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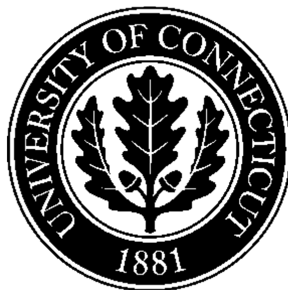

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A LEGAL FRAMEWORK FOR NET ZERO ALIGNED INSURANCE PRODUCTS

FRANZISKA ARNOLD-DWYER*

ABSTRACT

This paper examines how the contractual framework of existing insurance products for consumers and small businesses can be adjusted to help them reduce their net GHG emissions, and thereby facilitate the transition to a sustainable net-zero economy (= Net-Zero Aligned Insurance Products; "NZAIPs"). NZAIPs could give rise to legal and regulatory issues, and this paper considers how these issues could be addressed to create a legal environment that provides safe and fair market conditions for NZAIPs.

TABLE OF CONTENTS

I. INTRODUCTION 2
II. THE ROLE OF INSURANCE AND INSURERS 4
 A. NATURE OF INSURANCE 4
 B. CLIMATE CHANGE-RELATED RISKS 5
 C. IMPACT UNDERWRITING AND IMPACT INVESTMENT 6
 D. ROLE OF INSURERS 7
III. CONTRACTUAL DESIGN OF NZAIPs 11
 A. PRE-CONTRACTUAL NEGOTIATIONS 11
 B. PRICING 13
 C. TERMS (OTHER THAN PRICING AND CLAIMS) 16
 D. CLAIMS 21
IV. LEGAL AND REGULATORY ISSUES OF NZAIPs 26
 A. NZAIPS PRODUCT DESIGN 27
 B. THE MARKETING AND SALE OF NZAIPS 31
 C. CORPORATE PURPOSE: THE DUTY TO PROMOTE THE SUCCESS OF THE COMPANY 38
 D. UNFAIR CONTRACT TERMS 43
V. SUSTAINABLE DEVELOPMENT 48
VI. CONCLUSION 51

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* Dr. Franziska Arnold-Dwyer is a Senior Lecturer in Insurance Law at the Centre for Commercial Law Studies at Queen Mary University of London. The author would like to thank Megan Latham LLM and Poorva Kumar LLM for their research assistance under the QMUL Student Research Bursary Scheme.

I. INTRODUCTION

The impacts of climate change on the environment and communities worldwide are already felt: heat waves, droughts and flooding, retreating glaciers and ice loss, rising sea levels, more frequent and more severe windstorms, and more frequent compound extreme weather events.[1] All of these observed changes have been scientifically linked to the warming of the climate system as a result of human activity, and in particular, anthropogenic greenhouse gas ("GHG") emissions.[2]

The 2015 Paris Agreement seeks to curb the threat of climate change by setting goals to keep the global temperature rise below 2°C and pursue efforts to limit the temperature increase to 1.5°C, compared to pre-industrial levels.[3] Reaching the 1.5°C target requires the "rapid, deep and sustained reductions" in global GHG emissions by 43% by 2030, relative to 2019 levels.[4] In furtherance of the Paris Agreement goals, the UK government has set a legally binding target to reduce UK net GHG emissions by 100% by 2050,[5] and a 78% reduction target for 2035 (compared to 1990 levels).[6] As most of the operative provisions of the Paris Agreement do not set hard or binding targets, its implementation relies on "an enhanced transparency framework" which requires parties to set their own targets and report on progress.[7] There is widespread recognition that there is no time to rely on an international agreement alone. Additionally, achieving the Paris Agreement

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[1] Intergovernmental Panel on Climate Change, *Climate Change 2021: The Physical Science Basis.* ¶¶ A.2–A.3.5 (2021).

[2] *Id.* at ¶ A.4.1.

[3] Paris Agreement to the United Nations Framework Convention on Climate Change, art. 2, ¶ 1, Dec. 12, 2015, T.I.A.S. No. 16-1104 [hereinafter Paris Agreement].

[4] Sharm el-Sheikh Climate Change Conference, *Sharm el-Sheikh Implementation Plan*, ¶ 15 (Nov. 22, 2022) [hereinafter *Sharm el-Sheikh Implementation Plan*].

[5] Climate Change Act 2008, SI 2019/1056, § 1 (UK).

[6] Press Release, Dep't for Bus. Indust. Strategy, UK Enshrines New Target in Law to Slash Emissions by 78% by 2035, U.N. Press Release (April 20, 2021), https://www.gov.uk/government/news/uk-enshrines-new-target-in-law-to-slash-emissions-by-78-by-2035.

[7] Paris Agreement, *supra* note 3, at art. 13, ¶¶ 1, 2, 7(b).

goals requires bottom-up action from sub-state actors, businesses, investors, and financial institutions.[8]

Many large corporations now make publicly available information about their strategies for climate-related risks in accordance with the TCFD Recommendations,[9] and some have pledged to pursue decarbonising strategies. Yet, there is little information or practical support for consumers and small businesses on how they can make better-informed choices and take greater responsibility in transitioning to a net-zero economy.

Drawing on their risk management expertise, the insurance industry can do more to support policyholders, their business partners in the insurance value chain, other stakeholders, and wider society in reducing GHG emissions and transitioning to a net-zero economy in a fair and sustainable way. Some insurance companies are already engaged in climate impact investment and stewardship. In 2021 a group of the world's leading insurers launched the UN-convened Net-Zero Insurance Alliance, committing to transition their underwriting portfolios to net-zero GHG emissions by 2050.[10] By shifting the focus from the insurance industry's traditional post-disaster reaction approach to a proactive climate change risk mitigation approach that extends to consumers and small businesses, the insurance industry could make an even stronger contribution.

This paper will discuss the contractual framework and the legal and regulatory environment that are needed to develop and operate insurance products that help consumers and small businesses reduce their net GHG emissions, thereby facilitating the transition to a sustainable net-zero economy (= Net-Zero Aligned Insurance Products; "NZAIPs").

This paper does not propose the invention of insurance products that cover new risks; rather, it will examine how the design of existing insurance products for consumers and small businesses can be adjusted to achieve a positive contribution to the reduction of GHG emissions. This paper is structured as follows: Chapter 2 considers the legal relationship between

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[8] *See* U.N. Climate Change, Race to Zero Campaign, https://unfccc.int/climate-action/race-to-zero-campaign (last visited Oct. 10, 2022); *see also* Jonathan R. Macey, *ESG Investing: Why Here? Why Now?*, GEO. MASON CAPITALISM RULE L. PROJECT 1, 22 (2022).

[9] *See generally* RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES, TCFD (2017), https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf.

[10] U.N. Env't Programme, The Net-Zero Insurance Alliance: Statement of Commitment by Signatory Companies, https://www.unepfi.org/psi/wp-content/uploads/2021/07/NZIA-Commitment.pdf (last visited Oct. 10, 2022) [hereinafter Net-Zero Insurance Alliance].

insurers and policyholders, the purpose and functions of insurance contracts, and the role of insurers in a just transition to a net-zero economy; Chapter 3 discusses the contractual design for NZAIPs; Chapter 4 highlights some of the legal and regulatory issues that NZAIPs could give rise to, and how they might be addressed to create a legal environment conducive to NZAIPs; and Chapter 5 seeks to place NZAIPs within the wider context of sustainable development.

II. THE ROLE OF INSURANCE AND INSURERS

A. NATURE OF INSURANCE

The legal relationship between an individual policyholder and an insurer is based on an insurance contract, which is a contract to transfer risk from the policyholder (the insured) to the insurer. Generally speaking,[11] the insurer undertakes to pay the insured an indemnity (or to provide a corresponding benefit) upon the occurrence of the insured event that is adverse to the interests of the insured in return for the payment of a premium by the insured.[12] The policyholder transforms its risk of a large financial loss resulting from the loss of, or damage to, an asset, or the risk of incurring liability to a third party, into the certainty of "losing" a relatively small amount by way of premium payments. In return for paying premiums, the policyholder gains peace of mind that, in the event of a loss covered by the insurance contract, it will be indemnified for that loss by the insurer.[13] The insurer is able to absorb the risk more efficiently (1) as a result of the law of large numbers, (2) because of risk diversification, and (3) because an insurer can pool and invest the premium income more profitably compared to an

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[11] Not all contracts of insurance are contracts of indemnity insurance (i.e., compensating for an actual loss suffered as a result of an insured event). Some contracts of insurance are contingency contracts where the insurer provides for the payment of a predetermined sum of money upon the occurrence of a contingent event.

[12] Prudential Ins. Co. v. Comm'r of Inland Revenue, [1904] 2 KB 658, 663.

[13] Behavioural economics theory has it that most people are "risk adverse." In the insurance context that means that they have a preference for the certainty of paying a (small) premium over the uncertainty of a large future financial loss. *See* Ronen Avraham, *The Economics of Insurance Law—A Primer*, 19 CONN. INS. L. J. 29, 37 (2012).

insured investing his premium saving if he does not buy insurance for a particular risk.[14]

Thus, insurance is a mechanism for transferring and pooling risk. The process of assessing risks to be transferred and calculating a premium that is reflective of the specific risk and the underwriting pool is called "underwriting." There is an overall social gain as the aggregate exposure to the risk of all policyholders participating in that pool is mitigated.[15] Insurance also has a wider societal benefit in that it provides fast compensation to victims of disasters, accidents, torts, and income security in retirement or ill-health, easing the burden on tax-funded benefits and compensation schemes.[16]

Additionally, insurance companies act as investors: to protect the value of the premium income against inflation, insurers invest the premiums into assets that generate a return. For certain life insurance products, the investment return on the premium is a core component of the pay-out to the policyholder or its beneficiaries ("insurance-based investment products"). In those instances, insurers act as asset managers: the insurer invests (some of) the premium, on behalf of the policyholder or beneficiary, in specified investments funds which the insurer manages. The pay-out on maturity varies according to the investment performance of the fund (and the underlying assets) in which the premium has been invested.

B. CLIMATE CHANGE-RELATED RISKS

The insurance industry itself is exposed to climate change-related risks that could impact an insurer's business model and financial stability. They fall into three broad categories: (1) physical risks, (2) transition risks, and (3) liability risk.[17] Physical risk materializes through the impact of climate change on physical assets which insurers may insure, and in relation

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[14] *See generally* Eric A. Posner & E. Glen Weyl, *An FDA for Financial Innovation: Applying the Insurable Interest Doctrine to Twenty-First-Century Financial Markets*, 107 NW. U. L. REV. 1307, 1308, 1314 (2013).

[15] *Id.*at 37. *See also* Lloyd R. Cohen & Michelle E. Boardman, *Methodology: Applying Economics to Insurance Law—an Introduction*, *in* RESEARCH HANDBOOK ON INTERNATIONAL INSURANCE LAW AND REGULATION 19, 22–23 (Julian Burling & Kevin Lazarus eds., 2011).

[16] Avraham, *supra* note 13, at 41.

[17] The three categories of climate change-related risks were first introduced by Mark Carney, the former Governor of the Bank of England and U.N. Special Envoy on Climate Action. *See* Mark Carney, Breaking the Tragedy of the Horizon—Climate Change and Financial Stability, *in* BANK OF ENG. (Sept. 29, 2015).

to which they may become liable to pay claims, and in which insurers may invest. Transition risk has several sub-categories: (i) the strategic and market risk arising from the contraction of the carbon sector, related industries, and technical innovations; (ii) the investment risk in relation to stranded assets which can affect the valuation and profitability of investment portfolios; and (iii) the reputational risk arising from not transitioning to low carbon or net-zero operations in a timely and meaningful manner. Finally, the liability risk for insurers arises from (1) actions brought against insurers directly relating to the consideration of climate change in investment decision-making or inadequate disclosure of climate change risks in public documents or product information and, (2) liability insurance coverage they provide to their insureds, indemnifying them for damages and defense costs to third parties contributing to climate change, failing to mitigate or adapt to climate change, non-compliance, non-disclosure and corporate governance failures relating to climate change.

C. IMPACT UNDERWRITING AND IMPACT INVESTMENT

How can insurers play a role in the transition to a net-zero economy? They can do so primarily through "impact underwriting" and "impact investment," as well as by reducing GHG emissions in their operations. "Impact underwriting" generally refers to using insurance to promote economic, social, and environmental sustainability for the benefit of society as a whole. The United Nations Environment Programme ("UNEP") Finance Initiative ("FI") Principles for Sustainable Insurance ("PSI"), Principle 1 requires insurers to "[d]evelop products and services which reduce risk, have a positive impact on ESG issues and encourage better risk management."[18] Broadly speaking, this can be done by (1) supporting sustainable activities by providing insurance coverage; (2) developing insurance products and services that that shift non-sustainable behavior and processes of policyholders in a more sustainable direction; and (3) reducing underwriting activities that harm sustainability.[19] The challenge for insurers to engage with environmental impact underwriting was set by António Guterres, Secretary General of the United Nations, in 2021: "We need net-zero commitments to

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[18] *The Principles*, U.N. Env't Programme, https://www.unepfi.org/insurance/insurance/ (last visited Oct. 10, 2022). The PSI are aspirational, and not binding on the signatories. "ESG issues" stands for environmental, social, and governance issues.

[19] *See, e.g.*, Race to Zero Campaign, *supra* note 8.

cover your underwriting portfolios, and this should include the underwriting of coal -- and all fossil fuels."[20]

"Impact investment" is an investment approach that, in addition to financial returns, pursues ethical or societal goals that benefit a wider group of stakeholders or society as a whole. Impact investment with a focus on sustainability has been on the horizon since the late 1990s and has been more firmly placed on the agenda of policymakers, regulators, and financial markets since the launch of the Principles for Responsible Investment[21] in 2006 and the adoption of the Sustainable Development Goals ("SDGs")[22] by the United Nations in 2015. Impact investment with environmental objectives can involve (1) the divesting of carbon-intense assets from sectors detrimental to environmental considerations; (2) refraining or limiting fresh investment in those assets and sectors; (3) investing in companies engaged in reducing their carbon footprint; and (4) directing investments at economic activities aimed at climate risk reduction.

D. ROLE OF INSURERS

As this paper focuses on NZAIPs insurance products, more detailed consideration needs to be given to whether and why insurers should engage in impact underwriting. There are a number of risks. Impact underwriting could reduce an insurer's profits and competitiveness and create protection gaps if, for example, the insurer stops insuring coal and fossil businesses. Providing insurance for "green" technologies, assets, and projects can be more expensive as they tend to be innovative and are often untested (as a result, there is insufficient data for risk modelling and pricing)[23] and

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[20] António Guterres, Secretary-General of the U.N., Closing Remarks to Insurance Development Forum (June 8, 2021), https://www.un.org/sg/en/content/sg/speeches/2021-06-08/closing-remarks-insurance-development-forum.

[21] *The Six Principles for Responsible Investment Offer a Menu of Possible Actions for Incorporating ESG Issues into Investment Practice.*, PRINCIPLES RESPONSIBLE INV., https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment (last visited Oct. 10, 2022).

[22] G.A. Res. 70/1, Transforming Our World: The 2030 Agenda for Sustainable Development, ¶ 59 (Oct. 21, 2015).

[23] Maryam Golnaraghi, *Investing in Climate-Resilient Decarbonized Infrastructure to Meet Socio-Economic and Climate Change Goals*, GENEVA ASS'N 1, 3–4 (Dec. 10, 2019), https://www.asiainsurancereview.com/Magazine/ReadMagazineArticle?aid=43145.

sometimes their physical characteristics can pose higher risks than their conventional equivalents (e.g., their location in vulnerable geographies, the materials used are more susceptible to physical damage, and the reliance on emerging technologies).

NZAIPs pose their own challenges: a combination of inertia, insufficient customer demand, potentially high research and development costs (which in the UK requires a formal internal approval and testing process),[24] the risk of free riders, and the regulatory focus to date being the financial risks from climate change,[25] all of which may be limiting insurers' current appetite and capacity for developing NZAIPs.

NZAIPs also raise jurisprudential questions as to whether it is appropriate for insurers to seek to influence the behavior of their policyholders. There is existing scholarship on the conception of insurance as "governance," and insurers as "quasi-regulators,"[26] where insurance is conceived as a tool to control policyholders' behavior or achieve specific outcomes. Arguably, in motor insurance and health insurance, insurers have been taking this role for some time by giving preferential terms and better premium rates to policyholders who drive safely (as evidenced by a clean driving record) and lead a healthy lifestyle (in health insurance, the pre-contractual questionnaire often includes questions about smoking, alcohol consumption, and exercise). Just like governments make laws, the insurance contract imposes obligations on policyholders to govern their behavior throughout the term of the contract and, like law enforcement agencies, the insurance industry uses sophisticated inspection and audit systems to ensure that policyholders comply.[27] This "governance" function of insurance has been criticized because insurers assume regulatory functions that a governmental body could perform without being subject to the standards we expect from, and the limitations placed upon, governmental authority[28] such as transparency, due process, and acting intra vires and reasonably.

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[24] Fin. Conduct Auth.[FCA], *Product Intervention and Product Governance Sourcebook*, ¶ 4.2 (Jan. 2023) [hereinafter PROD].

[25] Bank Eng. Prudential Regul. Auth. [PRA], *Enhancing Banks' and Insurers' Approaches to Managing the Financial Risks from Climate Change*, ¶¶ 1.2, 2, SS3/19 (Apr. 2019).

[26] *See generally*, RICHARD V. ERICSON, AARON DOYLE & DEAN BARRY, INSURANCE AS GOVERNANCE (2003). *See* Carol A. Heimer, *Insuring More, Ensuring Less: The Costs and Benefits of Private Regulation Through Insurance*, *in* EMBRACING RISK 116, 116–145 (Tom Baker & Jonathan Simon eds., 2002).

[27] ERICSON ET AL., *supra* note 26, at 361.

[28] Kenneth S. Abraham, *Four Conceptions of Insurance*, 161 U. PA. L. REV. 653, 685–91 (2013).

Moreover, it has been noted that in contrast to laws and regulations aimed at reducing risks to the public, insurers only "regulate" out of self-interest to reduce their own liability.[29]

This rather sinister conception of insurers as quasi-regulators is not appropriate for NZAIPs, which aim to help consumers and small businesses transition to a net-zero economy. Accordingly, the contractual design discussed in Chapter 3 sees insurers as enablers that nudge consumer and small business policyholders towards emission-reducing or carbon-neutral activities. Contract law is used to incentivize commitment to reducing GHG emissions.[30] A similar idea has been put forward in relation to investors who can use the "green pill" of contract law to incentivize and enforce net-zero commitments of their investee companies.[31]

While insurers have not yet widely adopted the role of net-zero enablers, they will increasingly be incentivized to consider it as customer demand for NZAIPs rise. In addition, as voluntary sustainability and climate disclosure frameworks harden into mandatory disclosure requirements,[32] there will be increasing pressure from investors, shareholders, and other stakeholders on insurers to engage in climate impact underwriting. UN-convened insurance industry frameworks such as the PSI[33] and the Net-Zero Insurance Alliance set expectations for transitioning underwriting portfolios to net-zero GHG emissions.[34]

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[29] Kenneth S. Abraham & Daniel Schwarcz, *The Limits of Regulation by Insurance*, 98 IND. L. J. 215, 227 (2022).

[30] *See infra* Chapter 3.

[31] John Armour, Luca Enriques & Thom Wetzer, *Green Pills: Making Corporate Climate Commitments Credible* 1, 39–53 (ECGI Working Papers Series in L., Paper No. 657, 2022).

[32] *See* Bank Eng. Prudential Regul. Auth. [PRA], *supra* note 25, at ¶ 3.20 (In the UK all insurers must engage with the TCFD Recommendations); Fin. Cond. Auth., *Proposals to Enhance Climate-Related Disclosures by Listed Issuers and Clarification of Existing Disclosure Obligations*, ¶ 1.13, PS20/17 (Dec. 2020); Fin. Cond. Auth., *Listing Rules*, ¶ 9.8.6(8)(a), LR 9/33 (Jan. 2023) (premium-listed insurers must include a compliance statement in their annual financial report, stating whether they have made disclosures consistent with the TCFD recommendations or providing an explanation if they have not done so); *see also* Companies Act 2006, ¶¶ 414CA–414CB (UK) (insurers that are traded companies must prepare an annual "Strategic Report" including information on their environmental impact and strategies, and products that are environmentally harmful.).

[33] *The Principles*, *supra* note 18.

[34] Net-Zero Insurance Alliance, *supra* note 10.

The role of insurers as "net-zero enablers" is in line with emerging theoretical frameworks on "stakeholder capitalism,"[35] "environmental stewardship,"[36] and a wider meaning of "corporate purpose,"[37] which see the role of corporations as not just optimizing short-term profits for shareholders, but maximizing long term shareholder value creation, by taking into account the needs of all their stakeholders and society at large. This includes taking responsibility for protecting the environment. The EU Commission has put forward a proposal for a directive on corporate sustainability due diligence, which will require companies that fall within its scope to, inter alia, address the adverse environmental impacts of their actions, including their value chains inside and outside Europe.[38] The UNFCCC COP27 Sharm el-Sheikh Implementation Plan affirms that sustainable and just solutions to the climate crisis require "social dialogue and participation of all stakeholders," and, in particular, financing from financial institutions and institutional investors for a global transition to a net-zero economy.[39] As a carrier of climate change-related risks,[40] it would ultimately be in the insurance industry's own mid-term interest to support their customers in reducing net GHG emissions. Although "impact underwriting" is a newly coined term, the insurance business model is inextricably linked to requiring or encouraging (better) risk management by policyholders.

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[35] *See generally* Klaus Schwab, *Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution*, WORLD ECON. F. (Dec. 2, 2019), https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/; KLAUS SCHWAB, STAKEHOLDER CAPITALISM: A GLOBAL ECONOMY THAT WORKS FOR PROGRESS, PEOPLE AND PLANET (2021).

[36] *See generally* Nathan J. Bennett, Tara S. Whitty, Elena Finkbeiner, Jeremy Pittman, Hannah Bassett, Stefan Gelcich & Edward H. Allison, *Environmental Stewardship: A Conceptual Review and Analytical Framework*, 61 ENV'T MGMT. 597 (2018).

[37] *See Principles for Purposeful Business: How to Deliver the Framerwork for the Future of the Corporation*, BRIT. ACAD. (Nov. 2019), https://www.thebritishacademy.ac.uk/publications/future-of-the-corporation-principles-for-purposeful-business.

[38] *Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and Amending Directive*, at 1–2, COM (2022) 71 final (Feb. 23, 2022).

[39] *Sharm el-Sheikh Implementation Plan*, *supra* note 4, at ¶ 28, ¶ 30.

[40] *See supra* Chapter 2.2.

III. CONTRACTUAL DESIGN OF NZAIPS

To date, the insurance industry's climate change focus has been on managing the financial risks of climate change. In practical terms, insurance for weather-related risks associated with climate change (e.g., property damage and business interruption losses caused by windstorms, floods, or wildfire) and climate-related liability claims offers policyholders financial protection against the impact of loss. This can build resilience of individuals and government budgets to the financial impact of climate change risks. However, it does not prevent the loss from climate change risks, and it does not address the root cause of climate change (i.e., GHG emissions). Moreover, as extreme weather events become more frequent and severe, certain climate change-related risks are, or are becoming, uninsurable.[41] It is clear from initiatives such as the PSI and the Net-Zero Insurance Alliance,[42] that the insurance industry recognizes that it must bring about a paradigm shift from a post-disaster reaction approach towards a comprehensive and integrated climate risk mitigation and risk management approach to climate change risks. NZAIPs are part of this process.

This paper will consider four interconnected areas within the design of a contract of insurance —pre-contractual negotiations, pricing, terms and claims—that lend themselves to influencing choices by policyholders aimed at reducing their net GHG emissions.

A. PRE-CONTRACTUAL NEGOTIATIONS

As noted above, the legal relationship between an individual policyholder and an insurer is based on an insurance contact. Under English law, this relationship pre-dates the point of entering into the contract. The insurer will ask a prospective consumer-policyholder questions about the risk to be insured in order to determine whether to take the risk and, if so, on what terms. The prospective consumer-policyholder is under a pre-contractual duty to take reasonable care not to make a misrepresentation to

[41] For example, in California some homeowners can no longer buy any property insurance covering for wildfires, whilst others can no longer afford to buy insurance because of spiraling premium prices. *See* Mary W. Walsh, *How Wildfires Are Making Some California Homes Uninsurable*, N.Y. TIMES (Nov. 20, 2018), https://www.nytimes.com/2018/11/20/business/california-fires-insurance.html; *see also* Opinion on Sustainability within Solvency II, ¶ 5.52, EIOPA-BoS-19/241 (Sept. 30, 2019).

[42] *The Principles*, *supra* note 18; Net-Zero Insurance Alliance, *supra* note 10.

the insurer.[43] A prospective non-consumer policyholder owes the insurer a pre-contractual duty to give a fair presentation of all circumstances material to the risk.[44] Information about the prospective policyholder's carbon-intense assets and activities, or its decarbonizing activities, can be material to the insurer's underwriting assessment.[45] At the pre-contractual stage, insurers can influence prospective policyholders' behavior by offering different levels of coverage and different levels of premiums depending on the existing risk management measures and risk attitude of the prospective policyholder.

UNEP FI has published guidance on how ESG factors can be integrated into insurers' risk assessment frameworks applicable to their underwriting portfolios.[46] For larger businesses, some brokers and insurers have already started to use pre-contractual ESG risk assessments that seek to identify the ESG issues faced by prospective policyholders. For example, leading insurance broker Marsh offers an ESG risk assessment in which the prospective policyholder is awarded an ESG rating, which then informs the scope of coverage for directors and officers insurance and, in particular, eligibility for add-on cover for investigation costs related to climate-related financial disclosures.[47] The ESG risk assessment and rating might prompt the policyholder to choose pathways for mitigating ESG risks and set targets for improving its ESG rating.

In relation to consumers and small businesses, it is unlikely that insurers would want to incur the expense of a GHG emission assessment of property and business operations as it would be of limited direct relevance to the risk assessment for property and business insurance. The level of GHG emissions cannot (yet) be linked to the risk of loss of or damage to buildings, personal property, business assets, and business operations. There is no legal duty on consumers and small businesses to reduce or disclose GHG emissions, to which liability would attach on breach. However, insurers could use this point of contact and information exchange to make available

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[43] Consumer Insurance (Disclosure and Representations) Act 2012, c. 6, § 2(2) (UK).

[44] Insurance Act 2015, c. 4, §§ 3(1), 3(4) (UK).

[45] *Id.* at § 7(3).

[46] Env't Programme, Managing Environmental, Social and Governance Risks in Non-Life Insurance Business (June 2020), https://www.unepfi.org/insurance/insurance/.

[47] *Delta Side D: Cover for investigation costs related to TCFD reporting*, MARSH, https://www.marsh.com/uk/services/financial-professional-liability/products/delta-side-d-cover-investigation-costs-tcfd-reporting.html (last visited Oct. 10, 2022).

standardized information on (1) the likely GHG emissions of the property by reference to its size, type of heating, and EPC rating; (2) reducing GHG emissions of buildings and in transport, for example by reference to the recommendations of the UK's Climate Change Committee;[48] and (3) available government schemes and grants aimed at reducing GHG emissions.[49] By raising awareness on these matters, insurers can enable consumer and small business policyholders to make better-informed choices on these matters.

Insurers, too, have pre-contractual information obligations, as set out in the Financial Conduct Authority ("FCA") Handbook ICOBS Insurance: Conduct of Business Sourcebook ("ICOBS"), which range from information about itself, its services, and the insurance product in question. The ICOBS obligations will be discussed in Chapter 4.

B. PRICING

Pricing in insurance means the level of premium payable by the insured. The premium is calculated by the insurer by reference to the level of risk that is transferred and the costs of the insurer associated with assuming the risk. Given the crowded consumer insurance and commoditized business insurance markets, premiums need to be competitive and yet be capable of generating a profit for insurers. If premiums are too high and become unaffordable, policyholders may decide to remain uninsured, and this will create protection gaps. Pricing is primarily a commercial matter, but there are also some legal considerations. The product design requirement for "fair value" and whether premium discounts are consistent with "corporate purpose" will be discussed in Chapter 4. In addition, under the UK insurance solvency regulatory regime,[50] an insurer must set premiums so that the insurer continues to have enough funds for its

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[48] Climate Change Comm. [CCC], *The Sixth Carbon Budget: Buildings*, (Dec. 9, 2022).

[49] *See infra* Chapter 3.4.

[50] The UK's current insurance solvency regime is based on the EU Solvency II Directive 2009/138/EC (recast) which was implemented in the UK with the Solvency 2 Regulations 2015 (2015/575). Council Directive 2009/138, 2009 O.J. (L 335) (EC); Solvency 2 Regulations 2015, SI No. 575 (UK). With the UK's withdrawal from the EU, the EU Solvency II regime was "onshored" into the UK domestic law, such that it continues to apply with the relevant adjustments to insurers and reinsurers with head offices in the UK. This process of "onshoring" was effected by the European Union (Withdrawal) Act 2018. European Union (Withdrawal) Act 2018, c. 16 (UK).

technical provisions[51] and to match or exceed its solvency capital requirements.[52]

How can premium pricing affect GHG emissions? Insurers could use pricing structures that penalize carbon-intense activities or reward net GHG emission reducing activities. Coal companies are already facing premium rate increases of up to 40%,[53] although the increase is more likely to result from restricted underwriting capacity following a growing number of insurers exiting the coal market. For small businesses and consumers, the level of GHG emissions could be made a pricing factor. However, unless an increase in premiums for higher GHG emissions can be linked to the risk insured, there is a risk that to do so would be in breach of the "fair value" principle.[54]

In regard to rewards, in the US, some home insurers already offer premium discounts for LEED-certified homes.[55] In the UK, an Energy Performance Certificate (EPC) is already required when a property is being built, sold, or rented. The UK Government is consulting on plans that would require mortgage lenders to take a property's EPC rating into account in their lending decision and offer financial rewards (lower interest rates, cash-back, and extended mortgages) to facilitate improvements to a home's energy efficiency.[56] These plans could be extended to property insurers, so that

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[51] Bank Eng. Prudential Regul. Auth. [PRA], *Technical Provisions*, ¶ 2.1 (Jan. 1, 2016).

[52] Bank Eng. Prudential Regul. Auth. [PRA], *Solvency Capital Requirement – General Provisions*, ¶ 2.1 (Jan. 1, 2016).

[53] *Managing the Transition: Mining Risk Review 2020*, WILLISTOWERSWATSON (2020), https://willistowerswatson.turtl.co/story/mining-risk-review-2020-ungated/page/3/2.

[54] *See infra* Section 4.1.

[55] LEED (Leadership in Energy and Environmental Design Green Building Rating System) is a system developed by the U.S. Green Building Council that is a recognized environmental standard in the building world and has high efficiency and sustainability standards. *See Green insurance: Being kind to the environment can save you money on your policies*, INS. INFO. INST., https://www.iii.org/article/green-insurance (last visited Oct. 10, 2020).

[56] The UK Government is proposing the annual disclosure of portfolio-wide Energy Performance Certificate (EPC) data and the gross value of lending for energy performance improvement works by mortgage lenders. *See* Dep't for Bus., Energy & Indus. Strategy, *Improving Home Energy Performance Through Lenders*, at 19 (Feb. 12 2021), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/936276/improving-home-energy-performance-through-lenders-consultation.pdf.

premium rebates might be offered in relation to insured properties that improve their energy performance in prescribed ways (e.g., carrying out energy efficiency retrofitting or installing low-carbon heating) during the policy term.

Could motor insurers discount the premiums for hybrid and electric cars? Until recently, motor insurance for hybrid and electric cars has been more expensive compared to petrol or diesel cars, as insurers have had scant historical data to price repairs.[57] The risk of injuring third parties is the same, but it has been reported that electric cars are considered to be a lower theft risk because of their limited range and still limited charging infrastructure.[58] As more data has become available, premium levels for hybrid and electric cars have been adjusted, and some motor insurers have offered premium discounts to electric car owners as an incentive to new customers.[59] Although the practice of "price walking"—giving premium discounts to new customers but not to existing customers—has been banned for consumer motor and home insurance since January 1, 2022,[60] motor insurers could consider a one-off premium discount for existing customers switching from a petrol or diesel car to an electric or hybrid car. For businesses, insurers could consider packages at attractive premium rates for electric and hybrid car fleets. As the shift to zero-emission vehicles is part of the UK Government's "Ten Point Plan for a Green Industrial Revolution,"[61] motor insurers should give consideration to how they could contribute by offering attractive premium rates for electric cars.

Motor policies that offer "Pay as You Drive" coverage could incentivize the policyholder to drive less; a telematic device that is installed in the car tracks the miles driven, and the policyholder is charged a premium on a per-mile basis.[62] Less driving means less risk, which in turn means lower premiums, less fuel consumption, and reduced GHG emissions. Although

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[57] *Choosing an electric or hybrid car: The basics of low-emission vehicles*, AVIVA (Jan. 23, 2020), https://www.aviva.co.uk/insurance/motor/car-insurance/electric-and-hybrid-cars/.

[58] *Are electric cars more expensive to insure?*, WHAT CAR? (Nov. 4, 2019), https://www.whatcar.com/advice/owning/are-electric-cars-more-expensive-to-insure/n18043.

[59] *Id.*

[60] Fin. Conduct Auth. [FCA], *General Insurance Pricing Practices Market Study: Feedback to CP20/19 and Final Rules*, ¶ 3.2 , PS21/5 (May 2021).

[61] HM Gov't, *The Ten Point Plan for a Green Industrial Revolution*, ¶ 4 (Nov. 18, 2020), https://www.gov.uk/government/publications/the-ten-point-plan-for-a-green-industrial-revolution/title.

[62] *See, e.g.,* BY MILES., https://www.bymiles.co.uk/ (last visited Oct. 10, 2022).

this is an example of incidentally enabling an environmental goal, usage-based premium mechanisms could be marshalled to reduce GHG emissions.

Other pricing benefits that could be considered—depending on their suitability in the policy context—are lowering deductibles and increasing or reinstating sub-limits of liability that become applicable if the policyholder takes or refrains from taking specified actions.

C. TERMS (OTHER THAN PRICING AND CLAIMS)

For consumers and small businesses, insurance contracts are contracts of adhesion that are offered with standardized terms on a "take it or leave it" basis.[63] If the terms are too onerous, a prospective policyholder's only other options are to buy insurance from another insurer who offers better terms or not insure at all.

What kind of contractual terms can influence the policyholder's behavior and enable them to reduce the GHG emissions of its assets and activities ("green term" will be used as shorthand)? Before discussing specific examples, let us consider the characteristics of a well-drafted green term. First, if the green term imposes an obligation on the policyholder, it should be an action or inaction within the control of the policyholder and an obligation that the policyholder is realistically able to fulfill without imposing a disproportionate burden. Secondly, the substance of the green term (whether it is an obligation or an exclusion) must have a degree of salience—it must be relevant to the commercial purpose of the insurance contract in question, which is the risk transfer in relation to the insured subject matter. The difficulty is how this can be translated into meaningful green terms, given that climate change itself is a relatively abstract concept and that GHG emissions may not have direct salience to the insurance policy in question. Thirdly, if the term is an exclusion from coverage, the excluded risks must be well-defined and must not obliterate the cover.[64] Fourthly, as will be discussed below, terms in consumer (insurance) contracts are required to be fair. A green term will not stand up to legal and regulatory scrutiny,[65] unless these basic requirements are met.

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[63] Kenneth S. Abraham, *Four Conceptions of Insurance,* 161 U. PA. L. REV. 653, 660 (2013).

[64] Fin. Conduct Auth. v. Arch Ins. (UK) Ltd., Judgment, [2021] UKSC 1, [78].

[65] *See infra* Chapter 4.

Policyholders' motivation to take climate action is undermined by the "tragedy of the commons"[66]: individual acts by a consumer or a small business do not halt or reverse climate change, so they are likely to act according to their own self-interest without consideration of the impact on the common good. Therefore, to influence the policyholder's behavior effectively, good behavior should be rewarded, and bad behavior should be penalized. Bounded rational choice theory holds that a rational decision-maker decides on a preferred course of action that maximizes their personal advantage by balancing costs against benefits based on the knowledge and information available to them,[67] and prospect theory tells us that people's loss aversion tends to be greater than the prospect of a gain.[68] Applied to insurance contract law, compliance with a green term should trigger a contractual benefit to be conferred upon the policyholder by the insurer, and/or breach or non-compliance with a green term should trigger a remedy or have another negative contractual consequences. An exclusion in an insurance contract means that the excluded risk remains outside the scope of the cover, and a policyholder is thus put on notice that specified perils, assets, and activities remain at their own risk and do not attract insurance protection.

The primary benefit for the policyholder under an insurance contract is the claims payment in the event of a loss or insured event. What additional benefits could an insurer offer to reward compliance with a green term? In relation to health insurance, insurers are already offering additional benefits (such as vouchers for, or subsidized, gym memberships) to support a healthy lifestyle. Nudge theory suggests that incentives should be coupled with good information or feedback to enable better decisions going forward.[69] Thus, to be effective, the additional benefit would not just be a "perk" for the policyholder but would also be capable of reducing GHG emissions or have another positive effect on the environment, thereby benefitting the policyholder or society at large. For example, this could be a credits system or cash-back system for replacing a fossil fuel appliance or energy source

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[66] *Tragedy of the commons*, OXFORD DICTIONARY OF ECONOMICS (5th ed. 2017).

[67] *See generally* GARY S. BECKER, THE ECONOMIC APPROACH TO HUMAN BEHAVIOR (Univ. Chic. Press, 1976). Daniel Kahneman, *Maps of Bounded Rationality: Psychology for Behavioral Economics,* 93 AM. ECON. REV. 1449, 1449 (2003).

[68] Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk,* 47 ECONOMETRICA 263, 268 (1979).

[69] RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS 40–52, 207–14 (2008).

with an electric one,[70] the installation of a thermostat or light sensors, or a voucher for planting trees.[71] Other benefits that could be considered—depending on their suitability in the policy context—are premium reductions and rebates,[72] lowering deductibles and increasing or reinstating sub-limits of liability upon the policyholder taking or refraining from specified actions.

Whether a green term has been breached may depend on how compliance is assessed or measured and whether it imposes an absolute obligation on the policyholder (or an obligation to use "best endeavors" or "reasonable endeavors) to achieve a specified outcome. It is unlikely that there exists (yet) any methodologies for measuring GHG emissions from the operation of small businesses or from private households, but it is conceivable to set other GHG emission-related targets such as improving a specific aspect of energy efficiency (e.g., installing better insulation) or to reduce a specific carbon-intense activity (e.g., ceasing to use coal in fireplaces).

The consequences of breach of, or non-compliance with, a term, depend on the nature of the term in question. Infamously, English insurance contract law does not use the same classification scheme for contractual terms as general contract law.[73] This is not the place for a detailed exegesis of breach of insurance contract terms, and reference is made to the standard textbooks in the field.[74] A remedy in damages for breach of a green term may not be available if that breach itself has not caused any loss to the insurer which meets the contractual remoteness test in *Hadley v Baxendale*.[75] The insurer cannot decline liability for an insurance claim for breach of certain types of green terms, if the breach has been remedied before the insured loss occurred,[76] and/or non-compliance with the green term could not have

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[70] It should also be considered how this could be tied in with 'green reinstatement provisions.' *See infra* Chapter 3.4.

[71] *Plant a tree*, NAT'L TR., https://www.nationaltrust.org.uk/features/plant-a-tree (last visited Oct. 10, 2022).

[72] *See supra* Section 3.2.

[73] ROBERT M. MERKIN, COLINVAUX'S LAW OF INSURANCE, c. 8, ¶ 8-004 (13th ed. 2022).

[74] *See generally id.* JOHN BIRDS, MACGILLIVRAY ON INSURANCE LAW c.10 (15th ed. 2022); JOHN BIRDS & KATIE RICHARDS, BIRD'S MODERN INSURANCE LAW c.9 (12th ed. 2022).

[75] Hadley v. Baxendale, (1854) 156 Eng. Rep. 145, 147; 9 LR Exch. 341, 344 (UK) (the remoteness rule laid down in this case is that losses are recoverable if they flow naturally from the breach or if they are in the contemplation of both parties at the time of entry into the contract).

[76] Insurance Act 2015, c.4, § 10(4) (UK) (applying to insurance warranties).

increased the risk of any insured loss which actually occurred in the circumstances in which it occurred.[77]

With the above analysis in mind, set out below are some green term examples (excluding terms relating to claims and premium) collated, or based on clauses, from the Chancery Lane Project[78] and the Insurance Information Institute:[79]

- Coverage for alternative energy sources: for homeowners who generate their own geothermal, solar, or wind power and sell any surplus energy back to the local power grid, home and contents policies could include add-on cover (at no or low extra premium) to indemnify for the costs of inspection and reconnection, the extra expense of temporarily buying electricity from another source and for the income lost during a power outage, provided the outage is caused by an insured peril.
- The insurer's consent to building works or alterations to the insured property could be made conditional upon using energy-efficient materials and building systems in the new works or alterations (or less stringently, for the policyholder to do so where it is reasonable by reference to costs and efforts).
- A knowledge and information sharing clause that prompts the policyholder to assess climate change risks and impacts and shares this information with the insurers. Further, a provision that requires the insurer to provide a report with insights related to climate-related risks and mitigation of those risks that are relevant to the policyholder during the policy year.
- Setting the policyholder, a (soft) GHG emission reduction target in connection with the insured subject-matter. When the target is met, the insurer will reward credits that can be applied towards a premium discount, towards the costs of carrying out an energy efficiency

[77] *Id.* at § 11(2). Applies to a term (express or implied) of a contract of insurance, other than a term defining the risk, if compliance with it would tend to reduce the risk of one or more of the following – (a) loss of a particular kind, (b) loss at a particular location, (c) loss at a particular time. *See id.* at § 11(1).

[78] *Climate clauses: Insurance*, CHANCERY LANE PROJ., https://chancerylaneproject.org/practice-areas/insurance/ (last visited Oct. 10, 2022).

[79] *See Green Insurance*, *supra* note 55.

retrofit, or towards a net-zero activity or project benefitting the public. Alternatively, a (small) percentage of the premium could be returned to the policyholder to be used for an GHG emission-reducing measure in relation to the insured subject-matter or for investment in carbon sinks (such as having trees planted).[80]

- Excluding from cover loss or damage caused by, or liability incurred in relation to, specified carbon-intense activities.

These sample green terms could give rise to legal issues, some of which are discussed below. Translating "green term" aspirations into workable clauses for consumer and small business policy wordings presents other challenges too: contracts of general insurance tend to have a one-year policy period which does not lend itself to committing a policyholder to sustained longer-term action. The tragedy of the commons has already been mentioned above, and it is by no means clear whether this challenge is addressed more effectively by green terms that mandate or prohibit prescribed conduct or green terms that take more of a "nudge approach"[81] by rewarding GHG emission reducing behavior or outcomes. A recent insurance study has shown that "nudges" lose effectiveness if the policyholder does not trust the source of information, and if the content of the nudge is inconsistent with pre-existing beliefs.[82] The substantive content of green terms will evolve as more scientific evidence becomes available as to how GHG can be offset, reduced, or be removed from the atmosphere, and technologies to do so become more widely available. "Green terms" is an area that would benefit from joint research by behavioral economists, environmental scientists, climate technology engineers, underwriters, brokers, and lawyers.

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[80] By way of (non-insurance) example, British Airways offers customers a way to off-set their carbon footprint of the flight by making a donation to verified emission reduction projects, to which British Airways make a proportionate contribution. *See Planet: Protecting our natural environment*, BRITISH AIRWAYS, https://www.britishairways.com/en-gb/information/about-ba/ba-better-world/planet (last visited Oct. 10, 2022).

[81] THALER & SUNSTEIN, *supra* note 69, at 72–80.

[82] Peter J. Robinson & W.J. W. Botzen, *Setting Descriptive Norm Nudges to Promote Demand for Insurance Against Increasing Climate Change Risk*, 47 GENEVA PAPERS RISK & INS. – ISSUES & PRAC., 27, 29, 31 (2021).

D. CLAIMS

If the policyholder has made a valid claim under the contract of insurance, the insurer is required to pay the policyholder (or its beneficiary) a sum of money representing its insured loss (in indemnity insurance) or an agreed sum (in contingency insurance). This is also referred to as "cash settlement." Subject to the terms of the policy, the policyholder (or beneficiary) can then use the settlement proceeds as it pleases.[83] However, property policies frequently contain the basis of settlement clauses providing for the reinstatement or repair of insured buildings or personal property that have been damaged or the replacement of lost items. These reinstatement, replacement, or repair clauses could serve as a powerful precedent for green settlement provisions that mandate or encourage the recipient to apply settlement proceeds towards the reinstatement or repair of property with low carbon materials and lower GHG emission, or the replacement of personal property with recycled or lower emission alternatives ("green reinstatement"). For example:

- Comprehensive motor insurance: after a total loss when a petrol or diesel car is "written off," the policyholder replaces it with an electric or hybrid car. The sale of new petrol and diesel cars in the UK will be banned by 2030 as part of the UK Government's 'Ten Point Plan for a Green Industrial Revolution,"[84] so insurers could contribute to an earlier phasing out of petrol cars.
- Boiler breakdown insurance cover (as separate insurance or as part of home/property insurance): if a gas boiler breaks down, the policyholder replaces it with a greener alternative. A study by UK insurer More Than has found that amongst homeowners who still have a gas boiler (86%), more than two-fifths (43%) are willing to replace it with an electric one, one in four (27%) want to install a solar water heating system, and almost a fifth (19%) are looking to fit an air source heat pump.[85]
- Business insurance and home insurance: upon damage to a building, the policyholder repairs or refits the building to reduce emissions

[83] Rayner v. Preston [1881] 18 Ch D 1 at 2 (Eng.).

[84] *The Ten Point Plan for a Green Industrial Revolution*, *supra* note 61.

[85] *Homeowners urged to go green as insurance claims for heating breakdowns surge*, RSA INS. (Mar. 23, 2021), https://www.rsainsurance.co.uk/news/press-releases/2021/homeowners-urged-to-go-green-as-insurance-claims-for-heating-breakdowns-surge/.

and increase the energy efficiency (e.g., carry out roof repairs with better insulation or replace single-glazed windows with double-glazed widows) and uses sustainable materials to do so to the extent possible.

- Contents cover (as part of business or home insurance) or insurance cover for specific assets: upon loss or damage, the policyholder has the item repaired using sustainable materials to the extent possible or accepts a recycled replacement.

There are several options for how green reinstatement clauses could be drafted in property insurance. The key variables are (1) whether there is a reinstatement (or repair or replacement) alternative to a cash settlement, (2) if there is, which party has the right to elect between a cash settlement and reinstatement (or repair or replacement), and (3) if reinstatement (or repair or replacement) applies, whether the insurer is obliged, or can be required, to affect a green reinstatement. Different options might apply to different types of insured assets within the same property policy.

1. The claim is settled by way of cash settlement. However, where applicable, upon payment, the insurer provides information on sustainable reinstatement, replacement, and repair options, including what government schemes and grants (see below) are available.
2. The insurer has the right to elect between (a) cash settlement and (b) reinstatement. If the insurer elects option (b), the insurer is entitled to elect between conventional or green reinstatement.
3. The insurer has the right to elect between (a) cash settlement and (b) reinstatement. If the insurer elects option (b), the policyholder is entitled to elect between conventional or green reinstatement.
4. The insurer has the right to elect between (a) cash settlement and (b) reinstatement. If the insurer elects option (b), the insurer is required to effect green reinstatement.
5. The insurer is obliged to reinstate but is entitled to elect between conventional or green reinstatement.
6. The insurer is obliged to effect green reinstatement.
7. The policyholder has the right to elect between (a) cash settlement and (b) reinstatement. If the policyholder elects option (a), upon payment, the insurer provides information on sustainable reinstatement, replacement, and repair options, including what government schemes and grants (see below) are available. If the

policyholder elections option (b), the insurer is entitled to elect between conventional or green reinstatement.

8. The policyholder has the right to elect between (a) cash settlement and (b) reinstatement. If the policyholder elects option (a), upon payment the insurer provides information on sustainable reinstatement, replacement and repair options, including which government schemes and grants (see below) are available. If the policyholder elects option (b), the policyholder is entitled to choose between conventional or green reinstatement.
9. The policyholder has the right to elect between (a) cash settlement and (b) reinstatement. If the policyholder elects option (a), upon payment the insurer provides information on sustainable reinstatement, replacement and repair options, including what government schemes and grants (see below) are available. If the policyholder elects option (b), the insurer is obliged to effect green reinstatement.

Option 1 is the least onerous for insurers and is also the extent to which insurers have contemplated green reinstatement provisions to date.[86] Option 8, which gives the policyholder a choice between (1) cash settlement or reinstatement, and (2) conventional or green reinstatement, may be the safest option from an "unfair terms" perspective[87] because it gives the policyholder the greatest flexibility to choose a course of action that is most favorable to its circumstances. For all options except Option 6, one of the parties can opt for a cash settlement and/or conventional reinstatement, in which case there will be no positive net-zero effect. For all options where the insurer can elect reinstatement, the insurer is reliant on the co-operation of the policyholder to give access and control to the asset to be reinstated, replaced, or repaired and, accordingly, performance of the insurer's reinstatement obligation should be made conditional upon the policyholder's co-operation.

Paying for green reinstatement could be more expensive than making a cash settlement or paying for conventional reinstatement depending on the materials and construction techniques used. How should

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[86] *The UK's insurance and long-term savings industry could potentially contribute one third of the investment needed to meet the UK's Net Zero target,* ABI (July 7, 2021), https://www.abi.org.uk/news/news-articles/2021/07/abi-climate-change-roadmap/.

[87] *See infra* Chapter 4.4.

additional costs be allocated? In the context of property insurance, the starting point is that the insurer must indemnify the insured for the loss caused by an insured peril to the insured property, but no more than that.[88] However, the parties are, within certain limits, free to agree on how the indemnity is to be calculated.[89] The measure of indemnity can be contractually agreed upon by way of valued policies,[90] or can be reduced by contractual provisions for deductibles, retentions and limits of liability. In relation to insurance on real property, the parties may agree that the measure of indemnity is determined by reference to the cost of reinstatement of the property even if the costs of reinstatement are more than the pre-loss value of the property.[91] Policies insuring personal property may offer "new for old coverage" even if the new item is more valuable than the (old) insured asset.

Thus, it is not unprecedented that insurers absorb additional costs above their liability to indemnify for the loss once they are contractually committed to reinstatement or replacement. These additional costs would then be reflected in rising premiums for all policyholders in that class of insurance or across different pools. For NZAIPs with green reinstatement provisions, this would be a method of socializing some of the costs of transitioning to a net-zero economy. Arguably, it is a relatively inefficient method given the transaction costs of insurance and its limited and contingent reach (it relies on policyholders choosing NZAIPs, that a policyholder suffers an insured loss, has a valid claim, and that green reinstatement is chosen or applies automatically). If premium levels for NZAIPs exceed what policyholders are prepared to pay, there will be no market for NZAIPs and NZAIPs will not have any impact.

On the other hand, green reinstatement is an opportunity to "build back better" with the help of the insurance industry. "Build back better" is the UK Government's plan to support growth that, inter alia, enables the transition to a net-zero economy in the UK.[92] Moreover, government schemes and grants available to the policyholder could be used to absorb some of the additional costs. UK environmental schemes currently available

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[88] Castellain v. Preston [1883] 11 QBD 380, 386 (Eng.).

[89] N. of Eng. Iron Steamship Ins. Ass'n v. Armstrong [1870] 5 LRQB 244, 250 (Eng.).

[90] Subject to that the valuation is not fraudulent or so excessive that the policy is in the nature of a wagering contract. *See e.g.*, Marine Insurance Act 1906, c. 41, §§ 27(2), 27(3) (UK); Lewis v. Rucker (1761) 2 Eng. Rep. 1167; 97 ER 769 (KB).

[91] MERKIN, *supra* note 73, at ¶¶ 11-159, 11-160.

[92] HM Treasury, *Build Back Better: Our Plan for Growth*, 12 (Mar. 3, 2021), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/969275/PfG_Final_print_Plan_for_Growth_Print.pdf.

to eligible consumers are the Boiler Upgrade Scheme[93] and the ECO4 Scheme,[94] and to consumers and small businesses the Smart Export Guarantee,[95] the Plug-in Vehicle Grant,[96] and the Plug-in Van and Truck Grant.[97] The Boiler Upgrade Scheme and the Plug-in Grants are one-off direct grants that are applied on the point of sale or installation.[98] If green reinstatement provisions apply, they should be supplemented by policy language to the effect that the policyholder must ensure that any rights under those government schemes are preserved and exercised where applicable, and that the policyholder will give all necessary consents and assistance to that effect. The reinstatement or replacement costs of the insurer would thus be reduced by the amount of those grants. The Smart Export Guarantee and ECO4 schemes pay matching benefits for renewable energy generated over a number of years.[99] It would be more difficult to provide for the insurer to recoup any costs under those schemes, especially as the contractual relationship with the relevant policyholder may be limited to a one-year policy period. However, there are opportunities for insurers to offer add-on cover for renewable energy sources for extra premium.

Could the government give direct grants to insurers to subsidize green reinstatement for NZAIPs to be offered at competitive premium rates? Apart from budgetary constraints, such grants could be regarded as state subsidies in conflict with state aid rules. The UK is no longer bound by EU competition rules, and the WTO's General Agreement on Trade in Services[100] applies primarily to the cross-border flow of services. The Subsidy Control Act 2022 provides the framework for a new, UK-wide,

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[93] *Boiler Upgrade Scheme (BUS),* OFGEM, https://www.ofgem.gov.uk/environmental-and-social-schemes/boiler-upgrade-scheme-bus (last visited Oct. 10, 2022).

[94] *Energy Company Obligation (ECO),* OFGEM, https://www.ofgem.gov.uk/environmental-and-social-schemes/energy-company-obligation-eco (last visited Oct. 10, 2022).

[95] *Smart Export Guarantee (SEG),* OFGEM, https://www.ofgem.gov.uk/environmental-and-social-schemes/smart-export-guarantee-seg (last visited Oct. 10, 2022).

[96] *Guidance: Using the plug-in vehicle grant portal*, DEP'T TRANSP. & OFF. ZERO EMISSION VEHICLES (June 14, 2022), https://www.gov.uk/government/publications/plug-in-vehicle-grant-portal-guidance/using-the-plug-in-vehicle-grant-portal.

[97] *Id.*

[98] *Supra* notes 93, 96.

[99] OFGEM, *supra* note 95.

[100] General Agreement on Trade in Services, art. 1, ¶ 2(a), Jan. 1995.

subsidy control regime which will enable public authorities to grant subsidies aimed, inter alia, at achieving net-zero GHG emissions.[101] However, the "energy and environment principles" with which subsidies need to be consistent do not specifically envisage subsidies that achieve an overall reduction in GHG emissions linked to private households and small businesses.[102] It is suggested that it is more efficient to make grants available to policyholders, which an insurer could then take into account when a claim is settled by way of green reinstatement. Beyond the scope of this paper, but an area meriting further exploration, is the potential for public private partnerships, between public authorities and insurance companies, to use the risk management expertise and claims-related infrastructure of insurance companies supplemented by public finance, to deliver climate risk mitigation measures at the consumer level and for small businesses.

On balance, there is a case to be made for insurers adopting green reinstatement provisions in relation to specific categories of assets. At the very least, they raise awareness among consumers and small businesses that their homes and business premises can be rebuilt or repaired with low carbon materials and lower GHG emissions, and that certain types of personal property can be replaced or repaired with recycled or lower emission alternatives. At their most effective, green reinstatement provisions make a concrete contribution to the net-zero transition by enabling policyholders to remedy the loss of or damage to insured property with greener alternatives. Support for green reinstatement provisions can be derived from the Net-Zero Insurance Alliance's commitment to "[i]mproving claims management in an environmentally sustainable manner to promote a net-zero economy"[103] and Principle 1 of the PSI which requires insurers to "[i]ntegrate ESG issues into repairs, replacements and other claims services."[104]

IV. LEGAL AND REGULATORY ISSUES OF NZAIPS

The legal and regulatory issues that could arise in relation to NZAIPs are too numerous, therefore this paper will limit itself to discussing the following four issues that have already been alluded to in Chapter 3: NZAIPs product design requirements, the marketing and sale of NZAIPs, corporate

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[101] Subsidy Control Act 2022, c. 23, § 9 (UK).

[102] *Id.* at sch. 2 (indicating that Principle H may be limited to decarbonization linked to "industrial activities.").

[103] Net-Zero Insurance Alliance, *supra* note 10.

[104] Env't Programme, Principles for Sustainable Insurance, https://www.unepfi.org/insurance/insurance/ (last visited Oct. 10, 2022).

purpose and shareholder value (Companies Act 2006, § 172)[105] and unfair contract terms (Consumer Rights Act 2015, Part 2).[106] The paper will make some suggestions for changes to the legal and the regulatory environment that are needed to develop and operate NZAIPs, to ensure the protection of policyholder's rights, and to maintain broad access to insurance.

A. NZAIPs Product Design

The question of how insurance products can be designed or adapted to encourage or require policyholders to reduce GHG emissions and take climate action has received little public attention and scholarship so far.[107] Caldecott argues that, for a financial product to make a difference to the real economy's transition to environmental sustainability, the product must make a clear and measurable difference by either enabling the customer to adopt sustainable practices, or by reducing or increasing the cost of capital for green or polluting activities.[108]

UK-regulated insurers must comply with the product design requirements in the FCA Product Intervention and Product Governance Sourcebook (PROD).[109] Primarily, this means that the insurer is required to have in place an internal product approval process to ensure that the design of insurance products or the adaptation of existing insurance products (1) takes into account the objectives, interests, and characteristics of customers, (2) does not adversely affect customers, and (3) prevents or mitigates customer detriment.[110] Moreover, the product approval process must identify whether the product provides fair value to customers in the target market, including whether it will continue to do so for a reasonably foreseeable period (including following renewal).[111] In addition, insurers must test their insurance products appropriately, by assessing whether the

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[105] Companies Act 2006, c.46, § 172 (UK).

[106] Consumer Rights Act 2015, c.15, §§ 61–76 (UK).

[107] Insurance-based investment products where the premium is invested in environmentally sustainable investments are already available. It is suggested that they are an example of "impact investment," rather than "impact unwriting" with the objective of policyholders reducing their GHG emissions.

[108] Ben Caldecott, *Aligning Finance for the Net Zero Economy: New Ideas from Leading Thinkers*, CLIMATE-KIC 3 (Sep. 2020), https://www.unepfi.org/wordpress/wp-content/uploads/2020/08/200915_J932-CKIC-UNEP-ThoughtLeadershipSeries-DrBenCaldecott-11.pdf.

[109] PROD, *supra* note 24,

[110] *Id.* at ¶ 4.2.8.

[111] *Id.* at ¶ 4.2.14A.

insurance product over its lifetime meets the identified needs, objectives, and characteristics of the target market before bringing that product to the market.[112] The product design requirements are going to be underpinned by a new "consumer duty"—to come into force on 31 July 2023—which will require insurers to deliver good outcomes for consumers, including ensuring that consumers (1) receive fair prices and quality, (2) receive suitable products and good treatment, and (3) have access to products meeting their needs.[113]

Thus, if the target markets for NZAIPs are consumers and small businesses, insurers need to consider their respective needs, objectives, interests, and characteristics as they relate to the type of insurance (e.g., home and content, property, motor, and business insurance). It may be necessary to granularize the target market further to focus on shared characteristics in relation to the risk profile, experience and expertise, expectations, and the needs of specific market segments.

The PROD rules and guidance do not require insurers to consider whether the insurance product as a whole has beneficial or detrimental impacts on the environment. There is no explicit requirement that an insurer must take into account the target market's environmental objectives, if any, at the product design stage. If insurers are not prompted to consider environmental design features and the target market's appetite for insurance products with an environmental objective, they are less likely explore the design of, and demand for, NZAIPs, and are ultimately less likely to bring NZAIPs to market. If customers do not have access to NZAIPs or other sustainable insurance products, or are not aware of them as alternatives to regular insurance products, a NZAIPs' market is unlikely to develop any time soon.

This vicious circle of lack of supply and demand is aggravated further by the absence of a meaningful system of labeling of (insurance) products as "net-zero," "net-zero aligned," "green," or "environmentally sustainable." Without a transparent and comparable system of definitions and classification—a "Green Taxonomy"—there is yet little customer trust and confidence in those products' green credentials.[114] This lack of

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[112] *Id*. at ¶ 4.2.22.

[113] Fin. Conduct Auth., *A New Consumer Duty: Feedback to CP21/36 and Final Rules*, ¶ 1.19, PS22/9 (July 2022) [hereinafter *A New Consumer Duty*].

[114] *See e.g.*, Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the Establishment of a Framework to Facilitate Sustainable Investment, and Amending Regulation (EU) 2019/2088, 2020 OJ (L 198) 13, 14; Fin. Conduct Auth., *Sustainability Disclosure Requirements (SDR) and Investment Labels*, ¶ 1.3, CP22/20 (October 2022) [hereinafter SDR].

confidence affects market appetite. Ultimately, insurers are not permitted to bring insurance products to the market if the results of the product testing show that the products do not meet the identified needs, objectives, and characteristics of the target market.[115]

The PROD rules for insurance product design could be amended to integrate into the product design and approval process environmental sustainability factors and consideration of the target market's environmental objectives. By way of example, the proposed EU Insurance Distribution Directive Delegated Regulation will require insurers to: *"only design and market insurance products that are compatible with the needs, characteristics and objectives,* ***including any sustainability-related objectives****, of the customers belonging to the target market."* (emphasis added; "sustainability-related objectives" include environmental objectives).[116]

A similar amendment could be made to the PROD rules. However, clarification would be needed as to the meaning of "sustainability-related objectives," or any alternative label used (e.g., "environmental objective"). The EU has already started to address the need for a common classification system for environmentally sustainable economic activities with the EU Taxonomy Regulation.[117] For an economic activity to qualify as environmentally sustainable, four overarching conditions must be met:

1. It contributes substantially to one or more of the six environmental objectives (see below);
2. It does not significantly harm any of the six environmental objectives;
3. It is carried out in compliance with the specified minimum safeguards;[118] and

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[115] PROD, *supra* note 110, at ¶¶ 4.2.22R, 4.2.24R.

[116] Commission Delegated Regulation (EU) 2021/1257 of 21 April 2021 Amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as Regards the Integration of Sustainability Factors, Risks and Preferences into the Product Oversight and Governance Requirements for Insurance Undertakings and Insurance Distributors and into the Rules on Conduct of Business and Investment Advice for Insurance-based Investment Products, art, 1, 2021 OJ (L 277) 18, 20 [hereinafter Regulation 2021/1257].

[117] *See generally* Regulation 2020/852, *supra* note 114.

[118] These are, essentially, ensuring the alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental

4. It complies with technical screening criteria that have been established by the European Commission.[119]

The six environmental objectives are: (1) climate change mitigation, (2) climate change adaptation, (3) the sustainable use and protection of water and marine resources, (4) the transition to a circular economy, (5) pollution prevention and control, and (6) the protection and restoration of biodiversity and ecosystems.[120]

In contrast, the FCA is proposing to introduce "sustainable investment labels" to classify and label investment products according to whether "they aim to invest":

1. In assets that are environmentally and/or socially sustainable ("sustainable focus");
2. To improve the environmental and/or social sustainability of assets over time, including in response to the stewardship influence of the firm ("sustainable improvers");
3. In solutions to environmental or social problems, to achieve positive, real-world impact ("sustainable impact")."[121]

Under the proposals, the sustainable investment labels would not apply NZAIPs under consideration in this paper (as they are not investment products marketed by investment funds).[122] Instead, as will be discussed below,[123] under the FCA proposals, a general "anti-greenwashing" rule will apply to all regulated firms, including UK insurers.

Determining whether NZAIPs provide "fair value" entails looking at the relationship between the overall price to the customer and the quality of the product and services provided, and the overall costs to the insurer.[124]

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conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights.

[119] Regulation 2020/852*, supra* note 114, at art. 3. The technical screening criteria are intended to provide further detail on which economic activities by making a substantial contribution to the EU's environmental goals and are set by the European Commission through delegated acts. Insurance products and activities are not amongst the economic activities for which criteria have been provided.

[120] Regulation 2020/852, *supra* note 114, at art. 9.

[121] SDR, *supra* note 114, at ¶¶ 3.2, 4.3.

[122] *Id.* at ¶ 3.5.

[123] *See infra* Chapter 4.2.

[124] PROD, *supra* note 110, at ¶ 4.2.14 E.

Where the difference between the risk price to the insurer and the total price paid by the customer bears no reasonable relationship to the actual costs incurred by the insurer (or any another person involved in the distribution arrangements), the quality of any benefits or the quality of any other services provided, there is a presumption that the product does not provide "fair value."[125] Thus, if NZAIPs are too heavily reliant on exclusions[126] (e.g., for cover for carbon intense assets and activities) the remaining insurance protection might provide poor cover and is unlikely to be "fair value." Similarly, if the level of GHG emissions of the policyholder is made a pricing factor, but the increase in premium for higher GHG emissions cannot be linked to the risk insured, there is a risk that to do so would be contrary to the "fair value" principle. Higher premium rates for NZAIPs compared to the equivalent type of conventional insurance could still provide "fair value" if the NZAIPs cover provides additional benefits and services, such as green reinstatement and risk management and advice on climate change risks and reducing emissions. However, "fighting climate change" or "reducing GHG emissions" are not in themselves (non-financial) factors relevant to the "fair value" principle.

Instead of charging higher premiums, to promote NZAIPs and to encourage GHG emission reducing behavior or outcomes within the terms of the contract of insurance, premium reductions or rebates may be needed which, as will be discussed below, presents different challenges. Where the NZAIPs design takes a modular approach to coverage—by including cover for additional risks for additional premium—the product design and product information should make this clear.[127]

In addition, distribution channels and distributors must be appropriate for policyholders in the target market and must be monitored by insurers accordingly. However, as this chapter is concerned with contractual design, the governance of distribution is beyond its scope.

B. THE MARKETING AND SALE OF NZAIPS

In the UK, the marketing and sale of insurance is governed by rules and guidelines in ICOBS.[128] The key requirements are that the insurance product must be suitable for the policyholder (product suitability) and that prospective policyholders are provided with sufficient and accurate

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[125] *Id.* at 4.2.14M.
[126] *See supra* Chapter 3.3.
[127] PROD, *supra* note 110, at ¶ 4.2.25.
[128] ICOBS, *supra* note 122.

information about the insurance product so that they can make an informed decision about whether to buy it (product disclosure).[129]

Product Suitability: An insurer must take reasonable steps to ensure that a customer (whether the customer is a consumer or business insured) only buys an insurance policy under which he is eligible to claim benefits.[130] For example, a NZAIPs' motor policy providing cover for an electric vehicle would be unsuitable for an owner of a petrol fuel vehicle.

Prior to the conclusion of an insurance contract, an insurance distributor[131] must obtain information from the customer in order to establish the customer's demands and needs for insurance.[132] The insurance distributor must then ensure that the contract of insurance offered is consistent with these demands and needs.[133] In an advised sale, the insurance distributor must take reasonable care to ensure the suitability of its advice for any customer who is entitled to rely upon its judgment.[134] The customer's demands and needs in respect of their environmental preferences may be obvious from the subject-matter to be insured. For example, if the customer wants to buy motor insurance for an electric car, the insurance cover must be suitable for that risk. Conversely, if the asset to be insured is a coal plant, business property insurance that excludes cover for carbon-intense activities would be unsuitable. In other instances, the prospective customer's demands and needs in respect of environmental objectives may not be apparent, and more likely, there may be a lack of awareness that NZAIPs (or other green insurance alternatives) are available or of the benefits they offer.

Yet, under the current ICOBS product suitability rules, there is no requirement to make a suitability assessment on the customer's demands and needs in relation to environmental objectives. If consideration of the customer's environmental objectives and preferences is not part of the sales process, there is risk that such preferences will be overlooked. There is also a risk that insurance products that do not have environmental features are sold to customers who have environmental objectives, or vice versa. The proposed EU Insurance Distribution Directive Delegated Regulation[135] will

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[129] *Id.*

[130] Fin. Conduct Auth., *Insurance Conduct of Business Sourcebook*, ¶ 5.1.1 (Jan. 2023) [hereinafter ICOBS].

[131] An insurance distributor is an insurance intermediary selling insurance on behalf of an insurance company, or an insurer selling insurance directly to a customer. Fin. Conduct Auth., *Glossary*, 17 (Feb. 2023).

[132] ICOBS, *supra* note 122, at ¶ 5.2.2.

[133] *Id*. at ¶ 5.2.2B.

[134] *Id.* at ¶ 5.3.1.

[135] Regulation 2021/1257, *supra* note 116, at art. 2(1).

require EU insurers to ascertain, as part of the suitability assessment in relation to insurance-based investment products, the (potential) customer's "sustainability preferences" which includes asking questions about whether they wish to invest in an economic activity that contributes to an environmental objective, as defined by the EU Taxonomy Regulation.[136] The EU Insurance Distribution Directive Delegated Regulation is limited to insurance-based investment products and will not apply to UK insurance distributors.

The FCA consulted on whether there should be an equivalent UK requirement that advisers should consider sustainability matters in their investment advice and ensure that their advice is suitable for consumer sustainability-related needs and preferences,[137] but this suggestion has not been included in the finalized proposals.[138] The reason for this omission may be that there are not yet, enough sustainable insurance products that would meet sustainability-related needs and preferences of customers. Yet, ascertaining such preferences at the marketing stage—e.g., by asking the customer questions in person or by way of a questionnaire prior to any contract of insurance being proposed[139]—could assist in testing market appetite, collecting information on potential target markets for sustainable insurance products (which would be useful for new NZAIPs product design[140]), and providing an opportunity for insurance distributors to raise customer awareness of sustainable product alternatives. A customer may decide against a sustainable product option on the first occasion it is offered, but knowing that such options exist, he or she may go for it the next time. Of course, if a customer has expressed a preference for a NZAIP, or another sustainable insurance product, but none of the insurance distributor's insurance products meet the prospective customer's preferences, the insurance distributor should not make any recommendation for those products,[141] and should explain the reasons for not doing so.[142]

Product Disclosure: An insurer is responsible for producing, and an insurance distributor is responsible for providing to a prospective

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[136] *See generally* Regulation 2020/852, *supra* note 114.

[137] Fin. Conduct Auth., *Sustainability Disclosure Requirements (SDR) and Investment Labels*, ¶ 5.5, DP21/4 (Nov. 2021).

[138] *See id.*

[139] ICOBS, *supra* note 130, at ¶ 5.2.2A.

[140] *See supra* Chapter 4.1.130

[141] ICOBS, *supra* note 130, at ¶ 5.2.2B.

[142] This will be a requirement in relation insurance-based investment products under the amended EU Insurance Distribution Directive Delegated Regulation. *See* Regulation 2021/1257, *supra* note 116, at art. 2(3)(c).

customer, information about the insurance policy before the contract of insurance is concluded.[143] The customer must be given appropriate information about a policy in good time and in a comprehensible form. This must take into account the complexity of the policy and the type of customer, so that the customer can (1) make an informed decision about the arrangements proposed,[144] and (2) compare the insurance product to the insurance products of other providers.

In ICOBS, there are different sets of pre-contractual product information requirements for different types of insurance contracts.[145] However, none of them contain a specific product disclosure requirements to provide information on whether the policy pursues environmental objectives, or contains any other green or sustainability-related features. However, some of the more general information categories may be relevant to NZAIPs:

1. Significant features and benefits[146] or a summary of the insurance cover, including its main terms:[147] this could be the basis for including information on NZAIPs terms that provide for premium rebates or green reinstatement, or relate to insurance coverage for GHG emission reducing assets.
2. Significant or unusual exclusions or limitations:[148] this disclosure requirement could be relevant to an exclusion that places specified carbon-intense activities outside the scope of the policy cover, or deductions or sub-limits of liability relating to losses caused by carbon-intense activities. Either kind of term might be considered "unusual" if it is not one that is not normally found in comparable

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[143] ICOBS, *supra* note 130, at 6.-1.1, 6.2.

[144] *Id* .at 6.1.5, 6.1.6B.

[145] *Id.*at 6.1.7-A (a policy summary for commercial customers); *id.*at 6.1.10A (an insurance product information document ("IPID") for consumers in relation to general insurance contracts); *id.* at 6.3.1 (a disclosure statement for pure protection contracts); Fin. Conduct Auth., *Conduct of Busines Sourcebook*, 13 Annex 1 (Feb. 2023) [hereinafter COBS]; *id.* at 14.2.1 (a disclosure statement for life insurance contracts).

[146] ICOBS, *supra* note 130, at 6 Annex 2 (pure protection contracts and/or commercial customers); COBS, *supra* note 145, at 13 Annex 1 (life insurance).

[147] ICOBS, *supra* note 130, at 6 Annex 3 (consumer contracts other than pure protection contracts and life insurance).

[148] *Id.* at 6 Annex 2 (pure protection contracts and/or commercial customers); *id.* at 6 Annex 3 (consumer contracts other than pure protection contracts and life insurance).

contracts, and also "significant" if it would tend to affect the decision of customers generally to buy.

3. Obligations at the start and during the term of the contract:[149] this disclosure requirement might be relevant to terms imposing a contractual obligation on the policyholder to put in place a particular GHG emission reducing measures at the start of the contract (e.g., installation of better insulation) or a continuing obligation to take such measures or to refrain/reduce certain carbon-intense activities.
4. Obligations in the event claims are made:[150] this disclosure requirement could be relevant to green reinstatement provisions. For example, if property damage claims are settled by way of sustainable repairs and reinstatement, this would require the property owner's cooperation and it is therefore important that the customer is provided with information on these matters before the contract is concluded.
5. Pricing information:[151] it has already been noted that as "manufacturers of insurance products," insurers must consider a product's pricing structure and the value it provides to customers. Where an insurance policy has modular coverage sections, they should be priced separately so that it is transparent to the customer what s/he is being charged for. If a premium discount is available, there should be information as to when and to whom it applies. However, factors that are part of the general risk assessment for pricing the premium do not be priced and disclosed separately.

The FCA's proposals for specific consumer-facing disclosure and pre-contractual product disclosure requirements are limited to investment products. NZAIPs that are not investment-based insurance products would not fall within the scope of these disclosure requirements.[152] However, the FCA also proposes to introduce a new general "anti-greenwashing" rule that would apply to all financial products and services in the UK. Green-washing is a practice of gaining an unfair competitive advantage by selling a product

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[149] ICOBS, *supra* note 130, at 6 Annex 3 (consumer contracts other than pure protection contracts and life insurance).

[150] *Id.* (consumer contracts other than pure protection contracts and life insurance).

[151] *Id.* at 6 Annex 2 (pure protection contracts and / or commercial customers); *id.* at 6 Annex 3 (consumer contracts other than pure protection contracts and life insurance).

[152] SDR, *supra* note 114, at ¶¶ 3.5, 5.

representing that it has environmentally friendly or sustainable characteristic, when in fact that product does not meet basic environmental or other sustainability-related standards.[153] The "anti-greenwashing" rule would require all UK regulated financial firms (including insurers) to ensure that the naming and marketing of their financial products and services "is clear, fair and not misleading, and consistent with the sustainability profile of the product or services . . . ."[154] Any sustainability-related claims must be proportionate to the sustainability profile of the product or services and not exaggerated. The FCA has stated that it will use this new rule to challenge firms that it considers to be potentially greenwashing their products or services, and to take enforcement action if necessary, in order to ensure better outcomes for consumers, in line with the new consumer duty.[155]

It is suggested that, in the absence of specific sustainability-related disclosure requirements for NZAIPs that are not investment-based insurance products, an inclusive and proportionate approach to providing information on environmental objectives and green product features would be in line with the spirit of the general requirement that, when insurance distributors communicate information to a customer, they must ensure that is clear, fair, and not misleading.[156] Any claims that NZAIPs facilitate the reduction of GHG emissions must be evidence-based and proportionate. As discussed below, this approach may also be advisable to reduce the risk that green terms in consumer insurance contracts are found to be unfair under the Consumer Rights Act 2015, §§ 62 and 64.

Yet, given that there is no UK taxonomy that defines the meaning of "net-zero," "environmentally sustainable," or "green" in a consistent, transparent, and comparable way. Insurers may be reluctant to label an insurance product as NZAIPs or provide information that suggests that the product pursues environmental objectives so as not to be accused of "green-washing." Could the proposed "sustainable investment labels" give guidance on, or be adapted to, insurance products by analogy? The category description and criteria for each of the three "sustainable investment labels" are centered around the investment objective being sustainable. Therefore, it is not directly transferrable to insurance products. However, some of the "Principles" that have to be met to qualify for the sustainable investment labels could be applied mutatis mutandis to insurance products. For example:

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[153] Regulation 2021/1257, *supra* note 116, at ¶ 13.
[154] SDR, *supra* note 114, at ¶ 6.9.
[155] *Id.* at ¶ 6.10. For the "consumer duty" see *supra* Chapter 4.1.
[156] ICOBS, *supra* note 130, at ¶ 2.2.2.

- Principle 1, Sustainability Objective: "A sustainable investment product must have an explicit environmental and/or social sustainability objective"[157]—could be applied to insurance products that have an explicit environmental and/or social sustainability objective.
- Principle 3, Key Performance Indicators: "A firm must specify credible, rigorous, and evidence-based KPIs that measure a sustainable investment product's ongoing performance towards achieving its sustainability objective"[158]—could be applied to insurance products if the key performance indicators are adjusted appropriately.
- Principle 4, Resources and Governance: "A firm must apply and maintain appropriate resources, governance and organisational arrangements commensurate with the delivery of the sustainable investment product's sustainability objective"[159]—could be applied to insurance products.

As insurers develop NZAIPs and other green insurance products, it would be useful to extend the FCA's sustainability labels regime to insurance products other than insurance-based investment products. This would help customers to understand better, and develop trust in, insurance products with sustainable characteristics. In line with the new "consumer duty,"[160] insurers should take responsibility for establishing an environment in which consumers can act in their own interests and make informed choices; good product design, a more probing product suitability assessment, and more informative product disclosure would enable consumers to do so.

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[157] SDR, *supra* note 114, at ¶ 4.55.
[158] *Id.* at ¶ 4.57.
[159] *Id.* at ¶ 4.61.
[160] *See supra* Chapter 4.1; *see also A New Consumer Duty*, *supra* note 113, at ¶ 1.2.

C. CORPORATE PURPOSE: THE DUTY TO PROMOTE THE SUCCESS OF THE COMPANY

The predominant view in Anglo-American scholarship is that the purpose of a company is to create value for its shareholders.[161] Reflecting that purpose is the common law duty of the directors of a company to act in a way to promote the success of the company. Under the Companies Act 2006, § 172(1), a director of a UK (insurance) company has a statutory duty to: *"*act in the way he considers, in good faith, to be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to [amongst other matters] . . . (d) the impact of the company's operations on the community and the environment . . . . " (hereinafter the "s.172 duty").

The § 172 duty raises questions as to the extent of which directors of an insurance company would be permitted to forego higher profits of the company by giving premium discounts, or incurring additional costs, in relation to NZAIPs. The § 172 duty is owed by the directors to the company for the benefit of its members as a whole, but not to other stakeholders (such as policyholders). Promoting the success of the company means, primarily, to create value from which shareholders will benefit.[162]

As § 172(1)(d) indicates, the impact of the company's operations on the environment is a consideration for promoting the success of the company. Accordingly, a director of an insurance company could be expected to consider the company's strategic approach to environmental risks and impacts. As climate change has become a global threat, directors should consider whether and to what extent the company should pro-actively take climate action as part of its defensive strategy (averting reputational harm and reducing litigation risk), and as part of its offensive strategy (building a competitive advantage by developing new products meeting environmental objectives, enhancing customer loyalty and attracting talented employees

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[161] PAUL L. DAVIS, SARAH WORTHINGTON & CHRISTOPHER HARE, PRINCIPLES OF MODERN COMPANY LAW 249–50 (Sweet & Maxwell, 11th ed., 2021); BEATE SJÅFJELL & BENJAMIN J. RICHARDSON, COMPANY LAW AND SUSTAINABILITY: LEGAL BARRIERS AND OPPORTUNITIES 79–147 (Cambridge Univ. Press, 2015); Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance* 50 HARV. INT'L L.J. 129, 131 (2009); MATHIAS M. SIEMS, CONVERGENCE IN SHAREHOLDER LAW 176–78 (Cambridge Univ. Press, 2008).

[162] DAVIS & WORTHINGTON, *supra* note 161.

and investment).[163] Most UK insurers (by virtue of being large UK-authorised insurance companies) are subject to a public disclosure regime that requires an annual Strategic Report, with a § 172(2) statement and a non-financial information statement.[164] The key reporting requirement in respect of an insurer's underwriting and investment activities is "a description of … products and services which are likely to cause adverse impacts on the environment."[165] This should require disclosure in general terms of insurance coverage and/or investment provided for carbon-intense activities and assets. Although a description of products and services with a positive impact on the environment is not expressly required, a small sample survey of the most recent annual reports of Aviva,[166] Beazley,[167] Direct Line Insurance Group,[168] Hiscox Ltd,[169] Legal & General,[170] and RSA[171], would suggest that insurers also report on products, services, and activities with positive impacts on the environment. Such information would tend to show that the directors have discharged their § 172 duty with regard to the impact of the company's operations on the environment. Insurers who fail to put strategies in place for climate action in their operations and through their products and services

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[163] *See generally* DANIEL BRENNAN ET. AL., CORPORATE SOCIAL RESPONSIBILITY - THE CORPORATE GOVERNANCE RESPONSIBILITY OF THE 21ST CENTURY (Ramon Mullerat ed., Wolters Kluwer L. & Bus., 2d ed., 2011).

[164] *See generally* Companies Act 2006, c.46 (UK).

[165] *Id.* at § 414CB(2)(d)(i).

[166] *See e.g.*, *Aviva plc: Annual Report and Accounts 2021*, AVIVA, https://static.aviva.io/content/dam/aviva-corporate/documents/investors/pdfs/reports/2021/aviva-plc-annual-report-and-accounts-2021.pdf (last visited Oct. 10, 2022).

[167] *See e.g.*, *Annual Report and Accounts 2021*, BEAZLEY, https://reports.beazley.com/2021-annual/static/pdf/beazley-annual-report-2021.bba23f4c.pdf (last visited Oct. 10, 2022).

[168] *See e.g.*, *Annual Report 2021*, DIRECTLINE GRP., https://www.directlinegroup.co.uk/content/dam/dlg/corporate/Documents/sustainability/sustainability-report-2021/DLG_2021_Sustainability_Report.pdf (last visited Oct. 10, 2022).

[169] *See e.g.*, *2021 Annual Report*, HISCOX, LTD., https://www.hiscoxgroup.com/sites/group/files/2022-03/Hiscox_report_and_accounts_2021_0.pdf (last visited Oct. 10, 2022).

[170] *See e.g.*, *2021 Annual Report*, LEGAL&GEN., https://group.legalandgeneral.com/media/fx3kkujx/l-g-2021-annual-report-and-accounts.pdf (last visited Oct. 10, 2022).

[171] *See e.g.*, *RSA Annual Report and Accounts 2021*, RSA INS., https://static.rsagroup.com/rsa/investors/company-performance/annual-reports/rsa-annual-report-and-accounts-2021.pdf (last visited Oct. 10, 2022).

may suffer reputational harm, compare unfavourably to their competitors, and be the subject of negative publicity, resulting in loss of market share and creating a strategic risk to overall business viability.[172] Ultimately, these reputational, operational, and strategic risks could negatively reflect in the value of company and thus affect the shareholders' return on equity.

However, the § 172 duty does not permit directors to promote environmental goals at the expense of shareholders. Nor does § 172 take a "pluralist approach" whereby the directors must balance the interests of the members with those of the stakeholders.[173] The literature describes the § 172 duty as representing a philosophy of "enlightened shareholder value" where shareholders' interests are paramount, but the interests of stakeholders (including communities and the environment) are to be taken into account when determining the best way of promoting the company's success.[174]

Is an NZAIPs underwriting strategy, that envisages premium discounts outside a corporate purpose, focused on the benefit to shareholders and value creation? The answer could be yes if "shareholder value" is seen exclusively in terms of profit maximisation for shareholders. However, public debate and scholarship is starting to shift the corporate focus from "shareholder primacy" to a wider view of engagement with stakeholders and society.[175] Advocates of a wider corporate purpose argue that societal issues such as climate change cannot be addressed, and can even be made worse, by companies that solely focus on (short-term) financial performance since they ignore the longer-term, economy-and-society wide negative externalities that result, by placing them outside the realm of their business

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[172] *Issues Paper on Climate Change Risks to the Insurance Sector*, IAIS, 1, 16 tbl.1 (July 2018), https://www.insurancejournal.com/research/app/uploads/2018/08/IAIS_and_SIF_Issues_Paper_on_Climate_Change_Risks_to_the_Insurance_Sector_-1.pdf; Maryam Golnaraghi, *Climate Change Risk Assessment for the Insurance Industry*, GENEVA ASSOC., 1, 16–19 (Feb. 2021), https://www.genevaassociation.org/sites/default/files/climate_risk_web_final_250221.pdf.

[173] DAVIS & WORTHINGTON, *supra* note 161, at 420.

[174] *Id.*

[175] For an overview of the public, political and academic debate on 'corporate purpose' see Edward B. Rock, *For Whom Is the Corporation Managed in 2020? The Debate over Corporate Purpose*, 76 BUS. LAW. 363, 363 (2021); *see also* SJÅFELL & RICHARDSON, *supra* note 161; FREDERICK H. ALEXANDER, BENEFIT CORPORATION LAW AND GOVERNANCE: PURSUING PROFIT WITH PURPOSE (Berrett-Koehler Publishers, Inc., 1st ed., 2018).

decisions.[176] Some jurisdictions legally recognize benefit corporations—companies whose corporate form and constitution allow them to consider other interests.[177] Reference is made to the discussion above on the role of insurers as net-zero enablers in line with emerging theoretical frameworks on "stakeholder capitalism," "environmental stewardship," and a wider meaning of "corporate purpose."[178]

However, even if the corporate purpose debate is moving towards a more pluralist view that envisages a link between benefitting society more widely and long-term corporate growth, this is not the legal position under the § 172 duty. Moreover, there are market practices and company constitutional issues that put pressure on directors to maximise shareholder value within a short-term horizon, rather than engaging with sustainable corporate governance practices. A study carried out by EY for the European Commission identified a number of key drivers for board short-termism, including pressure from investors with short-term investment goals; board remuneration structures that incentivise the focus on short-term shareholder value rather than long-term value creation for the company; current corporate governance frameworks and practices that do not sufficiently voice the long-term interests of stakeholders; and the limited enforcement of directors'

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[176] *Principles for Purposeful Business*, BRITISH ACAD. 1, 8 (Nov. 2019), https://www.thebritishacademy.ac.uk/documents/224/future-of-the-corporation-principles-purposeful-business.pdf; Marco Rubio, *American Investment In The 21st Century: Project For Strong Labor Markets And National Development*, 1, 22 (May 15, 2019), https://www.rubio.senate.gov/public/_cache/files/9f25139a-6039-465a-9cf1-feb5567aebb7/4526E9620A9A7DB74267ABEA5881022F.5.15.2019.-final-project-report-american-investment.pdf.

[177] A company can register as a benefit corporation in some of the US States. *See* Sean Peek, *A Complete Guide to Starting a B Corp*, CO (May 5, 2020), https://www.uschamber.com/co/start/strategy/b-corp-advantages-and-requirements. In France, a company can register as or change its status to 'Société à Mission' under the Loi PACTE 2019. *See The PACTE law: for the growth and transformation of companies*, MINISTRY FIN. ECON. & INDUS. & DIGIT. SOVEREIGNTY (Sep. 11, 2019), https://www.economie.gouv.fr/loi-pacte-croissance-transformation-entreprises#. In the UK, a company can register as a community interest company, a special type of limited company which exists to benefit the community rather than private shareholders. Companies Act 2006, c.46, § 6 (UK). In addition, a mainstream company can formulate its corporate purpose more widely, so as to promote the success of the company for the benefit of its members by achieving those wider or other purposes. *Id.* at § 172(2) (this may protect to some extent against liability in shareholder actions).

[178] *See supra* Chapter 2.4; *see also supra* notes 34–36.

duties in the long-term interest of the company.[179] Moreover, insurance companies cannot ignore short-term performance as their regulatory solvency capital requirements are calibrated at a level to ensure their assets will be able to cover liabilities over the following 12 month period.[180]

Insurers must therefore be careful to limit premium discounts and costs associated with NZAIPs to levels that do not negatively impact shareholder value. For insurance companies designing NZAIPs that envisage premium discounts if the policyholder achieves GHG emission reductions, it would be prudent to correlate any premium discounts to a reduction in the underwriting risk, i.e., the risk of loss or adverse change in relation to the insured subject-matter. If no data is available to support such a correlation, it might also be helpful to show a link between the premium discount and a reduction in the insurance company's wider operational, strategic, or reputational risk in order to align its NZAIPs to its primary purpose of creating shareholder value.

Insurers must engage with their shareholders to foster stewardship and to ensure their support for the creation of sustainable value for shareholders that considers the wider interests of society in stemming climate change. It has been noted that a growing number of investors are "prosocial" and would prefer their investee companies to reduce socially harmful activities connected to its business, even if this might reduce profits.[181] Climate-conscious investors see value in their investee companies reducing GHG emissions, while improving the company's share value by taking climate action.[182]

There will come a tipping point where the maximization of shareholder value is aligned with insurance business models that have clear net-zero targets to be achieved with impact underwriting—including NZAIPs—and impact investment. This tipping point will be reached when the rising costs of climate-related risks and the business opportunities of

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[179] Rep. of the Eur. Comm'n, *Study on Director's Duties and Sustainable Corporate Governance*, ¶ 4.1 (July 29, 2020), https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en.

[180] Bank Eng. Prudential Regul. Auth. [PRA], *Solvency Captial Requirement – General Provisions*, ¶ 3.3 (Jan. 1, 2016).

[181] Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247, 250 (2017).

[182] John Armour, Luca Enriques & Thom Wetzer, Green Pills: *Making Corporate Climate Commitments Credible*, 18–20 (Eur. Corp. Governance Inst., Working Paper No, 657/2022, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4190268#.

product innovation and decarbonized or decarbonizing investments can no longer be ignored.[183]

As noted above, insurer's corporate reporting should (and in the case of UK premium listed insurance companies must) include a description of its environmental policies, products, and environmental matters arising in connection with its operations.[184] Reporting on these matters should include clear information on an insurer's NZAIPs offering. One of the reporting challenges is that there are still significant gaps in the analytics and data available that account for GHG emissions and reductions in underwriting portfolios.[185] In the absence of clear numerical data quantifying the GHG emission reductions brought about by an insurer's NZAIPs portfolio, it is important not to overstate the GHG emission reducing impact of NZAIPs, and instead focus on the support provided for consumers and small businesses in their transition to a net-zero economy.

D. Unfair Contract Terms

To what extent could the green terms found in NZAIPs be at risk of unenforceability for being "unfair" to the policyholder? Unfairness of contractual term is addressed in (1) the Consumer Rights Act 2015 ("CRA 2015"), Part 2, which only applies to consumer contracts,[186] and (2) the Unfair Contract Terms Act 1977, which does apply to non-consumer contracts but not to insurance contracts.[187] Accordingly, the discussion below is limited to green terms in consumer NZAIPs.

Under the CRA 2015, an unfair term of a consumer contract is not binding on the consumer,[188] although the contract will continue to have effect, so far as practicable, without the unfair term.[189] A term is unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer.[190] However, core terms of the CRA 2015—those that deal with

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[183] *Id.* at 11.

[184] Companies Act 2006, c.46, § 414CB (UK).

[185] Maryam Golnaraghi, *Anchoring Climate Change Risk Assessment in Core Business Decisions in Insurance*, Geneva Ass'n, 38–39 (Sep. 2022), https://www.genevaassociation.org/sites/default/files/2022-10/Climate%20Risk%203_web.pdf.

[186] Consumer Rights Act 2015, c.15, § 61(1) (UK).

[187] Unfair Contract Terms Act 1977, c.50, § 1(a), sch. 1.

[188] Consumer Rights Act 2015, c.15, § 62(1) (UK).

[189] Consumer Rights Act 2015, c.15, § 67 (UK).

[190] Consumer Rights Act 2015, c.15, § 62(4) (UK).

the main subject of the contract and the adequacy of the contract price—are not subject to the fairness assessment,[191] provided such core terms are transparent and prominent.[192]

Applied to consumer insurance contracts, the core term exception means that the fairness of the insuring clause, the premium level, deductible and limits, and policy exclusions cannot be challenged, provided the policy terms are transparent and prominent.[193] For the purposes of the unfair terms provisions in the CRA 2015, a term is transparent if it is expressed in plain and intelligible language and (in the case of a written term) is legible; while a term is prominent if it is brought to the consumer's attention in such a way that an average consumer would be aware of the term.[194] Given that green terms are not yet widely used and an average consumer would not be aware of them, exclusions and specific deductibles and limits applying to carbon-intense activities should not be buried in the policy wording. In particular, exclusions should explain or define environmental terms and any ambiguous terms in plain and intelligible language. Otherwise, the insurer could face the risk that (1) the exclusion might be subject to the fairness assessment, and (2) the meaning most favorable to the consumer would prevail and the exclusion might not apply.[195]

In contrast, green reinstatement provisions are unlikely to be regarded as core terms: in *Crash Services Ltd v. AXA Insurance Ltd*, the court held that a "preferred repairer clause" in a motor policy, giving the policyholder a choice of having her car repaired by an AXA approved repairer or an unapproved repairer, but where choosing the latter would mean fewer benefits and a higher excess, was a not a core term because it merely "sets out some of the detail and practicality as to how the indemnity term [being the core term] is to be satisfied."[196] Similarly, in *Bankers Insurance Co Ltd v. South*,[197] a claims condition was held to be a non-core term.

Core terms that do not meet the "transparency and prominence" tests and non-core terms are both assessed for "fairness" with the two key ingredients of unfairness being "contrary to good faith" and "significant imbalance." In *Makdessi v. Cavendish Square Holdings BV Parking Eye Ltd*.

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[191] Consumer Rights Act 2015, c.15, § 64(1) (UK).

[192] Consumer Rights Act 2015, c.15, § 64(2) (UK).

[193] Cour de cassation [Cass] [the court of cessation] Nice, 3e civ., Feb. 26, 2014, C-96/14, obs. V. Tourrès (Fr.).

[194] Consumer Rights Act 2015, c.15, § 64(4) (UK).

[195] Consumer Rights Act 2015, c.15, § 69 (UK).

[196] Crash Servs. Ltd. v AXA Ins. Ltd. [2018] NICty 3 [101] (N. Ir.).

[197] Bankers Ins. Co. Ltd. v. S. & Anor [2003] EWHC 380, [32],[33],[35],[36] (QB).

v. Beavis,[198] the Supreme Court applied the following tests established by the European Court of Justice in *Aziz v. Caixa d'Estalvis de Catalunya, Tarragona i Manresa*:[199]

1. The question whether there is a "significant imbalance in the parties' rights" depends mainly on whether the consumer is being deprived of an advantage which he would enjoy under national law in the absence of the contractual provision. In other words, this element of the test is concerned with provisions derogating from the legal position of the consumer under national law.
2. The imbalance must arise "contrary to the requirements of good faith." That will depend on whether the seller or supplier, dealing fairly and equitably with the consumer, could reasonably assume that the consumer would have agreed to such a term in individual contract negotiations.

How would these tests be applied to a green reinstatement provision? Green reinstatement provisions do not prima facie fall into any of the categories of terms that are potentially unfair set out in the "grey list" in the CRA 2015, Schedule 2.

Significant Imbalance in the Parties' Rights: In indemnity insurance, the insurer undertakes to hold the insured harmless against loss by an insured peril or perils specified in the policy.[200] Without the green reinstatement provisions, the insurer would pay the policyholder (or its beneficiary) a sum of money representing its insured loss and the insured can then use the settlement proceeds as s/he pleases.[201] In that sense, a green reinstatement provision is a derogation from (English) insurance contract law, but it is not necessarily a derogation that deprives the consumer policyholder of any advantage s/he would have had. A green reinstatement provision is arguably just another way of fulfilling the insurer's primary obligation to indemnify—to "hold harmless"—for loss. Standard property policies frequently contain basis of settlement clauses providing for the

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[198] Cavendish Square Holding BV v. Talal El Makdessi [2015] UKSC 67, [105] (appeal taken from EWCA Civ.).

[199] Case C-415/11, Mohamed Aziz v. Caixa d'Estalvis de Catalunya, Tarragona i Manresa (Catalunyacaixa), 2013 E.C.R. 164.

[200] Sprung v Royal Ins. (UK) Ltd. [1996] C.L.C. 70, 75, 80 (Eng.); Ventouris v Mountain [1992] 2 Lloyd's Rep. 281 (Eng.).

[201] Rayner v Preston [1881] 18 Ch D 1 at 6–7 (UK).

reinstatement or repair of insured buildings or personal property that have been damaged, or the replacement of lost items.

A green reinstatement provision where the insured can elect between (a) cash settlement or (b) reinstatement, replacement, and repair (Options 7, 8, and 9 in Section 3.4 above), do not give rise to a disadvantage which the consumer insured would have enjoyed in the absence of the provision as the consumer insured has a choice.[202] On the other hand, a green reinstatement provision where the insured has no right to choose between either (a) cash settlement or (b) reinstatement, replacement, and repair, could be disadvantageous to the consumer insured if s/he has to wait longer for a reinstatement, replacement, or repair of property compared to a cash settlement. If the damaged property is the consumer insured's place of living, s/he may need alternative accommodation during the period the property is reinstated or repaired. Most consumer home insurance policies already contain provisions to that effect. A green reinstatement provision could also be disadvantageous if the consumer insured would incur costs as a result of the reinstatement, replacement, or repair that s/he would not have incurred or could have chosen not to incur upon a cash settlement. Thus, a well-drafted green cash settlement provision must not make the consumer insured liable for any part of the costs of reinstatement, replacement, or repair (by way of contribution or by applying a limit of liability) even if the costs exceed the economic loss suffered by the consumer insured.

Good faith: Even if the green reinstatement provision derogates from the legal position of the consumer insured under insurance contract law, it would not necessarily be treated as unfair. The imbalance must arise "contrary to the requirement of good faith."[203] Applied to green reinstatement provisions, the question is whether an insurer, dealing fairly and equitably with the consumer insured, could reasonably assume that a consumer insured would have agreed to such a term in individual contract negotiations. In determining this question, the courts will take into account whether the term in question is common in that type of contract, whether there is an objective reason for the term, and whether, despite the imbalance it causes, the consumer is not left without protection.[204] Green reinstatement provisions are not yet frequently used. "Dealing fairly and equitably with the

[202] This was the reasoning of District Judge Gilipin in Crash Servs. Ltd. v. AXA Ins. Ltd. [2018] NICty 3 [170] (N. Ir.) in relation to a preferred repairer clause which gave the insured a choice between approved and unapproved repairers.

[203] Makdessi v Cavendish Square Holdings BV Parking Eye Ltd. v. Beavis [2015] UKSC 67 [105] (appeal taken from EWCA).

[204] *Id.* at [106].

consumer" is therefore likely to require that the term is prominently and clearly set out or summarised in the pre-contractual product information provided to the consumer insured.[205] There is an objective reason for green reinstatements provisions which is to hold policyholders harmless from loss in relation to their insured property, and to do so by reducing harmful impacts on the environment. The consumer insured is not left without protection as its insured loss is still indemnified, albeit, not by way of cash settlement.

Although the concept of a negotiated agreement in relation to standard terms is rather artificial, it is a helpful test for looking at what a reasonable consumer would have done.[206] Objectively, a consumer insured might have reason to accept a green reinstatement provision given that any insured loss suffered is still indemnified, and arguably, a consumer insured might even be "over-compensated" if one subscribes to the view that sustainable reinstatement, replacement, or repair is "building back better." However, this may not be the case where a consumer insured might incur additional costs as a result of the reinstatement, replacement, or repair.

If a green reinstatement provision was found to be unfair it would not be binding on the consumer insured.[207] In relation to traditional reinstatement clauses, it has been said that if reinstatement is physically or legally impossible before the insurer (or the policyholder, as the case may be) makes his election, any purported election is void and, subject to any other terms of the policy, the insurer's obligation reverts to making a cash settlement.[208] If the effect of a non-binding green reinstatement provision is that the insurer's obligation is to revert to making a cash settlement, the contract of insurance would still be capable of having effect without the green reinstatement provision and would, accordingly, continue to have effect.[209]

From the example of green reinstatement terms, some more general observations can be made: for terms not to fall foul of the fairness requirements, it is preferable to use green terms that encourage, rather than mandate, GHG emission reducing behavior, and to use rewards (premium rebates or discounts) instead of contractual penalties for non-compliance. Regardless of whether green terms fall with the core terms category, given that they are novel and probably not yet well-known and understood, it

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[205] CRA, s 64(2)

[206] Makdessi v Cavendish Square Holdings BV Parking Eye Ltd. v. Beavis [2015] UKSC 67, [108] (appeal taken from EWCA).

[207] Consumer Rights Act 2015, c.15, § 62(1) (UK).

[208] Anderson v. Com. Union Assurance Corp. [1885] 55 QBD 146 at 150 (Eng.).

[209] Consumer Rights Act 2015, c.15, § 67 (UK).

would be good practice to draw them to the policyholder's attention before the contract is concluded. That should, in any event, be the course of action of insurance distributors if requirements to ascertain a customer's sustainability preferences and to disclose sustainable product features were to be introduced.[210]

There are, of course, many other legal and regulatory issues which remain to be examined in another paper, including the competition issues that could arise if insurers agree upon standard green terms and premium levels for NZAIPs, and questions as to what extent insurers' solvency capital requirements should allow capital incentives for climate risk mitigation action by insurers (or penalize underwriting and investment activities in carbon intense activities) for reasons that are not directly linked to the regulatory objectives set out in the UK Financial Services and Markets Act 2000.[211]

V. SUSTAINABLE DEVELOPMENT

It was noted above that insurance is a mechanism for transferring and pooling risk, and ultimately, socializing the costs of risk. NZAIPs go further by seeking to reduce climate risk (by reducing GHG emissions) and to encourage better climate risk management at the policyholder level. NZAIPs can help policyholders make more informed choices and take greater ownership in their transition to a net-zero economy. The net-zero transition pathway for consumers and small businesses can be made more "just" if they receive financial, logistical, and advisory support from the insurance industry in relation to existing insurance products that already have good market penetration and are known to consumers and small businesses. However, as explained above, insurance companies have to deliver value for their shareholders and cannot spend unlimited resources on incentivizing and subsidizing the climate risk mitigation activities of their policyholders. To socialize the costs of the net-zero transition fairly and effectively, insurance companies should be able to access government schemes and grants

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[210] *See supra* Chapter 4.2.

[211] *See* Financial Services and Markets Act 2000, c.8, §§ 2B, 2C (UK). The Governor of the Bank of England, Andrew Bailey, said that he saw no case yet for setting additional capital requirements for climate change risks, or allow capital incentives for climate risk mitigation, for reasons that are not directly linked to the PRA's regulatory objectives. William Schomberg & David Milliken, *Bank of England's Bailey unconvinced by carbon capital rules*, REUTERS (June 1 2021, 4:45 PM), https://www.reuters.com/business/sustainable-business/reuters-events-bank-englands-bailey-unconvinced-by-carbon-capital-rules-2021-06-01/.

available to their policyholders, aimed at reducing GHG emissions, and work in partnership with public authorities to enable consumer and small business policyholders to implement climate mitigation activities in a sustainable manner.

It is also important to remember that "climate change mitigation" is just one aspect of addressing climate change;[212] that addressing climate change is just one of several environmental objectives;[213] and that addressing environmental objectives is merely a part of the SDGs in the 2030 Agenda for Sustainable Development.[214] Inevitably, there will be conflicts and complex trade-offs between different objectives and different SDGs at global and national levels, as well as in the strategic decision-making processes of businesses. Insurers who consider the development of NZAIPs must make sure that these products do not create protection gaps by increasing premiums to unaffordable levels or by excluding coverage for carbon-intense assets and activities where consumer or small business policyholders have no real choice or control over reducing GHG emissions associated with their assets and activities. Protection gaps are contrary to the principle of sustainable development because they can result in a significant financial burden for uninsured losses on affected individuals and business. Governments will be under pressure to step in and offer financial relief (with consequential effects on the taxes that need to be raised). Protection gaps

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[212] The approaches to combating climate change identified in the 2015 Paris Agreement are climate change mitigation, climate change adaptation and building loss resilience. Paris Agreement art. 4, ¶ 1, Apr. 22, 2016, T.I.A.S. No. 16-1104; *id.* at art.7, ¶ 1; *id.* at art. 8 ¶ 1.

[213] The environmental objectives are set out in Art.9 of the EU Taxonomy Regulation. Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the Establishment of a Framework to Facilitate Sustainable Investment, and Amending Regulation (EU) 2019/2088, art.9, 2020 OJ (L 198); *see also* G.A. Res. 70/1, ¶ 13, Transforming our world: the 2030 Agenda for Sustainable Development (Oct. 21, 2015) (take climate action); *id.* at ¶ 14 (conserve and sustainably use the oceans, seas and marine resources); *id.* at ¶ 15 (protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss).

[214] There are 17 SDGs in the 2030 Agenda for Sustainable Development setting out a route map for peace and prosperity interlinked to globally shared strategies that improve health, education, equality, inclusivity, and security. Further, they give access to natural resources; promote economic growth and innovation; stem climate change, and preserve biodiversity and ecosystems. *See generally* G.A. Res. 70/1, Transforming our world: the 2030 Agenda for Sustainable Development (Oct. 21, 2015).

may have a cascading effect on economic activities, supply chains, and the performance of loans and investments across the financial system.[215]

On the other hand, if an insurer's sustainability strategy for products and investments focus too heavily on social goals, it could constrain, delay, and reduce the available resources for the development of NZAIPs. The Intergovernmental Panel on Climate Change ("IPCC") has adopted the concept of "climate resilient development" ("CRD"), which is a strategy of coordinated and integrated implementation of climate change adaptation and mitigation solutions on a fair and equitable basis, which will improve social, economic, and environmental outcomes in line with the SDGs.[216] There is no single preferred pathway or best combination of adaptation, mitigation, and other sustainable development strategies, rather:

> The climate resilient development concept helps assess the extent to which solutions currently exist to meet societal goals or the extent to which an expanded solution space is required. The concept also helps assess the role of various actors, including governments, citizens, civil society, knowledge institutions, media, investors and businesses as well as assessing the need for arenas of engagement in which they can interact.[217]

CRD approaches are founded in recent interdisciplinary research,[218] and have been accompanied by a shift in international policies as evidenced in the Paris Agreement, which explicitly links its objectives of climate change mitigation, adaptation, and resilience to "the context of sustainable development."[219] There are diverging views, coloured by ideological positions on economic theory, about whether "sustainable development" and CRD are different, albeit, connected concepts. For some commentators, CRD merely constitutes an extension of the language of sustainable development to give greater emphasis to the role of climate action and

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[215] *Issues Paper on Climate Change Risks to the Insurance Sector*, *supra* note 172, at 14.

[216] Intergovernmental Panel on Climate Change [IPCC], *Climate Change 2022: Impacts, Adaptation and Vulnerability*, at 175, (2022), https://report.ipcc.ch/ar6/wg2/IPCC_AR6_WGII_FullReport.pdf; *id.* at 2655–2769.

[217] *Id.* at 171.

[218] For a comprehensive literature review, see *id.* at 2660.

[219] Paris Agreement, *supra* note 212, at art. 2, ¶ 1. *See also Sharm el-Sheikh Implementation Plan*, *supra* note 4, at ¶ 39

environmental protection in enhancing human and ecological well-being.[220] Other commentators suggest that CRD is an enabling condition or process to achieve sustainable development,[221]and some view CRD and sustainable development as separate concepts with different objectives.[222]

For an insurer, a CRD approach to overall strategy and risk management (including product development) would need to be consistent with an effective system of governance and risk management, which provides for sound and prudent management of its business proportionate to the nature, scale, and complexity of its operations.[223] "Sustainability" and "climate resilience" are not just lofty concepts that apply to current and future generations of mankind, but have a more practical and concrete meaning for insurers who need to manage their businesses in a way that delivers value for shareholders,[224] guarantees their financial stability, and ensures that liabilities owed to its policyholders can be discharged.[225] As risk carriers of climate change related risks,[226] it would ultimately be in the insurance industry's own long-term interest to act as enablers to the transition to a net-zero economy.

VI. CONCLUSION

The Geneva Association, a leading insurance think tank, recently provided guidance to insurers for anchoring climate change-related decisions and risk assessment holistically into their strategic decision-making processes.[227] This is an "exploratory, iterative, and adaptive process . . . aspiring to a holistic approach with a view to both sides of the balance

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[220] Peter Ferguson & Linda Wollersheim, *The World Bank's Resilience Discourse: Reactive Environmental Norm Diffusion and the Crisis of Global Climate Governance*, *in* RETHINKING MULTILATERALISM IN FOREIGN AID 160, 160 (1st ed., 2020).

[221] Intergovernmental Panel on Climate Change, *supra* note 216, at 171.

[222] *See e.g.*, Climate-Resilient Development: A Framework for Understanding and Addressing Climate Change, USAID (Mar. 2014), https://pdf.usaid.gov/pdf_docs/PBAAA245.pdf.

[223] Bank Eng. Prudential Regul. Auth. [PRA], *Conditions Governing Business*, ¶ 2.1 (Dec. 31, 2020).

[224] *See supra* Chapter 4.3.

[225] Bank Eng. Prudential Regul. Auth. [PRA], *Solvency Capital Requirements - General Provisions*, ¶ 2.1 (Jan. 1, 2016) ; Bank Eng. Prudential Regul. Auth. [PRA], *Technical Provisions*, ¶ 2.1 (Jan. 1, 2016).

[226] Physical, transition and liability risk, see *supra* Chapter 2.2.

[227] Maryam Golnaraghi, *supra* note 177, at 38–39.

sheet."[228] NZAIPs could be an important part of this approach as they have the potential, if designed appropriately, to support consumers and small businesses in their transition to a net-zero economy in a fair and sustainable manner. There remain significant legal and regulatory issues relating to the development, sale, and performance of NZAIPs, but the evolving legal landscape is already looking for ways to address some of these issues, and this paper has highlighted some possible solutions and areas that require further (interdisciplinary) research. NZAIPs directly support the SDG and the PSI and allow insurers to take an enabling role in a just and sustainable transition to a net-zero global economy, and it is hoped that they will take off in the next few years to deliver on their promise.

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[228] *Id.* at 40.