Leadenhall Capital Partners

June 2022

Leadenhall Capital Partners Response To The Institutional Investors Group on Climate Change's Consultation on Incorporating Derivatives and Hedge Funds into the Net Zero Investment Framework

https://www.surveymonkey.co.uk/r/LK9CNH8

Q10. Do you agree that the proposed approach in this discussion document is applicable to derivatives in asset classes that are not covered? If not, please set out problem/ special cases that demand alternative treatment.

We do not agree the that the proposed approach in the IIGCC Discussion Paper "Incorporating Derivatives and Hedge Funds Into The Net Zero Investment Framework" is applicable to Insurance Linked Strategies (ILS). As noted in 10.2.3 ILS are often classified as hedge funds but the proposed concepts described in the paper do not map easily to the instruments managed by ILS managers. ILS instruments are usually structured to use money market funds to back the value of Special Purpose Vehicles (SPVs), much like how collateral backs the value of derivatives.

(Re)insurers use the ILS industry to transfer insurance risks to the capital markets. If there is an insurance event associated with the specific insurance risks underwritten then holdings in money market funds backing the ILS are used to pay insurance claims.

Currently under carbon accounting rules insurance risks that are transferred to the ILS market are no longer valued on a (re)insurer's balance sheet. Consequently as carbon accounting rules for corporates are based on attributing emissions by capital weights according to a company's Enterprise Value no emissions are currently assigned to ILS.

This discussion paper debates the merits of assigning carbon emissions to the long positions of derivatives versus the net of long and short positions. Often the underlying instruments referred to are listed equities so the concepts of voting and engagement map easily from physical to synthetic holdings. These concepts do not map to insurance risks that are transferred to the ILS market.

Scope 1, 2 and 3 emissions associated with businesses are beginning to be produced by large (re)insurers. They are also starting to separately report the emissions associated with their asset holdings. There is also a public consultation currently open with the Partnership for Carbon Accounting Financials (PCAF) on how emissions can be separately assigned to insurance liabilities (https://carbonaccountingfinancials.com/public-consultation-on-insurance-associated-emissions-scoping-document). Leadenhall Capital Partners LLP concurs with the current adopted practice where corporate emissions are not assigned to ILS as they do not feature in (re)insurers' capital structures. However as separate emissions disclosures are being consulted on by PCAF Leadenhall proposes that the IIGCC facilitates a separate discussion, in parallel with the PCAF consultation, as to how emissions can be reported on consistently and separately in the ILS industry as in the (re)insurance industry. This is as opposed to applying cash and derivatives rules to ILS hedge funds where the concepts do not neatly map. Leadenhall looks forward to being part of this specific discussion group.