lloyd's is failing to even directly ask managing agents to target net-zero emissions by 2050, let alone set a binding framework to ensure they actually target and achieve net-zero. This is disappointing, and calls into question whether the Society is genuinely committed to transitioning the Market to net-zero emission by 2050. It also falls short of public commitments by the Society in relation to its net-zero ambition.[6]

No short or medium-term targets

16. The Guidance states that the Society is committed to the Market achieving net-zero emissions by 2050 (despite it not directly asking managing agents to do so, as set out above). However, the Guidance does not address short or medium-term emissions goals, or the need to follow a science based emissions reduction pathway towards net-zero emissions. This means that managing agents could fully comply with the Guidance by simply setting a long-term 2050 target, without taking any meaningful action to reduce emissions in the short or medium-term.

17. Targeting net-zero emissions by 2050 alone is clearly insufficient to mitigate the Market's climate impact or the climate risks it faces (which were set out in our First Letter). The principle of targeting net-zero emissions by 2050 is based on the Intergovernmental Panel on Climate Change's ("**IPCC**") analysis that, in order to limit warming to 1.5°C over pre-industrial levels, there must be rapid reductions in emissions transitioning to net-zero emissions by 2050.[7] As part of this, the IPCC found that there must be a 45% reduction in emissions by 2030 (compared to 2010 levels). If Lloyd's ambition to align the market with net-zero emissions by 2050 is meaningful, and not simply greenwash, then it should be intended to align the market with limiting warming to 1.5°C – including targeting the short and medium-term emissions reductions required for this, in line with climate science.

18. The Society appears to be aware of the need to follow science-based pathways towards net-zero emissions, and yet it is not asking managing agents to do so. The Guidance describes how to assess whether a policyholder's transition plan is credible, and states that policyholder transition plans should adopt *"a science-compatible pathway to limiting global warming with 1.5°C or 2°C"*. However, notably the Guidance fails to ask Lloyd's managing agents to comply with those same standards in their own transition plans.

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[6] For example: Lloyd's press release, 'Lloyd's provides market guidance and best practice for establishing an ESG framework' (25 October 2021) states that *"Lloyd's has committed to achieve net zero by 2050"*; Lloyd's press release, 'Lloyd's joins the Net-Zero Insurance Alliance and becomes part of the Glasgow Financial Alliance for Net Zero' (28 October 2021) states that *"Lloyd's will advocate and support all market participants to introduce and implement their own net zero plans in order to reach a net zero underwriting position for the market by 2050 at the latest"*; and the Statement of commitment by the Lloyd's Corporation for the Net-Zero Insurance Alliance (October 2021) states that Lloyd's will advocate for market participants to introduce net zero plans to support the transition to *"net-zero emissions by 2050 consistent with a maximum temperature rise of 1.5°C"*.

[7] IPCC, Special Report: Global Warming of 1.5 ºC (2018).

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No fossil fuel phase out

19. Rapid reductions in fossil fuel production are needed in order to limit warming to 1.5°C. As set out in our First Letter, annual production of coal, oil and gas must fall by 11%, 4% and 3% annually respectively,[8] and there must be no new or expanded fossil fuel production.[9]

20. In order to align their underwriting portfolios with such reductions, Lloyd's managing agents will need to have a specific fossil fuel phase out policy for their syndicates. The Guidance provides that managing agents should consider ESG risks arising from underwriting carbon-intensive businesses. However, this falls short in two regards. First, there are no targets or guidance on phasing out fossil fuels specifically, and in fact the Guidance rows back from the existing Fuel Targets. Second, it does not direct managing agents to exclude cover for activities and companies that are not compatible with a science-based transition to net-zero, and instead prefers engagement with policyholders on their transition plans.

No fossil fuel targets

21. The Guidance does not set any targets for phasing out fossil fuels, and instead rows back from the previous Fuel Targets (which were themselves insufficient). The Guidance does not state anywhere that the Society expects or is asking managing agents to meet the Fuel Targets. In fact, its section on sustainable underwriting (section 4) does not refer at all to the Fuel Targets, nor to fossil fuels.

22. The only reference to the Fuel Targets in the Guidance is in the *"Frequently asked questions"* section (see the Appendix). This describes the Fuel Targets as a "*sensible and pragmatic ambition"*, but states that Lloyd's is *"not mandating the exclusion of these policies"* and that managing agents must *"decide their own ESG targets and policy"*. Nowhere in the Guidance is there any indication of the kind of targets managing agents should aim for.

23. This is a significant watering down of Lloyd's position on fossil fuels. In its ESG Report 2020, the Society made clear that it expected managing agents to comply with the Fuel Targets. In particular, at that time, the Society:

    a. described the Fuel Targets as *"commitments"*, and stated that managing agents *"will be asked"* to comply with them (in our First Letter we called on Lloyd's to go further than this, and issue binding directions to mandate compliance with these asks);

    b. said that the Fuel Targets would be *"publicly accountable"* targets for the Market, and said that its new ESG Advisory Group (led by Bruce Carnegie-Brown) would help ensure those targets were achieved; and

    c. said that it would issue *"guidance to support all managing agents in our market to deliver these underwriting ambitions from 2022"*, and stated that this guidance would include *"worked examples"* for application of the Fuel Targets.[10]

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[8] UN Environment Programme & others, The Production Gap 2021 Report (October 2021). See page 15.
[9] IEA, Net-zero by 2050 (May 2021). See page 21.
[10] See Society of Lloyd's, ESG Report 2020 (December 2020) and accompanying press release. See also an Insurance Insider article, Lloyd's to phase out coal and oil sands underwriting by 2030 (16 December 2020), which notes: *"Sources said the Corporation is publishing the targets as a framework, with no penalties currently planned for managing agents that fail to comply. However, the Corporation is said to be committed to ensuring the marketplace moves cohesively towards these goals and if it fails to do so, Lloyd's may consider further action."*

24. The position in the Guidance is very different. The Guidance does not ask managing agents to comply with the Fuel Targets, does not include any measures for public accountability in relation to meeting the Fuel Targets, and does not include any guidance to support managing agents in implementing the Fuel Targets.

25. We note that Lloyd's was recently quoted in the Financial Times, stating that *"We remain of the view that ceasing to provide the cover for those areas is the right thing to do, so we're not rowing back"*.[11] In view of the above, this statement is actively misleading. It is irrelevant whether the Society considers that compliance with the Fuel Targets is *"the right thing to do"*, what matters is the framework it sets for its members. The Society is rowing back from the Fuel Targets because the Guidance does not ask managing agents to comply with them (despite the Society previously saying in the ESG Report 2020 that it would ask managing agents to do so).

Lack of exclusions

26. The Guidance falls short of recommending excluding coverage for carbon-intensive activities or businesses which are incompatible with a science-based transition to net-zero, and instead merely notes that exclusions are one option that managing agents may consider in their ESG strategies.[12]

27. The Guidance prioritises managing agents engaging with policyholders to support them in enhancing their transition plans over setting clear exclusion policies which need to be complied with. We welcome insurers engaging with policyholders on their transition plans. However, to be effective, engagement must be coupled with clear policies for excluding coverage for: (1) companies that do not take rapid action (e.g. within one year) to adopt a credible transition plan on a science-based pathway to net-zero in response to the engagement; and (2) activities and businesses that are incompatible with a science-based transition to net-zero. At a minimum, this should exclude cover for all new or expanded oil and gas production, as well as coal, tar sands and Arctic oil.

28. For fossil fuel companies in particular, it is unrealistic to think they will significantly change their behaviour just based on engagement from insurers, in the absence of exclusions. The transition to net-zero requires a fundamental shift in the businesses of fossil fuel companies, which still generate only a small portion of their revenues from clean energy. A review of 887 of the largest oil and gas companies found that 91% of them generate over 90% of their revenue from fossil fuel activities, and 95% of them are still exploring or preparing to develop new oil and gas reserves (which, as noted above, is incompatible with limiting warming to 1.5°C).[13]

29. Engagement from insurers (that is not coupled with exclusions) is not going to incentivise the necessary shift in fossil fuel companies' business models. In contrast, exclusions would have a significant impact on the energy sector, as demonstrated by the impact that the increasing number

[11] Financial Times, Lloyd's criticised over strategy to overhaul insurers' climate risks (3 November 2021).
[12] The Guidance states that managing agents *"may choose not to underwrite risks that do not align with their ESG strategy"*, and notes that one way managing agents *"may approach ESG integration"* is to *"Consider exclusions and/or road map to future exclusions"*.
[13] The Global Oil and Gas Exit List has analysed the businesses of 887 upstream and/or midstream oil and gas companies which together account for almost 95% of global oil and gas production. In addition, it found that only 12 of the 692 upstream companies included in the analysis generate under half of their revenue from fossil fuel activities.

of coal exclusion policies have had on the price of coal premiums and the availability of cover for new coal projects.[14]

Conclusion on the Guidance

30. The deficiencies in the Guidance set out above render it wholly inadequate to align the Market with Lloyd's publicised net-zero ambition. In summary:

    a. Managing agents can ignore the Guidance and Lloyd's net-zero 2050 ambition entirely, as it is not binding. The only consequence for not complying is receiving *"thematic feedback"* from Lloyd's. In addition, there will be no public accountability for individual managing agents or syndicates that do not follow the Guidance or adopt net-zero 2050 targets, as there is no transparency on their individual action.

    b. Nothing in the Guidance asks managing agents to take any short or medium-term action on climate change. Managing agents can comply with the Guidance, whilst not setting any short or medium-term targets or implementing any strategy to phase out fossil fuel coverage in line with climate science. The next decade is crucial for climate action, yet the Guidance allows managing agents to continue with business as usual and to continue underwriting fossil fuels projects that are inconsistent with limiting warming to 1.5°C.

<u>Risk of breach of legal duties</u>

Duties to manage climate risk

31. Extreme warming poses a fundamental threat to the insurance sector, and the Society is under legal duties to manage that risk by mitigating the Market's contribution to climate change (as set out more fully in our First Letter). The world is not on track to limit warming to 1.5°C. It is estimated (based on current policies and action) that the world will warm by 2.7°C by 2100,[15] which would lead to significant climate risks for Lloyd's members. Rapid action needs to be taken to avoid this.

32. The Guidance fails to mitigate the Market's contribution to climate change, for the reasons set out above. The Guidance allows individual syndicates to continue underwriting climate wrecking activities (in pursuit of short-term profits) that will lead to substantial longer term impacts to members' resilience and profitability. The Society is therefore at risk of breaching its legal duties to manage the Market's exposure to climate risks.

33. We note that the recent Glasgow Climate Pact[16] (agreed by 197 countries) calls directly on financial institutions to take climate action. It calls for *"financial institutions to accelerate the alignment of their financing activities with the goals of the Paris Agreement"*. In addition, it stresses the need for enhancing national targets to reduce emissions by 2030 in order to limit warming to 1.5°C, noting that *"this requires accelerated action in this critical decade on the bases of the best available*

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[14] For example, see Willis Towers Watson, <u>Power Market Review 2021</u> which found (at page 92 onwards) that the continued withdrawal of support for coal programmes is restricting the availability of cover for coal risks. In addition, a number of energy companies have stated that coal insurance cover has been reduced and/or premiums have increased; see Insure Our Future, <u>2021 Scorecard on Insurance, Fossil Fuels and Climate Change</u> (November 2021) at pages 16 and 19. For example Adani Australia CEO Lucas Dow has stated that insurers are increasing coal premiums to the point they become unaffordable.

[15] Climate Action Tracker, <u>Glasgow's 2030 credibility gap</u> (November 2021).

[16] <u>Glasgow Climate Pact</u> (November 2021) See paragraph 55 on the role of financial institutions, and paragraphs 22, 23, 25 and 29 on the need for short-term action up to 2030.

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scientific knowledge and equity". As the world's largest energy insurer, the Market has a critical role to play in achieving this.

Duties not to mislead

34. The Society and Council members are under legal duties not to make misleading public statements (including by omission), as set out more fully in our Second Letter. They risk breaching those duties, for two reasons:

    a. The Society has not clearly and fairly communicated the climate action it is taking to the public and policyholders. As set out in our Second Letter, the Society's press releases and Net-Zero Insurance Alliance commitment suggest it is taking concrete, effective action to align the Market with a science-based pathway towards net-zero. However, the detail of the Guidance (outlined above) shows that it is not in reality doing so.

    b. The Society publicly committed to the Fuel Targets, but is no longer asking managing agents to comply with them. The Society must set the record straight on the Fuel Targets.

Improving Lloyd's position on climate change

35. The Society can solve many of the problems we have identified with the Guidance by issuing further directions and guidance on climate change. To comply with the Society's and Council members' legal duties, these directions should meet the following standards:

    a. *Binding*: Any direction or guidance must be adopted on a binding basis. Our First Letter set out the Society's legal powers to do so.

    b. *Clear short, medium and long-term targets*: Managing agents must be required to set short-term (e.g. 2025) and medium term (e.g. 2030) emissions reductions targets for their syndicates' underwriting and investment portfolios (including scopes 1-3 emissions), on a science-based pathway consistent with limiting warming to 1.5°C above pre-industrial levels with little or no overshoot (meeting IPCC pathway SSP1-1.9[17] and the UK Government's emissions reduction commitments), towards a net-zero 2050 goal.

    c. *Fossil fuel phase out*: Managing agents must be required to: (1) immediately stop providing all cover for new or expanded coal, oil and gas projects; (2) immediately stop providing new cover in relation to coal, tar sands and Arctic oil projects (including cover for companies undertaking substantial amounts of those activities), and rapidly phase out existing cover in line with climate science; and (3) set a strategy for phasing out other oil and gas coverage, which is consistent with reducing oil and gas production by 4% and 3% annually respectively, and which includes ending coverage for fossil fuel companies that do not adopt credible science-based transition plans.

    d. *Transparent*: Managing agents must be required to disclose their climate targets and policyholder engagement strategies for their syndicates, as well as annual progress against those targets. This must include disclosure of the emissions associated with their underwriting and investment portfolios (scopes 1-3).

[17] IPCC, Contribution of Working Group I to the Sixth Assessment Report (August 2021).

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Yours sincerely,

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