LLOYD'S

Environmental, Social and Governance

Lloyd's guidance for managing agents

October 2021

Contents

Introduction

In December 2020 we published our first Environmental, Social and Governance (ESG) report setting out Lloyd's ambition to become a truly sustainable marketplace, and to play our part in supporting the global transition towards net zero.

Since the publication of our first ESG report, Lloyd's has engaged in extensive consultation with our market, with governments, regulatory authorities, brokers, NGOs and other key stakeholders, as we have looked to further develop our strategy. Achieving net-zero greenhouse gas emissions by 2050 is the direction set by governments in order to achieve the goals of the Paris Agreement and, as the world's leading global insurance marketplace, Lloyd's has a crucial role to play in the transition to a net zero economy in several areas:

– **Taking a leading role in advocating for net zero and the green industrial revolution within our sector and wider financial services**. Through our leadership of the SMI Insurance Taskforce, we have convened the insurance industry and are actively working with a wide range of business leaders across multiple sectors to address these challenges during a crucial period of time which requires multi-sector engagement on a vast scale

– **Promoting the development of new products and services to insure the transition and underpin the green industrial revolution**, including those that support new green technologies, for example through the Climate Action Report and Roadmap, published in July 2021

– **Providing best practice guidance and developing climate transition measurement methodologies** to support the market and wider sector through the transition to net zero

– **Showcasing the positive role of the market and the wider insurance sector** to our stakeholders

– **Showing leadership through the Corporation's own actions** in becoming net zero

Our ambition is for Lloyd's to be the commercial and specialty market of choice for insuring the transition to net zero by providing the vital risk management solutions that will underpin and enable businesses, governments and economies to take brave action, drive forward climate innovation and accelerate critical decarbonisation activities over the years ahead. Importantly, we are committed to supporting government policy in achieving net-zero greenhouse gas emissions by 2050. We will do so by aligning our own climate approach and activities and driving progress on a market-wide basis.

It is clear that continuing to provide (re)insurance for carbon intensive businesses and projects will become increasingly unsustainable, with climate and transition risks intensifying as the world moves towards that 2050 goal. Accordingly, it would be detrimental to our overall competitiveness and performance to risk becoming a market of last resort for carbon- intensive industries whose business models and operations will become increasingly unviable and unsupported in the decades ahead.

As a marketplace it is imperative that we work towards a sustainable underwriting approach, with a portfolio of customers and business that supports our ambition to achieve net zero by 2050. This approach means that we will continue to support harder-to-abate sectors who have a credible climate transition plan in place, which can be measured and tracked over the years ahead.

While we have set out our view on our own direction of travel and market-wide ambitions through our 2020 ESG Report, we recognise that each managing agent will need to adopt their own, independent, approach to meeting the sustainability challenge, which requires integrating sustainability as a core business objective.

To support you in that effort we have provided some directional guidance and best practice for establishing an ESG framework, as well as approaches to responsible investment and sustainable underwriting. In providing this guidance, we also recognise that it is up to each individual managing agent to decide their own ESG targets and policy, including their approach to sustainable underwriting and responsible investment strategies. We will therefore use a climate transition measurement approach, detailed in Chapter 2, to determine the market's progress towards this ambition.

1. Lloyd’s 2022 Approach

In this document we set out further guidance to support managing agents as they look to put in place ESG governance frameworks, including sustainable underwriting and responsible investment strategies. We will continue to engage in consultation with market participants and other stakeholders on our ESG strategy and look forward to receiving any comments on the material contained within this guidance.

To drive our collective progress towards a more sustainable market, our 2022 approach includes the following actions:

1. Lloyd’s will commit to be net zero by 2050 for the Corporation and the market. This will be underpinned by a best practice climate transition measurement model which will measure the market’s progress towards that goal

Lloyd’s approach will be to drive progress towards achieving net zero by 2050, recognising that this will require the market to make its own decisions on the risks it underwrites, the investments it makes, and the way in which to reduces its operational carbon emissions.

To support that ambition, through the SMI Insurance Task Force Lloyd’s will develop a climate transition measurement framework that will allow the Corporation to begin to track and measure the market’s progress on an aggregate basis in transitioning towards a net zero underwriting position by 2050. Following thorough testing to ensure it represents a workable measurement methodology, we will run a market pilot with a selected number of managing agents in 2022 to further refine and iterate the framework, ensuring it is fit for purpose.

Following the pilot, we expect to implement a ‘Sustainability Transparency and Reporting’ regime from 2023 onwards to get our first market-wide aggregate view of our underwriting portfolios and identify a baseline position. This first snapshot of our position will enable us to track our journey over the years ahead and demonstrate our positive contribution in the global transition to net zero.

2. Lloyd's expects each managing agent to implement an ESG strategy and framework that is fit for purpose for their business

Over time, each managing agent will be expected to implement an ESG strategy and framework against which we will measure the market's overall progress towards achieving net zero by 2050. Chapter 3 of this document sets out further details of our expectations on firms in developing and embedding their ESG approach, recognising that it is for each firm to determine the specific policies suitable for their individual business.

Lloyd’s expectation is that these ESG strategies will be developed throughout 2022 for consideration by Lloyd’s as part of the 2023 business planning cycle.

3. The Corporation will strengthen its ESG governance, as well as further developing its operational and investment approach

<u>Governance</u>
Following the appointment of Lloyd’s first Sustainability Director, an ESG Committee of the Council will be constituted with the responsibility to oversee Lloyd’s sustainability strategy and approach towards meeting net zero by 2050. This will be supported by a Sustainability Steering Committee which provides input, guidance and decision-making on Lloyd’s sustainability approach and initiatives.

<u>Operational decarbonisation</u>
The Corporation has committed to net zero for its own operations by 2025. This will be delivered across all areas of our operations in the UK and across our global network.

<u>Investments</u>
The Corporation will develop an approach to transition its Central Fund investment portfolio to net zero greenhouse gas emissions by 2050, by setting out measured intermediate targets in line with the principles of the Net Zero Asset Owner Alliance.

2. Climate transition measurement approach

Lloyd's, together with the global (re)insurance industry, has a vital role to play in individually and collectively driving and accelerating the transition towards a resilient, net zero economy. Importantly, we have a responsibility to insure the transition and support our customers as they decarbonise, including harder-to-abate sectors which are critical to the world's transition to net zero and depend on our support to manage and mitigate the risks they will face as they evolve to more sustainable, low-carbon business models.

We are committed to supporting government policy in achieving net-zero greenhouse gas emissions by 2050. We will do so by aligning our own climate approach and activities and driving progress on a market-wide basis. To that end, as a marketplace it is imperative that we work towards a sustainable underwriting approach, with a portfolio of customers and business that supports this ambition.

With our leadership of the HRH The Prince of Wales' Sustainable Markets Initiative Insurance Task Force, we have a unique opportunity to develop a measurement framework that will allow us to track and measure the market's progress on an aggregate basis in transitioning towards a net zero underwriting position by 2050. The development of this framework will enable us to better prepare and respond to the increasing reporting requirements that will inevitably come from a range of different stakeholders.

The SMI climate transitions measurement framework has three key objectives:

- Identify current carbon intensity hotspots in underwriting portfolios, incorporating both a point-in-time assessment and forward-looking metrics on the rate of green transition
- Encourage insurers and reinsurers to reduce their contribution over time to carbon-intensive activities and increase support for climate solutions, thereby insuring the transition
- Enable the insurance industry to collectively measure progress as it transitions its underwriting portfolios in support of decarbonisation

Upon completion of the first version of the climate transition measurement framework, and given the challenge in getting to a credible and robust measurement approach, our intention is to test the thesis being developed by the SMI Insurance Task Force.

Once we are satisfied that the framework represents a workable measurement methodology, we will run a market pilot with a limited number of managing agents in 2022 to further refine and iterate the framework. This approach will ensure it is fit for purpose for our market, before wider implementation of a 'Sustainability Transparency and Reporting' regime from 2023 onwards, to get our first market-wide aggregate view of our underwriting portfolios. This first snapshot of our position will enable us to track our journey over the years ahead and demonstrate our positive contribution in the global transition to net zero.

3. Embedding an ESG framework

Embedding an environmental, social and governance (ESG) framework enables firms to make robust decisions about their strategy and approach to driving sustainability across all of their business activities. By scrutinising insurance from an ESG perspective, managing agents can extend their understanding of risks and seize potential business opportunities, bringing benefits both to customers and other stakeholders.

Each managing agent should consider how they may develop and incorporate an ESG framework that is suitable for their business. Managing agents may want to consider the below key features for their ESG framework:

– A governance structure that embeds ESG in decision making

– Sustainability is embedded across underwriting and investments

– A risk management system that responds to ESG risks, including the financial risks of climate change in line with PRA supervisory statement SS3/19

– Data and reporting is used to monitor and disclose on ESG

Considerations in creating an ESG framework

The insurance industry is evolving to incorporate ESG considerations as part of ongoing business and operational activities. Lloyd's recognises that this is a new field and there is a need to learn from existing frameworks and best practices.

There are several ESG standards for reporting which managing agents may also wish to consider when putting in place their ESG frameworks. These include:

– Annual Task Force on Climate-Related Financial Disclosures (TCFD) reporting

– Annual UNEP FI Principles for Responsible Insurance (PRI) reporting

– Annual UNEP FI Principles for Sustainable Investment (PSI) reporting

– Annual Sustainability Accounting Standards Board (SASB) reporting

In addition, managing agents may want to consider reporting voting information for companies they are invested in, or voluntarily supplying product-specific reports on ESG indicators and engagement activities.

It is important for all insurers to consider their own risk appetite in the context of regulatory requirements and their own ESG ambitions. Managing agents may wish to consider identifying ESG related risks that are most material to their business and underwriting activities, when setting their ESG risk appetites.

PSI Principles

- Managing agents' Risk Appetite
  - Embed in decision-making ESG issues relevant to insurance business
    - Establish managing agents' strategy at board level to identify, assets, manage and monitor ESG issues
    - Integrate ESG issues into risk management underwriting, appreciate potential ESG related consequences of business transaction
    - Support innovation and enhance sustainable insurance product and service development
    - Integrate ESG issues into Claims Management
    - Incorporate ESG issues into Sales and marketing process, embed ESG consideration into organising culture
    - Integrate ESG issues into Investment management
  - Work together with policyholders and business partners to raise awareness of ESG issues, manage risk and develop solutions
    - Dialogue with clients and suppliers to outline the importance of ESG issues, encourage disclosure, and set clear expectations and requirements on ESG issues
    - Engage with Insurers, reinsurers peers to progress industry ESG advancement
  - Work together with governments, regulators and other key stakeholders to promote widespread action across society on ESG issues
    - Active dialogue with governments, regulators and other policy makers to develop integrated risk management approaches.
    - Utilise media to promote public awareness of ESG issues and good risk management
  - Demonstrate accountability and transparency in regularly disclosing piblicly ESG progress
    - Assess, measure, disclose and monitor ESG issues, participate in relevant disclosure or reporting frameworks

The diagram above sets out a framework, based on four main principles, to support managing agents in developing an ESG underwriting and risk governance process (if they do not have one already), based on the UNEP FI PSI. Managing agents could adopt the actions below to enhance ESG engagement at organisational and supply chain levels.

Source (table above): UNEP FI Principles for Sustainable Insurance

Minimum expectations of managing agents in 2022

– During 2022 we expect managing agents to create a first version of their own ESG frameworks, governance and strategies. These should contain the key features outline above and is fit for purpose to their individual business, the review of which will ultimately form part of Lloyd’s oversight framework

– The expectation is that these standards will be raised over time and Lloyd’s will provide further guidance on best practice as the frameworks embed

– We have asked all managing agents to submit an appropriate ESG strategy as part of the 2023 business planning process. This will be discussed through the Strategic Business Discussions (SBD’s)

4. Developing a sustainable underwriting approach

Establishing a policy on sustainable insurance

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.

To take advantage of the new opportunities that come with an increasingly green economy, managing agents may further want to consider both innovation and impact underwriting opportunities. ESG integration into underwriting may also be expanded to consider:

– Broker facilities / lineslips, binder and consortia managing agents may want to consider giving written guidance (either within the contract or as part of their own benchmark reporting) to those whom they delegate underwriting authority

– Categories of (re)insurance to be considered managing agents are encouraged to work through the impacts on all classes and product lines of insurance written through all distribution channels

Sustainable insurance policy implementation

While implementing their policy on sustainable insurance, managing agents may want to initially consider the most material areas of their underwriting operations (in terms of ESG risks) and how ESG can be integrated into these. The following discusses how managing agents may approach ESG integration in different areas of their underwriting process and might be a useful tool for ESG planning.

Client onboarding and distribution

– Consider how ESG factors can be considered
– Is additional data required?
– Are additonal metrics and scoring required?

Business planning, portfolio steering, and management information

– Setting appropriate ESG targets
– Consider what management information is required for monitoring of ESG targets
– Additional qualitative ESG considerations as part of business planning

Underwriting and new product development

– Consider how your underwriting process and portfolio management factors in ESG
– Consider how existing business can be updated to incorporate ESG factors
– Additional focus on ESG and product innovation through new business
– Underwriting integration (incl. exclusions)
– Consider exclusions and/or road map to future exclusions
– How can existing underwriting standards be updated to include ESG factors?
– How can existing and new relationships be improved to reduce ESG related risks?
– Feedback loop to claims management

Claims management

– Consider ESG factors as part of claims analytics process, to understand how new ESG-related risks are emerging
– Align claims journey with new ESG products and customers

Improving policyholder practice

Managing agents may be exposed to ESG risks through their underwriting activities. These risks may be managed and/or mitigated by engaging with direct policyholders and intermediaries. Managing agents may choose to develop a policyholder engagement strategy as part of their:

– Direct relationships with policyholders/clients
– Direct relationships with reinsurers
– Indirect relationships with brokers, binding authorities and cedants

For the latter, managing agents may wish to consider what additional data they require as part of their underwriting process to understand the potential ESG exposures. For example, look-through of underlying exposures for inward treaty reinsurance.

Policyholder transition plans
managing agents can partner with direct and indirect policyholders, to support them with their approach in transitioning from operations/activities that present the most material ESG risks to their business and to their insurer.

A credible climate transition plan is a document that outlines a scientific pathway for limiting global warming following UN high-level criteria or SBTi criteria. The transition plan identifies the scope, timeline, governance, and methodologies set out to monitor the progress of the transition.

A credible transition plan should be embedded in the company's governance. The credible climate transition plan incorporates considerations of the market and technological shifts, policy and legal changes, and reputational damage in a science-compatible pathway to limiting global warming with 1.5 oC or 2 oC. It may also include opportunities around falling costs of renewable technology, the need for investment in low carbon alternatives, and radical change in the energy mix.

The PRA has also separately recently issued guidance on transitions: Guidance for participants of the 2021 Biennial Exploratory Scenario: Financial risks from climate change (bankofengland.co.uk)

The framework below illustrates considerations managing agents can raise with policyholders to improve the sustainability of their business model.

1. Identification

Identify policyholders that pose the most material ESG risks from their underwriting activity.

These risks may arise from policyholders' exposures to climate risk, raw material and water scarcity, product liability, cyber security, pollution, waste and corporate governance. To facilitate this, managing agents may require additional ESG data.

2. Mitigation

Managing agents can mitigate ESG risks by establishing their engagement policy and collaborating with policyholders to develop credible transition plans.

Managing agents could help facilitate the transfer of policyholders' transition risks by writing appropriate insurance policies.

As part of this process, managing agents may also choose not to underwrite risks that do not align with their ESG strategy.

3. Enhancement

Managing agents could support in enhancing the policyholders' transition plans

By working with policyholders to improve their ESG understanding and practice, policyholders could enhance their business model and create competitive advantages compared to their peers.

4. Innovation

Managing agents could create an open dialogue to understand the policyholders' needs around sustainable underwriting.

The open dialogue allows managing agents to innovate their insurance products and how they underwrite.

Product innovation to support green industry

Product innovation will play a critical part in harnessing commercial opportunities that the transition to net-zero will bring. Managing agents can play an integral part in this journey through introducing, developing and offering sustainable insurance products that reflect changes in policyholders' risk profile, changes in physical and economic environment, change in technologies, and changes in societal needs.

Managing agents may wish to consider how they approach product innovation and whether they choose to adopt the Lloyd's commitment to support at least 2% of annual premiums from innovative insurance products by 2022 or to set their own.

Sustainable insurance governance

Managing agents may have identified the required level of oversight as part of setting a ESG strategy. Such sustainable insurance policy documents will typically outline the governance responsibilities of internal stakeholders. Responsibilities may be split into oversight duties and the day-to-day execution and management of the sustainable insurance policy, across internal stakeholders, including: the board, the underwriting committee, the CEO, chief underwriting officer, CFO, underwriting teams and ESG specialist/compliance teams.

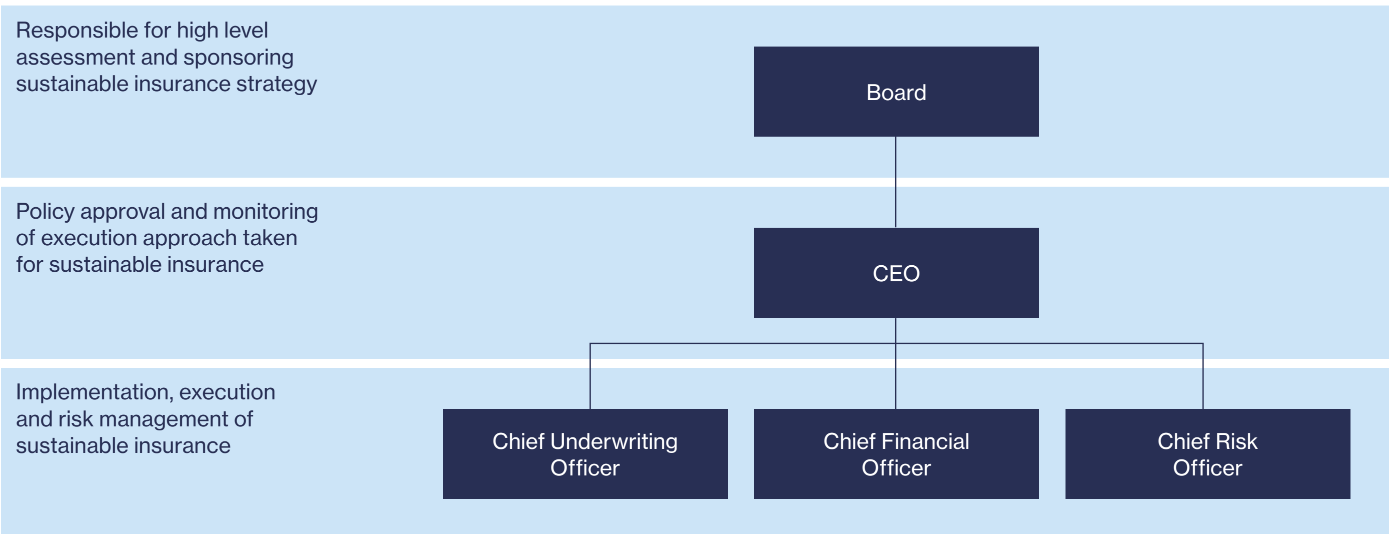
In line with Lloyd's overarching risk management approach, managing agents may wish to structure their approach to ESG using a three 'lines of defence' model, with the underwriting team representing the first line of defence, risk function as the second line of defence and internal audit function/external parties as the third line of defence.

Managing agents may seek to broaden the scope of their sustainable insurance policy, as regulatory requirements evolve and/or their underwriting activities adapt to reflect their ESG strategy and ambition.

The governance framework for a sustainable insurance policy should clarify the steps of identification, assessment, and management of key ESG issues and risks. The sustainable insurance process may also be expanded into product development, underwriting, claim settlement, product management, reserve assessment, and reinsurance management.

Minimum expectations of managing agents in 2022

- During 2022 we expect all managing agents to consider what sustainability and ESG factors they want to include as part of underwriting decisions. These factors should be incorporated into managing agent's ESG strategy and approach documents
- In addition, managing agents should consider the appropriate level of oversight and ESG governance responsibilities of internal stakeholders as part of setting their ESG strategy
- While developing their ESG strategy and approach, managing agents should consider the most material areas of their underwriting in terms of ESG risks, including areas relating to high carbon-intensity business



5. Setting a responsible investment policy

This section sets out guidance for developing your own responsible investment policy, as well as information on governance and links to training materials. A responsible investment policy will typically cover:

– Strategy and governance
– ESG integration
– Stewardship and voting
– Communication and reporting

Lloyd’s anticipates managing agents may need to develop their own responsible investment policies and governance frameworks, appropriate for their size, scale and ambition.

This guidance provides some examples under each category as a possible foundation for managing agents to tailor to their own responsible investment approach.

The first step of developing a responsible investment approach is for managing agents to understand their current status. Managing agents may choose to compare their current activities to those in the table below to establish their present responsible investment maturity. Depending on the level of maturity, implementing a responsible investment approach can take over a year, from developing a policy through to implementing changes in investment mandates and developing appropriate reporting. The proposed structure can be amended to reflect managing agents’ organisational goals, beliefs and structures.

		Low	Moderate	Advanced	Leading
Responsible investment strategy and governance	Corporate strategy and purpose	High level RI strategy in place but with limited application	Establishment of targeted RI strategy applied at high-level	Apply a clear vision and objectives of RI strategy at corporate level	Commitment to be Net-Zero prior to 2050; member of the Net Zero Asset Owners Alliance
	RI Policy and Governance	High level RI policy in place but with limited application	RI policy covers understanding of RI and investment beliefs	RI policies and process for ESG integration for all asset classes	RI strategy engrained in the firm's strategic priorities with board level governance
ESG integration	Strategic asset allocation (SAA)	Little to purely exclusions based integration only	Exclusion and positive screening	Exclusion and positive screening with ESG materiality analysis	Advanced ESG data analytics
	AM expectations	Little to no expectations of asset manager(AM) to integrate ESG factors	AM to integrate ESG factors across core asset classes only	Require AM to integrate ESG factors across all asset classes	Require AM to integrate ESG factors across all asset classes with periodic performance reporting
	AM oversight	Little to no monitoring of AM ESG integration	High level monitoring of AM ESG integration via questionnaire	Monitoring of AM's ESG integration via questionnaire and interviews	Monitoring of AM's ESG integration includes data review and preiodic performance review
Engagement and stewardship	Stewardship engagement	No stewardship activity at an asset owner (AO) level	Limited activity at an AO level, with reliance placed on AM activity	Committed to the stewardship code in relevant jurisdictions and expect AM to implement accordingly	Policy clearly communicated and supported by clear outcomes
	Voting [Equity]	No requirement for AM to vote on holdings	Limited requirement for AM to vote on holdings	Requirement for AM's to vote on all eligible shares	Publicly commit to voting against chair of the board
	Stewardship [Fixed Income]	No requirement for AM to conduct stewardship activities on fixed income	Limited requirement for AM to conduct stewardship activities on fixed income	Requirement for AM to engage issuers for ESG disclosure	Actively engage and monitor issuers' ESG performance and disclosure through AM
	Advocacy	No advocacy at an AO level	Limited advocacy activity at an AO level, reliance placed on AMs	AO involvement in investor coalitions	Leadership actively seek further legislation for RI and climate
Communication & Reporting	Reporting	Limited to no public statement on RI Unstructured disclosures with no alignment with any reporting standards	Extensive qualitative statement on RI	A small number of quantitive RI targets reported	Comprehensive number of quantitative RI metrics reported, reporting aligned with PRI reporting requirement if signatory

Strategy and governance

Responsible investment policies can take many forms and there is no single right way of developing one. Currently, policies can take the form of high-level statements on an organisation's webpage, a code of conduct, communication on a separate responsible investment policy document, be addressed throughout a range of policy documents covering different areas, or in some cases are incorporated into an organisation's investment policy statement.

Some managing agents may choose to have a standalone responsible investment policy while others may have a policy framework that includes inter alia responsible investment, exclusions, stewardship and climate change. For some managing agents, developing an appropriate responsible investment policy will be an iterative process, with the scale and breadth of any policy developing in line with market practice in what is a dynamic space.

Once the policy is in place asset owners will need to encourage and liaise with asset managers to turn the policy into concrete investment decisions and, in turn, to proactively incorporate ESG and sustainability issues into new investment mandates; managing agents who are acting as their own asset managers will need to incorporate policies appropriately into their in-house investment process.

Internal governance

Having identified the oversight involved in their responsible investment policy, managing agents' policy documents may also outline the governance duties of all internal stakeholders. Responsibilities could be split into oversight duties and the day-to-day execution and management of the investment policy, across internal stakeholders, including (where each of these exists): the board, the investment committee, the CEO, chief investment officer, CFO, investment teams and ESG specialist/compliance team.

In line with Lloyd's overarching risk management approach, managing agents could structure their framework through a three 'lines of defence' model. It would be appropriate to regard the investment team as the first line of defence, to use the additional oversight carried out by the internal risk teams as the second line of defence, and to plan internal audit checks as the third line of defence.

Asset manager selection and oversight

A fully integrated responsible investment policy calls for a robust governance approach. All stakeholders need to be accountable, some at several stages of the responsible investment process.

For those managing agents who work with external investment managers, external governance is critical, and falls into two parts.

Firstly, managing agents may need to develop a set of ESG criteria for asset manager selection. This could include:

- Responsible investment alignment
- Fee structure
- Governance structure
- Active ownership
- Conflict of interest
- Related party transactions etc

Secondly, managing agents may need an ongoing mandate for external asset managers that clearly demonstrates their competency in ESG integration which could include the requirement for a responsible investment policy to be in place.

Integrated ESG investing

The PRI defines ESG integration as "the explicit and systematic inclusion of ESG issues in investment analysis and investment decisions." In the context of Lloyd's market, ESG integration means embedding ESG factors into investment analysis and investment decisions.

To incorporate ESG issues into investment decisions, analysis and portfolio construction, it is essential to develop a robust understanding of ESG megatrends and their impact at the global level. Other elements of integrated ESG analysis include:

- Red flag indicators: companies with high ESG risks or in the exclusion industry category
- Company questionnaires and management interviews when information is not fully publicly disclosed
- Creating a watchlist both for high ESG risks companies and high ESG opportunities companies
- Internal research may include benchmarking with industry peers through proprietary research, identifying the material ESG factors and monitoring performance or conducting scenario analysis

to investigate the impact of their current ESG direction of travel
– External research could also be utilised, either through third party database, or through ESG specialists

In an active integrated ESG strategy, the asset manager may choose to become involved in the strategy of the underlying investments within the portfolio, for example actively participating in company AGMs to influence responsible ESG policies on the part of those companies.

At a more straightforward level, an integrated strategy can also mean that the designated investment managers will be asked to assess a wide range of material factors in investment decisions, not just financial, and including environmental, social, and governance (ESG) factors.

To integrate ESG considerations into their externally managed assets, asset owners (or their investment consultants) will assess external managers' integration practices. As ESG integration techniques vary widely, it is important for asset owners to define what ESG integration means to them in their investment strategy, policy and selection, appointment and monitoring (SAM) process.

This enables asset owners to evaluate external managers that meet their expectations for the level and style of ESG integration applied to their portfolio and allows asset managers to clearly understand those expectations.

CFA Institute provide an overview of how ESG integration may work across equities, fixed income and investment research. Source: guidance-case-studies-esg-integration.ashx (cfainstitute.org)

Stewardship and engagement

Stewardship or active ownership is increasingly seen as an important component of responsible investment. Stewardship can encourage companies to change their behaviour and improve ESG performance. Usually, this can be through voting engagement at shareholder meetings participating on ESG related shareholder resolutions. Stewardship activity doesn't need to be limited to equities. More recently, there have also been increasing examples of stewardship being performed at the issue stage of corporate credit, through the use of covenants linked to ESG.

As asset owners, managing agents can either directly engage with companies they own/lend to or understand how their appointed asset managers engage with companies. The following illustrates considerations managing agents can make as asset owners when setting an investment strategy and appointing an asset manager.

How will ESG be considerd as part of investment strategy and strategic asset allocation?

What criteria will be included as part of ESG mandate requirements and RfPs?

How will stewardship factor in asset manager selection?

What framework will be used to monitor asset manager stewardship activity? What is the frequency of asst manager's performance evaluation?

In most instances, Managing Agent investment portfolios are managed by a third-party asset manager. Managing agents may consider the following framework to understand their asset managers' engagement and voting activity, and how this aligns to their overall ESG strategy.

How does the asset manager identify material ESG issues relating to companies they choose to include in their portfolio

What strategy does the asset manager have for stewardship and engagement? What are the common goals to achieve these? e.g. governance, exec pay, diversity and inclusion

How does the asset manager disclose their engagement activities i.e. do they make public statements?

Does the asset manager collaborate with other stakeholders, investor coalitions, and/or policy makers as part of their stewardship activities?

What are the reporting metrics and reporting frequencies for engagement activities? e.g. no. of positive resolutions, evidence of voting activity

Managing agents should also consider the difference of engagement activities between fixed income and equity.

Monitoring and reporting

We anticipate that managing agents will need to assess the ESG characteristics of their investments using a combination of proprietary and third-party ESG research tools to ensure compliance with their responsible investment policies.

The Sustainable Finance Disclosure Regulation (SFDR) imposes mandatory ESG disclosure obligations for asset managers and other financial markets participants. Managing agents may refer to their asset managers' SFDR disclosures to understand how they consider sustainability risks and use SFDR disclosures as a useful criteria when appointing a new asset manager as part of the governance framework and subsequent monitoring and reporting activities.

Minimum expectations of managing agents in 2022

- During 2022 we expect all managing agents to consider what sustainability and ESG factors they want to include in their sustainable investment strategy. These factors should be incorporated into Managing Agent's ESG strategy and approach documents
- Managing agents who work with external investment managers should develop a first set of ESG criteria for manager selection and develop an ongoing mandate for external managers incorporating ESG considerations, such as responsible investment policies and ESG integration capabilities
- Managing agents should identify the appropriate level of oversight and ESG governance responsibilities of internal stakeholders as part of setting their responsible investment policy
- While developing their responsible investment approach, managing agents should consider the most material areas of their investments in terms of ESG risks, including areas relating to high carbon-intensity business

Frequently asked questions

Do managing agents need to stop underwriting thermal coal-fired plants, thermal coal mines, oil sands and Arctic energy exploration activity on 1 January 2022?

As outlined in our 2020 ESG Report, we think it is a sensible and pragmatic ambition, but we are not mandating the exclusion of these policies. It is up to each individual managing agent to decide their own ESG targets and policy, including their approach to sustainable underwriting.

However, we are committed to supporting government policy in achieving net-zero greenhouse gas emissions by 2050. We will do so by aligning our own climate approach and activities and driving progress on a market-wide basis. Within that framework, it is clear that continuing to provide (re)insurance for carbon intensive businesses and projects will become increasingly unsustainable as climate and transition risks intensify. Accordingly, it would be irresponsible and detrimental to our overall competitiveness and performance to risk becoming a market of last resort for carbon-intensive industries whose business models and operations will become increasingly unviable and unsupported in the decades ahead.

As a marketplace it is imperative that we work towards a sustainable underwriting approach, with a portfolio of customers and business that supports our ambition to achieve net zero by 2050. This approach means that we will continue to support harder-to-abate sectors who have a credible transition plan in place, which can be measured and tracked over the years ahead. As we work towards that goal, in supervising the market we have an obligation to satisfy ourselves, our market participants, and our customers that we are supporting multi-sector decarbonisation and that transition is taking place across our portfolio of business.

Upon completion and thorough testing of the first version of the SMI climate transition measurement framework, our intention is to run a pilot across the Lloyd's market through the first half of 2022, as the basis of our Sustainability Transparency and Reporting' regime which will measure the market's progress at an aggregate level towards a net zero aggregate underwriting position. During this time our intention is to test, iterate and refine the framework in consultation with the market, to ensure that we have a credible measurement methodology and approach before implementation through the 2023 SBF process.

Do managing agents need to stop investing in thermal coal-fired plants, thermal coal mines, oil sands and Arctic energy exploration activity on 1 January 2022?

In our 2020 ESG Report, we committed to phasing out new investments in these areas from 1 January 2022 and to phase out existing investments in in these areas by the end of 2025 as part of our responsible investment strategy. This also applies to phasing out existing investments in respect of companies with business models which derive at least 30% of their revenues from either thermal coal-fired power plants, thermal coal mines, oil sands or new Arctic energy exploration activities by the end of 2025.

This market wide ambition remains, and the Corporation has applied this in respect of Central Fund assets. However, we are not mandating the exclusion of these investments. It is up to each individual managing agent to decide their own ESG targets and policy, including their approach to responsible investment strategies.

What does "insuring the transition" mean for the market?

Lloyd's has a responsibility to insure the transition and support its customers as they decarbonise, including harder-to-abate sectors which are critical to the world's transition to net zero and depend on our support to manage and mitigate the risks they will face as they evolve to more sustainable, low-carbon business models.

Insuring the transition means continuing to support harder-to-abate sectors who have a credible transition plan in place, together with providing risk management solutions for green innovation and renewable energy investment and expansion. As we work towards that goal, we have an obligation to demonstrate to our stakeholders that our market is supporting multi-sector decarbonisation and that transition is taking place across our portfolio of business.

With our leadership of the HRH The Prince of Wales' Sustainable Markets Initiative Insurance Task Force, we have a unique opportunity to develop a measurement framework that will allow us to track and measure the market's progress on an aggregate basis in transitioning towards a net zero underwriting position by 2050.

Upon completion and thorough testing of the first version of the SMI climate transition measurement framework, our intention is to run a pilot across the Lloyd's market through the first half of 2022, as the basis of our Sustainability Transparency and Reporting' regime which will measure the market's progress at an aggregate level towards a net zero aggregate underwriting position. During this time our intention is to test, iterate and refine the framework in consultation with the market, to ensure that we have a credible measurement methodology and approach before implementation from 2023 onwards.

What is Lloyd's expectation of managing agents in developing their ESG frameworks?

Lloyd's expects managing agents to create their own ESG frameworks, governance and strategies that meet this minimum level and is fit for purpose to their individual business, the review of which will ultimately form part of Lloyd's oversight framework.

Each managing agent should consider how they may develop and incorporate an ESG framework that is suitable for their business. Managing agents may want to consider the below key features for their ESG framework:

– A governance structure that embeds ESG in decision making
– Sustainability is embedded across underwriting and investments
– A risk management system that responds to ESG risks, including the financial risks of climate change in line with PRA supervisory statement SS3/19
– Data and reporting is used to monitor and disclose on ESG

We have asked all managing agents to submit an appropriate ESG strategy as part of the 2023 business planning process. This will be discussed through the Strategic Business Discussions (SBD's) and Lloyd's will request managing agents submit their ESG strategy as part of the Syndicate Business Planning (SBF) process. Lloyd's will not be making oversight decisions based on these but will review them and provide thematic feedback for consideration by managing agents.

Will the data initially being provided by managing agents as part of the Sustainability Transparency and Reporting regime be reported on publicly at either managing agent or syndicate level?

No. The data will initially be used to form an aggregate view of the market's underwriting portfolios. This will provide a first snapshot of our position and will enable us to track our journey over the years ahead, demonstrating our positive contribution in the global transition to net zero.

Will the market be consulted on the proposed climate transition measurement framework and resulting market-wide Sustainability Transparency and Reporting regime?

Yes. We will be undertaking an initial pilot of the SMI ITF climate transition measurement framework with a select number of managing agents to further refine and inform our Sustainability Transparency and Reporting regime. We will also be asking managing agents for feedback through 2022 and 2023 as we implement the framework.

What data will the climate transition measurement framework be using to assess underwriting portfolios?

The SMI ITF are currently working through the proposed data requirements for the climate transition measurement framework. A combination of current emissions and transition plan data will be used to feed the initial version of the measurement model and to test the prototype.

The Framework looks to bring together multiple datasets, both at an individual insured and higher levels (e.g. sector). However, this data is imperfect, incomplete and inconsistent – collation, transformation and judgement overlays will be required as we test, refine and iterate the framework through Q4 2021.

It is not our intention to create new datasets, and we will seek to use commonly captured data and rating factors to inform the measurement framework. Following the initial H1 2022 market pilot, we will communicate the data requirements for the 2023 Sustainability Transparency and Reporting regime to all managing agents and brokers.

Please direct any questions relating to this guidance and its contents to **ESGenquiries@lloyds.com**

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