A BIBA BROKERS' GUIDE TO

SUSTAINABILITY

2020 – Issue 1

In association with

WELCOME

The importance of sustainability is increasingly prevalent across all aspects of our lives and our corporate lives are no exception.

BIBA's supplements are brought to you through a partnership of BIBA, Allianz and DAC Beachcroft. We hope that you find DAC Beachcroft's legal expertise, Allianz's industry knowledge and BIBA's desire to share these with you helpful. We welcome ideas for future subjects.

Green issues are becoming part and parcel of risk and insurance. BIBA's 2020 Manifesto commits to creating a green finance toolkit for members and this guide sets the scene on issues that may impact brokers and their customers as well as the planet.

We were delighted that Allianz supported our call for action on green repairs in the Manifesto. This subject is covered in much more detail inside along with other key topics like; insurance and climate change; the regulator's expectation and escape of water solution.

I recommend this as a highly valuable read to help the insurance industry remain relevant.

Mike Hallam, ACII, Chartered Insurance Practitioner, Head of Technical Services, BIBA

WAKING UP TO CLIMATE CHANGE

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Insurers need to prepare for a rise in liability claims against insureds, particularly those in the oil and gas industry, as they increasingly become a target for litigation. These types of claim may fall into three broad categories:

1. Efforts to prevent the development of activity considered harmful to the environment are enjoying increasing success. Typically, this type of action has targeted governments for failure to address climate issues as part of public policy, and is now increasingly targeting state and private operations. Client Earth recently succeeded in halting a project for a major new coal mine in Poland.

2. There are already examples of companies and their Directors and Officers being targeted for failure to address and report on climate change exposures. This has, in turn, led to more scrutiny from shareholders and the commencement of securities lawsuits for alleged failure to act on climate change issues, or misrepresenting the measures being taken.

3. Individuals seeking compensation for the impact of pollution and, more broadly, climate change. Such claims are well-suited to class actions or group litigation. So far, most attempts to try these cases have been dismissed at an early stage, but they are starting to gain more traction. There is now an established body of scientific data on the impact of climate change, e.g. Carbon Majors report in 2013 and a series of recent IPCC special reports, as well improvements in attribution science.

It is the second and third categories where liability insurers (for D&O liabilities and third party liabilities respectively) are reassessing their potential exposure to climate change risks. There is now a clear focus on the risks of exposure to insureds from climate change. This goes beyond the commercial concerns about insuring corporations in the fossil fuel industry to a renewed assessment of entities involved in anything from electrical distribution to agriculture.

While most of the climate change-related litigation continues to be seen in the US, companies and their insurers need to be increasingly aware of the risk of being targeted in courts around the world, as the bar is raised for what is considered to be acceptable corporate behaviour.

The German Courts are currently hearing the case of a Peruvian farmer's claim against RWE for the alleged impact of its emissions on farming and contribution to global warming. The Court refused to dismiss the case and will now consult with experts on whether it is possible to measure the contribution to the environmental impact from RWE's emissions.

In the UK, the family of a nine-year old girl who lived next to a busy road and died from asthma was given permission to apply for a fresh inquest following her death. Just like the claims against tobacco companies, it is incontrovertible that pollution damages health. If the Courts can find a way to attribute this impact between the state and private companies, we can expect to see this litigation around the world.

INSURANCE SOLUTIONS FOR A CHANGING CLIMATE

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A key purpose of insurance is to help individuals and businesses secure their future in a changing world. However, with climate change and environmental damage currently presenting a number of unknown risks to the insurance industry, some predict that certain parts of the world could one day become uninsurable.[1] Global awareness of these issues is driving society to seek greener ways of living and working. Fortunately, the Industry is developing products and implementing methods for a more sustainable future.

GREENER TRANSPORT SOLUTIONS

The Automated and Electric Vehicles Act forms part of the government's overall 'Road to Zero' strategy, and sets out the ambition "for all new cars and vans to be effectively zero emission by 2040".[2] The Act seeks to improve electric charging infrastructure and modernise insurance rules to cover self-driving vehicles. There are currently around 246,000 plug-in cars and 8,500 vans on British roads[3] with this number only expected to increase. Many electric vehicles (EVs) today operate using lithium-ion batteries, but with growing consumer demand for longer journeys, wider range and quicker charging times, manufacturers are exploring more advanced battery technologies. This is a consideration for insurers, since more expensive technology could push up the price of EV repairs. Similarly, there may be higher costs associated with specialist labour and tools, all of which will need to be considered in the underwriting process.

Electric scooters (E-scooters) are classified by the UK Department for Transport as 'powered transporters' meaning that they are mechanically rather than manually propelled. Whilst they are increasingly popular on the continent as an easy, cheap and energy-efficient mode of transport, their use remains all but illegal in the UK on anything other than private roads. This is due to a number of factors including issues around vehicle taxation, licensing, registration and the use of relevant safety equipment. With urban areas becoming increasingly congested and commuters seeking more sustainable modes of transport, E-scooters potentially could offer a solution. Similar to 'Boris Bikes' in London, cities of the future may see widespread use of such powered transporters, with companies seeking to capitalise on micro-mobility options for fleet vehicles. This won't be possible until a process is in place to comply with the legal framework; however should this happen, the insurance industry will need to develop suitable solutions.

REUSE AND RECYCLE

In addition to the use of 'green parts' in the motor industry (see page 8), insurers are seeking increasingly

[1] Strategic Risk Asia Pacific. (2018). Climate risk could make world 'uninsurable'.https://www.strategicrisk-asiapacific.com/climate-risk-could-make-world-uninsurable/1428841.article

[2] HM Government (2018). The Road to Zero: Next steps towards cleaner road transport and delivering our Industrial Strategy. [online] Department for Transport, p.6. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/739460/road-to-zero.pdf [Accessed 29 Nov. 2019].

[3] https://www.nextgreencar.com/electric-cars/statistics/

sophisticated methods to reduce waste in the repairs process. In the property space, insurers are starting to focus on restoration rather than replacement for a wide variety of items such as wooden surfaces, bathtubs and brick and stonework. One such specialist restoration company is Plastic Surgeon, with whom Allianz has partnered, and who reported that of all cases presented to them, only 16% of items were unrepairable.[4] This initiative reduces the amount of waste sent to landfill and the joint project between Allianz and Plastic Surgeon has so far saved a quarter of a tonne from being sent to landfill.

It's further suggested that a process which focusses on repair rather than replacement can be more cost-effective and accelerate an insurer's ability to settle claims, ultimately benefitting the broker and policyholder. With awareness of recycling growing, such initiatives may become commonplace for insurer-funded repairs.

RENEWABLE ENERGY

In 2018, a record 33% of total electricity generation in the UK came from renewable sources[5] and the insurance industry has moved to provide appropriate cover. One example is wind turbines, where insurance comes into play not only in the construction phase but also for ongoing maintenance. Since onshore wind turbines are often located in remote coastal areas in challenging weather conditions, performing maintenance can be particularly tricky. Commercial operators of wind turbines may wish to consider various covers, such as 'operational all risks' and 'business interruption'.

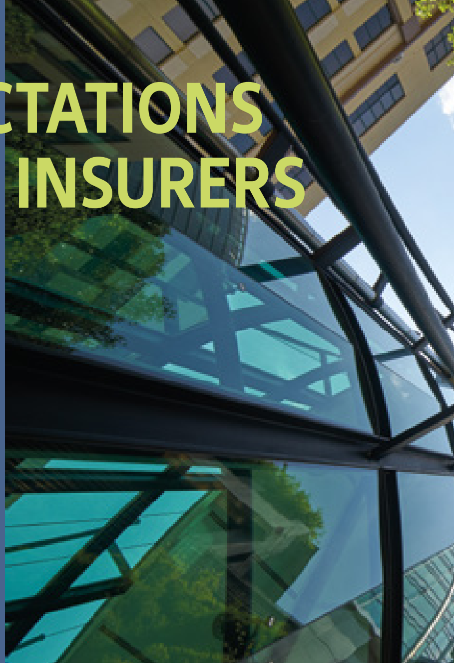
With solar energy set to become the world's largest source of power by 2035, there's been an increase in photovoltaic (PV) solar systems, most generally recognised as rooftop installations. However, ground-mounted PV systems are well suited to commercial premises, since these are not subject to the characteristics of the roof, and insurance policies have been developed to cover the construction and ongoing maintenance of such installations. Future advances in technology, combined with the adverse effects of climate change, may require insurers to reset the benchmark for renewable energy risks and develop new, innovative propositions.

SUMMARY

Progress is clearly being made within the industry to help society meet sustainability targets but there needs to be a continued focus to effect lasting change. Insurers and brokers will continue to play a key role in this, both through the development of new, relevant insurance solutions but also in their capacity as risk advisers.

[4] https://www.plastic-surgeon.co.uk/blog/insurance/restoration-vs-replacement-for-insurance-claims/#
[5] Department for Business, Energy and Industrial Strategy: Statistical Press Release 25 July 2019. Digest of UK Energy Statistics 2019.

REGULATOR EXPECTATIONS ON BROKERS AND INSURERS



In July 2019 the UK Government published its green finance strategy. The strategy recognises the role of the financial sector in delivering global and domestic climate and environmental objectives.

In the strategy the Government welcomed the actions UK regulators are taking to embed climate considerations into their supervisory practices and approach.

THESE ACTIONS INCLUDE:

- In July 2019 the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA") (together with the Financial Reporting Council and The Pensions Regulator) issued a joint statement on climate change. In the statement they recognised that climate change is one of the defining issues of our time and that it "presents far-reaching financial risks relevant to our mandates from both physical factors, such as extreme weather events, and transition risks that can arise from the process of adjustment to a carbon neutral economy". The regulators urged companies to consider the likely consequence of climate change on their business decisions, in addition to meeting their responsibility to consider the company's impact on the environment.
- In April 2019 the PRA published a Supervisory Statement (3/19) on enhancing banks' and insurers' approaches to managing the financial risks from climate change.
- Establishing the Climate Financial Risk Forum ("CFRF") in March 2019. The objective of the CFRF is to build capacity and share best practice across financial regulators and industry to advance financial sector responses to the financial risks from climate change.
- Co-founding the Sustainable Insurance Forum, a network of insurance supervisors and regulators from around the world who are working together on sustainability challenges facing the insurance sector.
- As far back as 2015 the PRA published a report on the impact of climate change on the UK insurance sector.

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More recently the FCA has published its feedback statement on climate change and green finance (FS 19/6). The FCA's future activity on climate change will focus on three outcomes:

- issuers of listed securities making appropriate disclosures on their exposure to material climate change risks and opportunities;
- regulated financial services firms to integrate consideration of material climate change risks and opportunities into their business, risk and investment decisions;
- in its consumer protection role, ensuring consumers have access to green finance products and services, which meet their needs and preferences, and receive appropriate information and advice to support their investment decisions.

Brokers and insurers need to understand the regulatory framework that is beginning to emerge for greening the financial system. Business models will need to be adapted to embrace green finance – both in order to appeal to customers and to meet regulatory requirements.

'GREEN PARTS' IN MOTOR REPAIR

One way the motor repair industry can make strides to improve sustainability is through the increased use of so-called 'green parts' - undamaged, reusable vehicle components which have been reclaimed from end-of-life accident-damaged vehicles.

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Using these in the repair process brings obvious environmental benefits whilst also helping to prevent delays and tackle claims inflation. Despite these significant benefits, the use of 'green parts' is still the exception rather than the rule for insurer-funded repairs.

We're increasingly told that every person and industry has a responsibility to reduce the impact of their activities on the environment. Insurers have been apprehensive when it comes to vehicle repairs and many still believe that using just new components is the only way to prioritise customer satisfaction. Perceptions and societal norms need to be challenged, with safety and quality repair as the key areas where we need to build confidence for 'green parts'.

SAFETY

No insurer wants to see a vehicle returned to the road that is less safe than the day it rolled off the production line. For now, insurers and repairers will continue to be cautious about which parts will be reused; if the safety of a component can't be guaranteed, it won't be included on an approved list. The opportunity to fit 'green parts' that are not safety related is significant though and we need to do much more to embrace this opportunity. Commonly damaged parts such as panels, wing mirrors and headlights can be reused without any safety compromise.

REPAIR QUALITY

Customers expect their vehicle to return from the bodyshop looking at least as good as it did prior to an accident. They don't expect any reduction in the pleasure they gain from using their vehicle nor the value realised when they come to sell it. To achieve that outcome, an insurer needs a specialist, professional supplier of 'green parts' and a highly capable repair network. That supply chain exists today and we need to demonstrate that capability consistently to our customers.

Recent Allianz-commissioned research[1] revealed that 69% of motorists would opt for a green replacement part over a brand new component to repair their vehicle, with 77% citing environmental reasons as the main driver for their choice. Both private and business customer attitudes to sustainability are changing and many now demand that the organisations they buy products and services from reduce their environmental impact. We can deliver against that expectation if we continue to challenge existing practices and commit to making initiatives such as using 'green parts' normal practice.

[1] Independent research carried out by One Poll from 1 October – 10 October 2019 amongst 250 UK motorists. https://www.mynewsdesk.com/uk/allianz-insurance/pressreleases/allianz-research-reveals-69-percent-of-motorists-would-accept-a-green-car-part-to-help-the-environment-2936179

THE CLIMATE OF RENEWABLE ENERGY

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Hurricane Dorian in August 2019 was one of the most powerful hurricanes ever to make landfall causing an estimated $7 billion worth of damage. It is thought that warmer ocean temperatures result in more intense tropical storms generating increased rainfall. Insurers have long since recognised that these huge claims affect their bottom line. A number of insurers have made it clear that they consider climate change to be a reality and manmade.

Deriving our energy from renewables is fundamental in reducing global emissions. From an underwriting point of view, this is a complex area involving new technology and assets constructed in entirely new locations. To date, loss ratios have been high with a number of insurers entering the market, only to leave it a few years later. However, investors are putting pressure on insurers to support the sector. Insurers are engaging experts to assist on the actuarial side in modelling future weather events and are developing a deeper understanding of the sector. Bespoke products such as parametric insurance can also provide solutions for weather sensitive risks or whatever is the unique risk for that insured.

There is a recognition that these insureds gather a wealth of data through the use of cutting edge monitoring systems which can, and ought to, be used by underwriters to better understand the technology and produce better margins. Drones can assist insurers and insureds to carry out regular surveying of assets, such as off-shore wind turbines. This not only provides health checks but will also reduce repair costs and claims.

While there has been a huge shift to renewable energy, in order to meet its net zero targets, the UK will have to find a solution for the heating and cooling of buildings as well as a huge reduction in vehicle emissions. One such solution for heating of homes and businesses may be the use of green hydrogen with, or instead of, gas. This can use existing infrastructure but does require significant investment to become a reality. In terms of vehicles, innovations such as highly automated road passenger services (HARPS) may revolutionise our private and public transport system thereby reducing the number of vehicles on the road. These are exciting ideas but they need to become a reality in a short timeframe.

Higher premiums can guard against inevitable losses arising from new designs, natural catastrophes etc. However, with increased awareness, and therefore preparedness, of the effects of climate change, the insurance market can ensure that cover is affordable and insurers will be an integral part of the solution.

ESCAPE OF WATER - ENVIRONMENTAL IMPACT

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The Food and Agriculture Organisation of the United Nations names water scarcity as one of the current leading challenges for sustainable development, with predictions that global demand for water "could increase by 50% by 2030".[1] It's clear that reducing water waste is more important than ever.

Data from the Association of British Insurers (ABI) documented 74,000 escape of water (EoW) claims worth £245m notified in Q3 2019, the highest level since Q1 2018 (77,000).[2] In the same quarter there were only 14,000 fire and explosion claims. This trend indicates the insurance industry still has a key role to play in assisting customers to protect their properties from the damaging effects of a water leak.

POTENTIAL REPERCUSSIONS

Further to the waste implications, escape of water is literally money down the drain for property owners. Costs may include physical damage to buildings and contents but also business disruption, restoration and costs for alternative temporary premises, as well as those associated with the loss of any metered water.

HELPING POLICYHOLDERS TO REDUCE WASTAGE

There's no single dominant cause of leaks, but some key factors include poor workmanship, frozen pipes in unheated or vacant locations and aging systems (such as old lead piping). Prevention and mitigation is key to reducing the number of EoW claims. This begins in the construction phase and so requires the principal contractor to oversee independent certification of work throughout installation, including pressure testing to a clearly defined pressure regime. It's also important to appoint a competent plumber, affiliated to an industry body – such as the Chartered Institute of Plumbing and Heating Engineers (CIPHE).

Business owners can also undertake a number of preventative steps. One is identifying the location of the stopcock and knowing how to turn the water off in an emergency. Another is to maintain low background heating during cold periods and ensure adequate lagging to pipes and tanks to reduce the chance of the pipes bursting.

Simple practices such as inspection and maintenance programmes, undertaken by a competent, qualified plumber, can also help in ensuring plumbing systems remain in good health.

Water leak detection products can serve a useful purpose and a number of products exist providing a range of solutions. These include leak detection sensors, auto valve shut-off and programmable water supply on/off timer switches. Some even allow for remote monitoring with text and email alerts should a leak occur, and real-time monitoring of usage to identify where economic savings can be made.

Through better EoW risk management, not only can potential damage and business disruption be avoided, but financial savings made against unnecessary water wastage, as well as positively impacting upon one of our most precious resources.

Allianz offers practical risk management guidance for property managers via our website www.allianz.co.uk/riskmanagement.

[1] Food and Agriculture Organization of the United Nations. (2019). Water Scarcity – One of the greatest challenges of our time. [online] Available at: http://www.fao.org/fao-stories/article/en/c/1185405/ [Accessed 3 Dec. 2019]
[2] ABI property claims data 1987 - 2019

ELECTRIC VEHICLES

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The internal combustion engine has been the preferred alternative to horse power from the birth of the motor car in the late nineteenth century, but consumer appetite is changing, and at an increasingly rapid rate. There are a number of factors influencing the move to alternative power sources, including advancements in technology, change in government policy and a change in consumer attitude and consciousness of environmental issues.

As the UK government has committed to banning the sale of new petrol and diesel vehicles by 2040, hybrid vehicles combining a petrol engine with an electric motor, designed to reduce fuel consumption and emissions and extend range are gaining in popularity. With manufacturers investing heavily in developing battery technology, fully electric models are no longer only the domain of the Tesla, though range and charging infrastructure remain a challenge for the automotive industry. Whilst Part 2 of the 2018 Automated and Electric Vehicles Act set out the government's commitment to upgrade the existing network of fossil fuel filling stations, concerns remain regarding the ability of the national grid to cope with demand that a wholesale move to electric powered vehicles will bring. Possible solutions include smart charging, where the time and rate of a battery re-charge is controlled intelligently, alongside the use of wind and solar power.

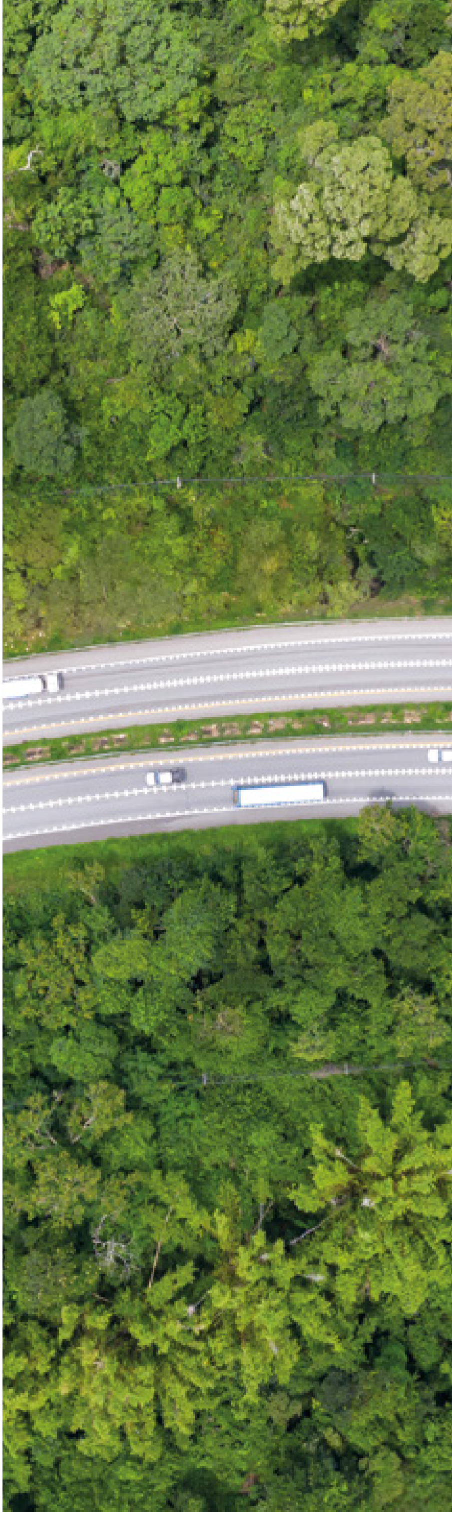
An alternative to battery powered electric vehicles are those using hydrogen fuel cells. These units use chemical reactions between hydrogen and oxygen to generate electrical power. On the plus side, hydrogen powered vehicles are ecologically friendly as they only emit water vapour. However, hydrogen is a highly flammable gas

which carries an inherent risk of fire unless the cell is fortified to prevent it exploding in the event of a high velocity impact.

Running in tandem with the development of alternative fuel cells is that of vehicle connectivity and automation. Sophisticated driver assistance systems such as adaptive cruise control and autonomous emergency braking which was once the domain of the prestige marques are becoming mainstream on new vehicles. Although they are yet to hit our roads, the government's appetite to be front and centre in the development and deployment of automated vehicles is abundantly clear. Trailed by primary legislation to put in place an effective insurance regime, the three-year project currently being undertaken by the Law Commissions of England & Wales and the Scottish Law Commission to review driving laws in preparation for the introduction of self-driving vehicles early in the next decade represents a real statement of intent.

These changes provide challenges not just for consumers, governments and regulators but also for insurers and brokers, who may need to understand the implications of these new technologies - the risks involved, consumer demand for new products based on usage or automated vehicles, and how to price for them (if at all) without the benefit of historical data. All sorts of questions will be thrown up: what are the comparative risks of an electric battery fire as opposed to the explosion of a hydrogen tank? What will be the impact of ongoing advancements in vehicle technologies on the cost of repairs, and on premiums? The list is endless.

As the desire to find ecologically friendly mobility solutions for short and final mile journeys gathers momentum, there is the question of micro-mobility: electric bikes, scooters, skateboards and the like. To what extent will their use in public places be legalised; will insurance become compulsory for all or any of them; and to what extent may insurance cover be provided through household policies? These are among the myriad of questions that will have to be decided.



MANAGING ESG RISKS IN UNDERWRITING

Identifying and managing risks is at the core of insurance. On the one hand, an awareness and understanding of environmental, social and corporate governance (ESG) issues is crucial for allowing insurers to reduce risks and capture opportunities in underwriting, claims, and investment and asset management.

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But insurers are also well placed to lead by example in 'doing the right thing', through being sustainable, responsible and helping the world become more resilient to ESG challenges.

WHAT IS ESG?

ESG factors are extra-financial factors that can influence, and be influenced by, our business activities. If not addressed appropriately they can escalate into substantial risks.

ESG factors impact on a wide range of areas, such as how companies respond to climate change, manage their supply chains and evidence consumer protection.

WHY IS ESG IMPORTANT?

Insurers and brokers may need to be able to demonstrate use of ESG criteria to evaluate the risks they accept and investments they make, since failure to do so could not only adversely affect the balance sheet but also customers, employees, shareholders and wider society. The industry is subject to an increasing number of international standards and best practice frameworks across ESG; in February 2019, the Principles for Sustainable Insurance acted as the first global guide for managing ESG risks in underwriting across Property and Casualty lines. This discussed the importance of sharing knowledge across the industry to make it easier for business partners to carry out ESG due diligence on clients and transactions.

However, the importance of embedding an ESG framework extends to all companies. If not managed effectively, ESG risks can bring about reputational, supply chain and business disruption risks, plus be detrimental to the environment

PRACTICAL EXAMPLES OF ESG-BASED DECISIONS

In recent times we've seen insurers (including Allianz) turn away from coal business, both as an investor and an insurer. We've strengthened our exclusion criteria so we no longer invest in energy companies which could put the Paris Climate Agreement's target at risk. Further, we've committed to sourcing 100% of our electricity from renewable sources by 2023.

In October 2019, Aon announced plans to launch an impact fund and low carbon factor fund for its discretionary asset management clients.[1]

Allianz was voted the number 1 sustainable insurer in the Dow Jones Sustainability Index 2019 and won Business Sustainability Initiative of the Year at the 2019 British Insurance Awards

OPPORTUNITIES ARISING FROM ESG

ESG can offer opportunities to insurers which plan and respond effectively to environmental and societal changes. Early warning ESG indicators can help to spot a deteriorating situation before an event occurs and assist in risk selection. The insurance industry can also help make sector more sustainable using risk management skills and knowledge which they can pass onto their customers.

A proactive ESG strategy could also have other benefits, such as improving employee engagement, company culture and strengthening brand reputation.

[1] Fixsen, R. (2019). Chart of the week: Responsible investment surges in importance. [online] IPE. https://www.ipe.com/news/esg/chart-of-the-week-responsible-investment-surges-in-importance/www.ipe.com/news

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