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14 June 2021

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United Kingdom

The Society of Lloyd's of London and the Council of Lloyd's of London
1 Lime Street
London, EC3M 7HA
For the attention of Bruce Carnegie-Brown and John Neal

By email: [redacted]

Dear Sirs,

Lloyd's of London Environmental, Social and Governance Report 2020

1. ClientEarth is a charity that uses the power of the law to protect people and the planet. We are international lawyers finding outcome-focused solutions for the world's biggest environmental challenges. From our offices in London, Brussels, Warsaw, Berlin, Madrid, Beijing, Luxembourg and Los Angeles, we work on laws throughout their lifetime, from the earliest stages to implementation and enforcement.
2. We are writing in relation to the Environmental, Social and Governance Report 2020 (the "**ESG Report**") issued by the Society of Lloyd's of London (the "**Society**") in December 2020.
3. We welcome that, in the ESG Report, the Society has for the first time set a policy for the Lloyd's market (the "**Market**") in relation to climate change, and in particular has set targets for managing agents in relation to investment in and underwriting of projects and companies related to thermal coal, tar sands and Arctic exploration activities (the "**Climate Targets**"). However, as set out below, those targets are insufficient to align the market with the goals of the Paris Agreement (the "**Paris Goals**")[1] and do not adequately manage the risks posed by climate change to Lloyd's members.
4. We set out below a number of questions in relation to the status and scope of the ESG Report. In outline, we ask the Society to confirm:
    a. its position on whether the Market should be aligned with the Paris Goals, and whether it accepts that it has a duty to set a climate policy for the Market;
    b. the legal status of the Climate Targets within the Lloyd's framework of rules, and whether it accepts that it has the power to make the Climate Targets on a binding basis; and

[1] 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"*.

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c. whether it will monitor and publicly disclose information on managing agents' compliance with the Climate Targets.

Lloyd's position on alignment with the Paris Goals

Implications of the Paris Goals for the fossil fuel industry

5. The best available science indicates that, in order to limit warming to 1.5ºC above pre-industrial levels in line with the Paris Goals, global emissions must decline by 45% from 2010 levels by 2030 and reach net-zero by 2050.[2] In addition, certain sectors and countries will need to reduce emissions particularly rapidly and/or achieve net-zero emissions earlier than 2050, in order to achieve the Paris Goals. In particular, a rapid reduction in fossil fuel production is required. The International Energy Agency ("**IEA**") has assessed that, in order to limit warming to 1.5ºC and achieve net-zero across the global economy by 2050, the energy sector must be net-zero globally by 2040 (and in OECD countries by 2035), which requires all unabated coal and oil plants (and the vast majority of unabated gas plants) to close by 2040.[3]

6. The next decade is crucial for meeting the Paris Goals. Global fossil fuel production must decrease by 6% per year between 2020 and 2030 (including annual reductions of 11%, 4% and 3% for thermal coal, oil and gas production respectively),[4] and global unabated coal-fired power generation must be reduced to 80% below 2010 levels (including ending all coal use within OECD nations) by 2030.[5] Expanding production and exploring new fossil fuel reserves are incompatible with these required reductions and the remaining carbon budget,[6] as the IEA has recently confirmed.[7]

[2] Intergovernmental Panel on Climate Change ("**IPCC**"), 'Special report on global warming of 1.5ºC' (2018). Note that net-zero targets should not rely on unproven or uncosted emissions reduction technology. The IPCC states (at chapter 2) that *"[Carbon dioxide reduction] deployed at scale is unproven, and reliance on such technology is a major risk in the ability to limit warming to 1.5°C"*.
[3] IEA, 'Net Zero by 2050: A Roadmap for the Global Energy Sector' (2021).
[4] UN Environment Programme and others, 'The Production Gap 2020' (2020). See also Carbon Tracker's reports 'Breaking the Habit: Why none of the large oil companies are "Paris-aligned", and what they need to do to get there' (2019) and 'Mind the Gap: the $1.6 trillion energy transition risk' (2018).
[5] Climate Analytics, 'Global and regional coal phase-out requirements of the Paris Agreement: Insights from the IPCC Special Report on 1.5°C' (2019). The report also finds that unabated coal-fired power generation must be phased out before 2040.
[6] Countries are currently planning expansions to fossil fuel production that will result in a 2% annual increase in production globally. This equates to 120% more fossil fuel production than would be consistent with limiting warming to 1.5ºC. See UN Environment Programme and others, 'The Production Gap 2020' (2020).
New exploration is incompatible with the Paris Goals, as existing proven fossil fuel reserves would generate far in excess of the remaining carbon budget allowed for all emission sources. See IPCC, 'Fifth Assessment Report: Mitigation of Climate Change' (2014) at chapter 7.4, and Carbon Tracker's reports 'Balancing the Budget' (2019) and 'Unburnable Carbon' (2013). See also IPCC, 'Special report on global warming of 1.5ºC' (2018) which found the remaining carbon budget for all emissions was 420 $GtCO_2$ (in order to have a two-thirds chance of limiting warming to 1.5°C). This is recognised by the PRA, which states in 'The impact of climate change on the UK insurance sector' (2015) that *"all of the IPCC's carbon budgets consistent with a likely chance of meeting the 2°C goal are substantially lower than the estimated carbon potential of global coal, oil and gas reserves"*.
[7] IEA, 'Net Zero by 2050: A Roadmap for the Global Energy Sector' (2021), which modelled that no further capital expenditure on fossil fuel supply is necessary in a Paris-aligned pathway: *"There is no need for investment in new fossil fuel supply in our net zero pathway … Beyond projects already committed as of*

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Assessing Lloyd's Climate Targets against the Paris Goals

7. The ESG Report sets the following Climate Targets for managing agents:

   a. From 1 January 2022: no new insurance cover, and no new investments, in thermal coal-fired power plants, thermal coal mines, tar sands or new Arctic energy exploration activities.

   b. By the end of 2025: phase out existing investments in thermal coal-fired power plants, thermal coal mines, tar sands or new Arctic energy exploration activities, and investments in companies deriving at least 30% of their revenues from such activities.

   c. From 1 January 2030: no renewals of existing coverage for thermal coal-fired power plants, thermal coal mines, tar sands or new Arctic energy exploration activities, and no new cover or renewals for companies deriving at least 30% of their revenues from such activities.

8. The Climate Targets in the ESG Report are insufficient to achieve the reductions in emissions and fossil fuel production set out at paragraphs 5 and 6 above (absent voluntary action by members to align their activities with the Paris Goals), for a number of reasons:

   a. The Climate Targets do not set any requirement for managing agents or the Society to align their activities with the Paris Goals, nor to adopt any plans for reducing their scope 1 to 3 emissions. The vast majority of emissions from the Market and Society's activities will be scope 3 emissions arising from the projects and companies that they invest in and underwrite (for example, CDP analysis found that portfolio emissions of sampled global financial institutions were over 700 times greater than their operational emissions).[8] However, the Society and managing agents do not include such investment and underwriting[9] portfolio emissions in their emissions disclosures, and the Society has set emission reduction targets that relate only to operational emissions.[10]

2021, there are no new oil and gas fields approved for development in our pathway, and no new coal mines or mine extensions are required."

[8] CDP, 'Financial Services Disclosure Report 2020: The Time to Green Finance' (2020).

[9] We note that there has been less focus across the insurance industry on developing methodologies for measuring the carbon footprint of underwriting portfolios, compared to progress in developing methodologies for investment portfolios. See CRO Forum, 'Carbon footprinting methodology for underwriting portfolios' (2020) which states that underwriting portfolios have *"received considerably less attention"* and states that, as a result: *"carbon footprinting methodology quantifying the exposure of re-/insurers to carbon emissions of underwritten risks is currently underdeveloped and the emissions associated with insurers' core business remain unmeasured and undisclosed, albeit that the ability to footprint where premiums are invested is currently possible."* That report details a proposed methodology for measuring the carbon intensity of underwriting portfolios. In addition, we note that seven insurers are in the process of establishing a Net Zero Insurance Alliance (convened by the UN Environment Programme Finance Initiative Principles for Sustainable Insurance) that will set a common commitment for achieving net-zero emissions from underwriting portfolios.

[10] The Society does not currently disclose the emissions arising from its investments, and has set a target to achieve net-zero emissions by 2025 that appears not to include emissions from investments (see its Energy and Carbon Report 2020 and Annual Report 2020). Furthermore, the Society's ClimateWise Annual Reporting 2019-2020 included emissions disclosures for six managing agents, but none of those disclosures included emissions from investments or from underwritten projects and companies.

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b. There are no targets for reducing the underwriting of, or investment in, oil and gas (outside of tar sands and Arctic exploration). Accordingly (and in light of the lack of any requirement to meet the Paris Goals or reduce emissions), there is no requirement to support the necessary annual reductions of 4% and 3% for oil and gas production respectively.

c. The timelines for exiting the underwriting of coal, tar sands and Arctic exploration are not consistent with the Paris Goals and the required annual reductions in production. In particular: (1) renewals of existing policies are permitted up to 2030, and there is no requirement to decrease the amount of cover provided in the period leading up to 2030 (in order to support the necessary annual decreases in production); and (2) the Climate Targets do not come into force until 2022, leaving a loophole allowing new projects that will increase production or exploit new reserves to be underwritten in 2021, and then renewed up to 2030. By way of example, this would allow members to underwrite Adani's Carmichael coal mine and the Canadian Government's expansion of the Trans Mountain Pipeline in 2021, and then continue to underwrite them until 2030.

d. From 2030, the Climate Targets restrict provision of underwriting to companies that derive 30% or more of their revenues from coal, tar sands or Arctic exploration, and impose a similar restriction on investments from 2025. However, this will still allow managing agents to provide underwriting services to (and invest in) companies that: (1) continue coal, tar sands or Arctic oil production at a level that is inconsistent with the Paris Goals, but have a diversified business, such that their revenues from those fuels are below 30%; and/or (2) are planning new or expanded coal, tar sands or Arctic exploration projects (which, as set out above, is inconsistent with the Paris Goals), provided they generate less than 30% of their revenues from those fuels.

e. Existing Lloyd's rules require managing agents to adopt governance structures that address the social, environmental and ethical impacts of their operations and to adopt an effective risk management system (see Minimum Standards GOV 8.1 and RM 1.1). However, these have not in practice led to managing agents aligning with the required reductions in emissions and fossil fuel production outlined above, as evidenced by the fact that managing agents are not disclosing, or setting targets to reduce, the emissions from their investments or from underwritten projects and companies (see (a) above).

9. In addition, there are many important aspects of the scope of the Climate Targets that are, at this stage, unclear. By way of example, it is unclear from the ESG Report whether the Climate Targets: (1) apply to reinsurance business; (2) cover all infrastructure related to coal and tar sands projects (such as railway lines, export terminals, marine transport and pipelines); and (3) use the Arctic Monitoring and Assessment Programme's definition of the Arctic,[11] or use some other geographical definition of the Arctic. Depending on Lloyd's position on these points, the impact of the Climate Targets may be lessened (although they will not be sufficient to align the Market with the Paris Goals, regardless of Lloyd's position on these points, for the reasons outlined at paragraph 8 above).

[11] See the Arctic Monitoring and Assessment Programme's website on its geographical coverage.

Risks posed by climate change to the insurance industry

10. As you will be aware, warming in excess of the Paris Goals poses a fundamental threat to the insurance industry. In particular, we note the following physical and liability risks of warming:

    a. Climate change may lead to certain types of risk becoming uninsurable, as a result of either: (1) consumers being unwilling or unable to pay the increased level of premium that insurers require to accept the risk transfer (including as a result of increased reinsurance costs); (2) insurers being unwilling or unable to accept the maximum possible losses arising from risks for solvency requirement reasons; or (3) insurers being unable to accurately estimate the frequency and severity of risks in order to price premiums, due to unpredictable and rapidly changing risks.[12] This poses a fundamental risk to the insurance industry, as it has been forecast that extreme warming would lead to a world that is largely uninsurable.[13] Lloyd's may be more exposed than most insurers to such issues (and to increasing frequency and unpredictability in weather and climate-related events more generally) due to the fact that it has historically had a relatively high exposure to catastrophe risk.[14]

    b. Warming in excess of the Paris Goals poses significant macro-economic and financial stability risks to insurers' asset portfolios that cannot be effectively managed through portfolio construction and asset allocation. Such macro-economic impacts will be irreversible and far-reaching in breadth and magnitude, causing a substantial reduction in global GDP compared to a Paris-aligned scenario.[15]

[12] CRO Forum, 'The heat is on' (2019). These risks are recognised by regulators. See for example analysis in PRA, 'The impact of climate change on the UK insurance sector' (2015), EIOPA, 'Discussion paper on non-life underwriting and pricing in light of climate change' (2020), and IAIS and SIF, 'Issues Paper on Climate Change Risks to the Insurance Sector' (2018) which notes that insurers may face difficulty in accurately pricing physical climate risks, as the risks can change in non-linear ways. See Swiss Re, 'Socio-economic developments and climate-change effects to drive rising losses from severe weather events' (2020) which finds that unmitigated climate change could jeopardise the insurability of weather risks.

[13] See CRO Forum, 'The heat is on' (2019) which finds *"The 3°C scenario creates real insurability challenges and could therefore challenge the sector"*. See also statements by Henri de Castries (at the time, CEO and Chairman of AXA) that 4°C warming would lead to most assets being uninsurable (reported in Environmental Finance (2015)), by Thomas Buberl (CEO of AXA) that a world warmed by 4°C is *"not insurable"* (One Planet Summit – CEO speech (2017)), and by Jacki Johnson (at the time Group Executive for People, Performance and Reputation at IAG) that 4°C warming entails that *"the world becomes pretty much uninsurable"* (reported in the Australian Financial Review (2018)). See also 'Bank for International Settlements, 'The Green Swan: Central banking and financial stability in the age of climate change' (2020) which warns that unmitigated climate change would lead to a systemic financial crisis affecting the financial health of the insurance sector, which would render climate risks uninsurable.

[14] See Standard & Poor, Ratings Direct: Lloyd's (2020), which states: *"In our view, Lloyd's is more exposed to environmental risk than the industry average because it writes significant amounts of property reinsurance and insurance. In particular, it is more exposed to natural catastrophe risk"*. See also AM Best Company, Credit Report: Lloyd's (2020) and Fitch, Lloyds of London (2020), which both assessed that the credit profile of Lloyd's is negatively impacted by its high exposure to natural catastrophe risk. We note that Moody's recently assessed that Lloyd's exposure to natural catastrophe risk reduced in 2020.

[15] See Network for Greening the Financial System, 'Technical supplement to the First NGFS Comprehensive Report' (2019), Mercer, 'Investing In A Time Of Climate Change — The Sequel' (2019) which finds: *"for nearly all asset classes, regions and timeframes, a 2ºC scenario leads to enhanced projected returns versus 3ºC or 4ºC and therefore a better outcome for investors"*, Swiss Re, 'The economics of climate change: no action not an option' (2021) which finds that global GDP could be 10% lower if the Paris Goals are not met, and 'Bank for International Settlements, 'The Green Swan: Central banking and financial stability in the age of climate change' (2020).

c. Extreme warming, and more frequent and severe weather and climate-related events, will increase the risk of litigation against energy majors in relation to climate change. Much of this risk will in turn be claimed under liability insurance (including long-tail claims under existing insurance contracts). An increasing number of proceedings have been issued against energy majors alleging liability for their contribution to climate change, as well as proceedings alleging deceptive practices and greenwashing, and it is anticipated that liability cover for such proceedings could pose a significant risk for the insurance industry.[16] By way of example, Moody's has warned insurers about liability risks arising from climate change litigation, and has indicated that it therefore views the reduction of cover for coal and other carbon-intensive industries as positive.[17] We note that Lloyd's anticipates an increase in such litigation, as attribution science improves.[18]

11. In addition to the risks that warming itself poses to the insurance sector, the necessary transition to a lower carbon world poses significant risks to insurers' asset portfolios.[19] Investments in fossil fuel assets (including the subject of the Climate Targets – thermal coal, tar sands and Arctic exploration projects) are particularly vulnerable to transition risks, including the risk of stranded assets,[20] falling demand for fossil fuels and falling investor confidence in fossil fuels.[21] Energy majors will be subject to increasing legal and regulatory requirements to rapidly reduce emissions on a pathway consistent with Paris Goals (including meeting the IEA's targets set out above), as demonstrated by the recent judgment of the Hague District Court in *Milieudefensie and others v Royal Dutch Shell*,[22] in which Shell was ordered to reduce scope 1 to 3 emissions by 45% (compared to 2019 levels) by 2030. In addition, companies are subject to increasing regulatory requirements to adopt and disclose emissions reduction strategies in line with the Paris Goals.[23]

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[16] See UN Environment Programme Finance Initiative Principles for Sustainable Insurance, 'Insuring the climate transition: Enhancing the insurance industry's assessment of climate change futures' (2021) which found that climate litigation risks are material for insurers, but are not generally being assessed by insurers in a quantitative and scenario-based manner. See also the Sabin Center for Climate Change Law's Climate Change Litigation Databases in respect of US litigation and non-US litigation.

[17] Moody's, 'Research Announcement: Moody's – Insurers' retreat from coal is positive, reducing stranded asset risk, limiting liability risk' (2020). See also Moody's, 'Announcement: Moody's: Climate change heightens key risks for P&C insurance, reinsurance sectors' (2018) which found that climate change has a net negative impact on the property and casualty (re)insurance industry.

[18] Lloyd's, 'Below 2°C: Insurance for a low carbon economy' (2020).

[19] See for example analysis in PRA, 'The impact of climate change on the UK insurance sector' (2015).

[20] Stranded asset risks are already materialising. For example, analysis by Carbon Tracker indicates that seven oil and gas firms wrote down assets totalling $87 billion within a nine month period in 2019-2020, as reported in the Guardian.

[21] BloombergNEF, 'New Energy Outlook' (2020). We note that Lloyd's itself expects *"steep declines in [fossil fuel] revenue, particularly for coal and oil"*, see Lloyd's, 'Below 2°C: Insurance for a low carbon economy' (2020).

[22] Case number / cause list number: C/09/571932 / HA ZA 19-379.

[23] See Article 19a paragraph 2(a)(iii) of the EU Commission's proposals for a Corporate Sustainability Reporting Directive which requires in scope undertakings to disclose plans to ensure their business model and strategy are compatible with limiting global warming to 1.5 °C, the twelfth final provision of the Spanish Climate Change and Energy Transition Law which requires in scope companies to disclose their plans to reduce greenhouse gas emissions (including a five year target), and Article 173 of the French Energy Transition Law. See also the Task Force on Climate Related Financial Disclosure's draft guidance in relation to disclosure of transition plans in its 'Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans' (2021).

Legal duties on Lloyd's to mitigate climate change

12. The Society is subject to legal duties to manage the Market's exposure to such climate risks, including by reducing the Market's contribution to climate change through its underwriting and investment activities:

    a. As summarised in the Society's cooperation agreement with the Prudential Regulation Authority (the "**PRA Agreement**"), the Society *"has responsibilities for regulating and directing the business of insurance at Lloyd's under Lloyd's Acts"* (section A paragraph 7), and in particular is responsible for *"the overall strategic direction of the market, control over how much (and what type of) risk to allow into the market as a whole, the market-wide control framework (including but not limited to performance management)"* (section B paragraph 6(b)).

    b. That responsibility includes the discharge of specific legal duties under the PRA Solvency II rules to supervise, and ensure the efficacy and implementation of, managing agents' Solvency II risk management systems for underwriting and investment (including their written policies in relation to risk management). The Solvency II risk management rules (which require the adoption and implementation of effective risk management systems and policies) expressly apply to the Society (see the PRA Solvency II Conditions Governing Business at rules 1.1(2), 2.4, 3.1 and 12.1). Those rules must be read together with PRA Solvency II Insurance General Application rule 3.1, which provides (amongst other matters) that the Society must supervise the insurance business carried on by Lloyd's members, where the context of a rule requires it to do so. In the context of the Society's responsibilities under the PRA Agreement (outlined above), compliance with the Solvency II risk management rules requires the Society to supervise managing agents' risk management systems.

    c. In relation to investments, the Society is under a specific legal duty to supervise and ensure managing agents' compliance with the prudent person principle ("**PPP**"; see PRA Solvency II Investments rule 1.1(2) and 2.1, read with PRA Solvency II Insurance General Application rule 3.1). The PPP requires insurers to avoid investing in assets giving rise to risks they cannot properly manage, and to invest in a manner that ensures the security and profitability of the portfolio as a whole. As noted above at paragraph 10, extreme warming poses significant risks to insurers' asset portfolios. Accordingly, investing in fossil fuel assets that contribute to such warming may not meet the PPP requirement to invest in a manner that ensures the security and profitability of the portfolio as a whole. In addition, as noted at paragraph 11 above, investments in fossil fuel assets are subject to significant transition risks. Such transition risks are by their nature complex and unpredictable, and yet can manifest in a short timeframe. As a result, in many cases it will not be possible to manage the risks properly, in accordance with the PPP.[24]

[24] The PRA recognises that the complex nature of climate transition risks may render them incapable of management under the PPP. See PRA, 'Policy Statement PS14/20: Solvency II: Prudent Person Principle' (2020), which states: *"In line with the requirements, firms must avoid exposures to risks that they cannot effectively manage. The PRA notes that some risks (such as climate transition risk and political risk) are complex and poorly understood and, therefore, will be more difficult to manage. The PRA expects firms to pay particular attention to such risks in their investment risk management policies"*.

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d. In the context of the financial risks arising from climate change, the discharge of the above duties requires that the Society ensure that managing agents comply with the PRA's expectations that they have a *"credible plan or policies in place for managing exposures"* and take mitigating actions that are *"realistic, credible, consistent with regulatory expectations, and achievable"*.[25] As the Society is vested (under the PRA Agreement) with *"control over how much (and what type of) risk to allow into the market as a whole"* and in this context is subject to the same regulatory expectations as managing agents themselves,[26] it follows that it must adopt such a plan and take such action. This is particularly so given the significance of the climate risks faced by insurers, as outlined at paragraph 10 above. We note that the Society accepts, in its most recent ClimateWise report, that it *"has a market oversight role with regards to climate related risks"*.[27]

e. Commensurate with its broad responsibilities, the Society has wide-ranging powers to enforce compliance with PRA rules and guidance. See, for example, the Miscellaneous Provisions Byelaw at paragraph 6 and the Membership Byelaw at paragraphs 40 and 42, read with the Enforcement Byelaw at paragraphs 3(c)(ii), 16 and 18. See also the Lloyd's Act 1982 at section 6, which confers broad powers on the Council of Lloyd's (the "**Council**") to regulate the Market through byelaws.

f. In turn, the PRA has broad powers to ensure that the Society complies with its duty to supervise and regulate the Market. See sections 314 and 318 of the Financial Services and Markets Act 2000.

g. Finally, we note that members of the Council are individually responsible under the Constitutional Arrangements Byelaw *"to consider the impact of [Lloyd's] operations on the community and the environment"* (see paragraph 3.2). In addition, each Council members *"must act in the way he considers, in good faith, would be most likely to promote the success of the Society for the benefit of the members as a whole"*, taking into account *"the likely consequences of any decision in the long term"*. Council members risk breaching these duties if they do not take steps to reduce the Market's impact on climate change, and instead allow member to prioritise short term revenues over their collective long term resilience and profitability.

13. In view of the above, the Society is legally obliged to set a credible policy for the Market to limit its exposure to climate change risks. That policy must include reducing the contribution of the Market to climate change by aligning with the Paris Goals, in order to help avoid those risks from eventuating. The Society is in a unique and powerful position, given Lloyd's primacy in the energy insurance sector. In 2018, the Market generated $2.6 billion of premiums within the energy sector, which was approximately 40% of global premiums.[28] We expect that its share of insurance of the most damaging fossil fuel projects will be higher than 40%, as Lloyd's is (prior to the ESG report coming into force in 2022) the last major insurance player in Western Europe to allow underwriting of coal projects without any form of restrictions, and

[25] PRA, 'Supervisory Statement SS3/19: Enhancing banks' and insurers' approaches to managing the financial risks from climate change' (2019) at paragraphs 3.10 and 3.16.
[26] The PRA made clear in its Supervisory Statement SS3/19 at paragraph 1.1 that its regulatory expectations in relation to climate change apply to managing agents and the Society.
[27] Lloyd's, ClimateWise Annual Reporting 2019-2020 at page 32.
[28] See the London Market Group's report 'London Matters 2020'. In addition, Lloyd's invests a significant amount of funds. Lloyd's Annual Report 2020 recorded a total of £69.5 billion financial investments.

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has therefore served as a centre for insurance of coal and other fossil fuel projects. By introducing a climate change policy that restricts insurance of (and investment in) fossil fuels and aligns the Market with the Paris Goals,[29] the Society can therefore have a systemically significant impact on the insurance and energy industries that will make a material difference to efforts to mitigate the occurrence of climate change, and which will therefore materially mitigate members' own exposure to the risks that climate change would cause.

14. We note that Lloyd's itself recognises that insurers *"need to start considering the impact on climate change created by their products and services"* and proposes that insurers should take a *"holistic approach to climate-related issues across departments and portfolios"*.[30] In the context of the Market, this requires phasing out fossil fuel insurance in line with the Paris Goals, in order to mitigate the substantial risks posed by climate change to the Market more widely, as outlined at paragraph 10 above.

15. In setting any policy on climate risk, the Society should take into account the fact that governments are setting increasingly ambitious targets for emissions reductions. In such circumstances, it is prudent to plan for increasing regulatory requirements in relation to climate change, as governments take action to meet their stated commitments.[31] For example, the UK Government has committed to transitioning to a net-zero emissions economy by 2050 in the Climate Change Act 2008, has set a nationally determined contribution under the Paris Agreement to reduce emissions by 68% (compared to 1990 levels) by 2030,[32] and is introducing legislation to set a carbon budget that equates to a 78% reduction in emissions (compared to 1990 levels) by 2035.[33] In addition, the USA has announced plans to reduce emissions by 50-52% by 2030,[34] and Lloyd's anticipates that the USA is likely to be more interventionist in respect of climate under the Biden administration.[35] Similarly, Canada is currently legislating to commit to achieving net-zero emissions by 2050[36] and plans to introduce a target to reduce emissions by 40-45% (compared to 2005 levels) by 2030.[37] Furthermore, following the recent decision of the German Constitutional Court in relation to the German Climate Protection Act, Germany is introducing amended targets to reduce emissions by 65% by 2030 and 88% by 2040 (compared to 1990 levels) and to net-zero by 2045.[38]

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[29] Any climate policy that allowed the Market to contribute to warming in excess of 1.5°C would not constitute a credible plan to mitigate the Market's exposure to climate risks. As set out at paragraph 10 above, warming in excess of the Paris Goals poses significant risks to the insurance sector. Furthermore, the scientific consensus is that warming would need to be limited to 1.5°C in order to avoid many of the most disruptive potential effects of climate change, see IPCC, 'Special report on global warming of 1.5ºC' (2018).
[30] Lloyd's, 'Below 2°C: Insurance for a low carbon economy' (2020).
[31] See Carbon Tracker, 'Handbrake Turn: The cost of failing to anticipate an Inevitable Policy Response to climate change' (2020).
[32] The Government's 'UK Nationally Determined Contribution' (2020).
[33] See the draft Carbon Budget Order 2021 (which is to be enacted pursuant to Part 1 of the Climate Change Act 2008).
[34] See the White House, Fact Sheet: President Biden Sets 2030 Greenhouse Gas Pollution Reduction Target (2021).
[35] Lloyd's, Annual Report 2020 (at page 13).
[36] In Bill C-12: The Canadian Net-Zero Emissions Accountability Act.
[37] As reported in Global News (2021).
[38] As reported in Reuters (2021).

Questions for Lloyd's

16. In view of the above, please clarify:

    a. Does the Society consider that the Climate Targets in the ESG Report are sufficient to align the Market (including its emissions from investments and from underwritten projects and companies) with the Paris Goals? If so, please explain the basis for this view.

    b. If the answer to (a) is no, then:

        i. Does the Society accept that it will ultimately be necessary for the Market (including its emissions from investments and from underwritten projects and companies) to align with the Paris Goals? If not, please explain why.

        ii. Does the Society intend to revise the Climate Targets or introduce further policies, such that they fully align the Market with the Paris Goals? If so, when does it intend to do so?

    c. Does the Society intend to take steps to address the other deficiencies in the ESG Report outlined above, including: (1) introducing climate targets for all oil and gas projects and companies; (2) amending the timelines for exiting the underwriting of coal, tar sands and Arctic exploration (including setting targets for annual reductions, in advance of the final exit); and (3) introducing restrictions on providing underwriting to companies that plan any new coal, tar sands and Arctic exploration projects or that undertake more than a certain threshold level of production from coal, tar sands or Arctic oil?[39]

    d. Does the Society accept that it is subject to a legal duty (on the grounds outlined at paragraph 12 above or otherwise) to set a credible policy on climate for the Market that mitigates climate risk by aligning the Market with the Paris Goals? If the Society considers that it is not subject to such a legal duty, please explain the basis for this.

<u>Status of the Climate Targets</u>

17. The status of the Climate Targets within the framework of Lloyd's rules that govern the Market is unclear, despite the fact that the Council has the power to make the Climate Targets binding. The ESG Report states that managing agents will be *"asked"* to meet the Climate Targets and that *"guidance … to support managing agents to implement these changes will be developed with stakeholders and issued during 2021."*

18. Given that the Climate Targets are described as asks, we have concerns that the Society and Council may not intend to enact them on a binding basis under Lloyd's rules or byelaws. If the Climate Targets are not binding on managing agents and/or there are no formal mechanisms for enforcement, then managing agents will not have sufficient incentive to comply with them.

19. The Council has the power to make the Climate Targets binding. We note in particular:

[39] The Society's Coal Exclusion Policy in relation to the Central Fund contains threshold production limits for coal. It excludes investment in companies that: (1) produce more than 20 million tons of coal per year; (2) generate more than 30% of their electricity from burning coal; (3) operate at least 10 GW of coal-fired power stations; or (4) generate more than 30% of their revenue from producing coal. However, the Climate Targets do not include any threshold production limits analogous to (1) to (3) above.

a. Under paragraph 40 of the Membership Byelaw, the Council has a broad power to *"give such directions or impose such conditions or requirements on any member (or any class or group thereof) as it thinks reasonably necessary or appropriate"*. The Membership Byelaw gives a non-exhaustive list of purposes for which such directions or conditions may be imposed, which includes (amongst other matters): *"directing that the member cease, or reduce the level of, his underwriting business at Lloyd's, underwriting business of a specified class"*; protecting the reputation of the Society; protecting the assets of the Society; and ensuring compliance with regulatory requirements. Such directions or conditions are binding on members and, if breached, can be the subject of enforcement action: see the Membership Byelaw at paragraph 42 and the Enforcement Byelaw at paragraphs 3(c)(ii), 16 and 18.

b. Part I of the Underwriting Byelaw gives the Council a similarly broad power to make directions that it considers reasonably necessary or appropriate, and includes a similar non-exhaustive list of purposes for which the power can be exercised. Again, such directions are binding and can lead to enforcement action: see the Underwriting Byelaw at paragraph 65 and the Enforcement Byelaw at paragraphs 3(c)(ii), 16 and 18.

c. See also the Underwriting Byelaw at paragraph 24 (the power to make binding underwriting guidelines) and paragraph 31 (the power to issue a binding code of practice).

20. In our view, these broad powers clearly encompass the power to make the Climate Targets (as well as any more ambitious targets that the Society and/or Council might wish to implement in order to align the Market with the Paris Goals) binding. Given the significant risks posed to insurers by climate change[40] and the systemic importance of Lloyd's within the energy sector, setting targets for mitigating climate change will protect members by mitigating those risks, will protect the reputation of Lloyd's and will mitigate the impact of climate change on the Society's asset portfolios. In addition, as set out more fully above, the Society is required to set a credible policy on climate change, in order to meet its regulatory obligations. Setting non-binding targets will not be sufficient to meet those obligations, as there is a clear risk that managing agents will not comply with non-binding targets.

Questions for Lloyd's

21. In view of the above, please can you clarify the status of the Climate Targets and proposed guidance? In particular:

a. Does the Society accept that the Council and/or Society have the power to make the Climate Targets and any accompanying guidance on a binding basis (for example, through directions made under the Underwriting Byelaw or Membership Byelaw)? If the Society does not accept this, please explain the legal basis for its position.

b. Will the Climate Targets and accompanying guidance be formally made under any Lloyd's rules or byelaws?

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[40] Such risks have been highlighted by regulators. See for example: PRA, 'The impact of climate change on the UK insurance sector' (2015), PRA 'Supervisory Statement SS3/19: Enhancing banks' and insurers' approaches to managing the financial risks from climate change' (2019), and Bank of England 'Quarterly Bulletin 2017 Q2: The Bank of England's response to climate change'.

c. Will compliance with the Climate Targets and accompanying guidance be binding on managing agents under Lloyd's rules or byelaws?

d. What formal enforcement action does the Society propose to take against managing agents that fail to meet any of the Climate Targets or accompanying guidance?

Disclosure of compliance with the Climate Targets

22. Given the systemic importance of climate change and Lloyd's position as a key player in the global energy insurance sector, it is important that Lloyd's demonstrates transparency in its activities and policies in respect of climate change. We welcome that the ESG Report acknowledges the importance of transparency, noting in the section titled *"Improving transparency"* that *"Our stakeholders – from customers and regulators, through to market participants, employees and ratings agencies – have a growing expectation of greater reporting and transparency."*

23. Despite this commitment by the Society to transparency, the ESG Report does not outline the steps that it will take to disclose progress in relation to the Climate Targets. It is vital that the Society publishes information on all failures by managing agents to comply with the Climate Targets. As the Society has published the Climate Targets in its ESG Report, it is likely that stakeholders and the public will assume that they are being complied with. If the Society does not publish information on breaches of the targets, this risks misleading stakeholders and the public as to the steps being taken in practice by the Society and the Market to mitigate climate change.

Questions for Lloyd's

24. In view of the above, please clarify:

    a. What steps does the Society intend to take to monitor managing agents' compliance with the Climate Targets?

    b. Will the Society commit to publicising each breach by managing agents of the Climate Targets, in order to transparently enable stakeholders and the public to ascertain whether the published targets are in practice being complied with?

ClientEarth

Yours sincerely,

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