

The heat is on for a green syndicate

MARTIN MITCHELL, Whittington compliance director, questions whether it is time for an ethical, environmentally friendly Lloyd's syndicate and looks at what might be needed to make this happen

Global warming is no longer a concept propounded at the fringes of our political parties or media; it features prominently in the latest budget, it is high on the agenda of the United Nations and even the US federal government is waking up to the idea. No other potential catastrophe scenario has focused the minds of the establishment quite like climate change has managed to during the past few years.

Every industry has a responsibility to act and insurance is certainly no exception. A lot of people are talking about it, but action is more problematic. There has been some debate over the development of a so-called "green syndicate". But what exactly would a green syndicate do? Would it insure customers who were themselves green in some way? Would it insure ventures designed to assist others to become green, or even provide insurance to companies that fell foul of green regulations? Greenness suggests some ethical or moral values, which do not necessarily make a syndicate specialising in such policies commercially viable; to move corporately in a significant way there must be the potential for profit.

Global warming accepted

Proof of warming caused by elevated levels of CO₂ in the atmosphere and prediction of long-term warming are being accepted pervasively by the international science community – and governments are starting to listen. By way of an example, the head gardener of Trelassick, a National Trust property in Cornwall, England, for 27 years, says: "Every January for the past

15 years I have recorded the number of different plants in bloom. In 1991 there were 30 plants flowering in January. This has risen to 220 in 2004." This is widely construed as evidence of what is commonly referred to as the greenhouse effect.

According to some sources, UK sea levels have risen by around 10 cm since 1990 and research by the Department for Environment, Food and Rural Affairs indicates that about 10% of the population of England and Wales lives within areas that are potentially at risk from flooding or coastal erosion, in properties valued at £220bn (\$451.06bn).

Future predictions are even more extreme. It is estimated that if current trends continue, by the end of the century the Earth's average temperature could rise by approximately 3.5°C and sea levels by one metre. The amount of land area affected by drought could increase from 5% to 30% by the end of this century.

Climate change is expected to exacerbate the frequency and magnitude of weather-related catastrophes. By 2050 mega-catastrophes such as hurricane Katrina, which used to occur every 100 years, are predicted to happen every 25 years.

Unless something is done, the International Energy Agency predicts an increase in world energy demand of 60% by 2030, implying a 60% rise in CO₂ emissions. If the UK were to cut emissions (2% of the world total) to zero tomorrow, that would be taken up, if the current rate of increase in Chinese emissions continued, in less than two years.

Given the enormity of the problem, just how realistic is it that our industry can make a really positive difference?

There are certainly a number of concerns regarding

ing the negative impact of climate change for us. Global warming means price volatility, uncertainty and increased liability. Larger catastrophes require more capacity and capital. There are also questions over the insurability of risks associated with global warming. But we must dig deeper to seek the opportunities for us to help secure a better future.

Interest in green issues

Andrew Galloway, the managing director of West Hill Corporate Finance, has been interested in green issues for some time. Indeed, West Hill has recently advised Eurotrust, a Danish wind-farm property developer, on a capital raising followed by a move to the Alternative Investment Market (AIM). He explains that there has been a huge growth in green and ethical funds not only in the UK but also internationally. This has been fuelled by strong performance of a number of climate change-related stocks, such as carbon-trading emissions companies or clean-energy businesses. In relation to the availability of capital for insurance, he comments: "There are lots of ethical and sustainable funds willing to back the right insurance ventures with green credentials – the issue, as always, is to find good underwriters with an attractive business model."

Research carried out by Lloyd's last year claimed that only one in four companies have changed their risk-management strategy as a result of increasing weather-related catastrophes. While we as an industry cannot enforce environmentally friendly behaviour, we can encourage it by playing our part in product innovation and encouraging behavioural change, for example by encouraging damage limitation through standards specified in policy wordings, or

where claims payments include advice for better defensive measures.

International insurance service provider Whittington recently organised a round-table to discuss what a green Lloyd's syndicate might do and to set out lines of business and products it might write. The session included participants from Benfield, the Climate Exchange, Lloyd's, Acclimatise, The Carbon Trust, St Paul Travelers and Whittington.

One of the factors that sparked Whittington's interest in a green syndicate was the 360 Risk Project posted on Lloyd's website. Lloyd's has a team concentrating on emerging risks and Trevor Maynard, an actuary, is taking the lead on climate change. He says: "There are two main approaches to the climate change problem, using the technical terms mitigation and adaptation. Mitigation means reducing or offsetting CO₂, adaptation means becoming more prepared and surviving."

The purpose of the brainstorm was to define a workable mission statement for a green syndicate and set out lines of business and products which it might write. There might be several approaches and it could be that, in time, more than one syndicate could emerge in Lloyd's specialising in different aspects.

Having worked through a number of options, the participants concluded that they were very firmly in favour of the concept of insuring companies and risks that were in some way green, with preliminary screening before underwriting, as described in the green syndicate prospectus (see panel).

Commenting on the prospectus, Stephen Cane, chief executive, Europe of Whittington, says: "I am not sure whether the time is ripe for a green syndicate – it may make more sense at this

Green syndicate prospectus

Taking advantage of the growing interest in climate change and green issues, the syndicate will focus on policyholders who share a responsible attitude towards climate change and the use of sustainable resources, leading to an above-average return on equity over the cycle.

The syndicate proposes to underwrite a diversified book of predominantly direct and facultative business, in the energy, property/casualty and personal lines (coverholders and affinity group) classes of business. It is expected that policyholders subscribing to the syndicate's philosophy will have superior risk management and more favourable claims experience, resulting in the possibility of lower premiums, better broker commissions and increased profitability.

Loyalty to the syndicate will be promoted by a sense of belonging to a group of like-minded policyholders, as well as the attraction of utilising the knowledge base of the syndicate staff and advisers. Policyholders will be encouraged to adopt best practice, both before placement and after any claims.

The syndicate will operate a unique pre-underwriting screening system, which will rate each risk on a scale of A to G, describing the extent to which it complies with or promotes sustainability, the protection of natural resources, carbon neutrality, energy efficiency and social and corporate responsibility. The ratings will be derived from the increasing amount of information available from published indices, the Carbon Disclosure Project, the Carbon Trust, disclosures in reports and accounts and industry knowledge. They will take into account the track record of the policyholder and the nature of the risk itself. The criteria used will be publicised and, in time, the brokers will be expected to provide this information when placing the risk.

The syndicate will not, in general, write risks at the lower end of the A-to-G scale and will monitor and publish its achievements in writing risks in each category regularly.

Because of the pioneering nature of the syndicate it will need reinsurance protection, particularly in its early years, and it is anticipated that this will be provided by the Lloyd's market, which, it is thought, will be keen to show its interest in this innovative approach. In addition, the syndicate will need co-operation from other Lloyd's syndicates in sharing underwriting expertise, possibly by means of consortia.

The possibility of a profit share with policyholders, or with suitable green causes, has yet to be considered. The public relations positioning of the syndicate will have to be carefully considered – while it will adopt best practice itself, its focus will be on providing a better product to chosen policyholders.

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stage to form a consortium underwritten by a number of syndicates, but it would certainly seem that there is a lot of growth potential."

Rating scale will need work

It is recognised that the rating scale will need development work, but a number of publicly available sources of information are now available, such as the Carbon Disclosure Project, the FTSE-4Good Index and the Dow Jones Sustainability Index, increasingly used by fund managers, where the extent to which companies are addressing their emissions are already affecting their share price and their prospects. Is it beyond the bounds of possibility that risks could be screened

in this way before conventional underwriting?

Sunny Sehgal, assistant director, environmental risk of HSBC Insurance Brokers, says that HSBC has been taking climate change seriously for several years and would welcome a syndicate specialising in this area – he is handling a great deal of business that would benefit from the expertise which the syndicate would develop.

So could a green syndicate business model evolve into something that is attractive to capital, to Lloyd's, to brokers and, of course, to insurance buyers? It is just possible one day soon these ideas will become reality.

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