IAIS Consultation

Print view of your comments on "Draft Application Paper on the Supervision of Climate-related Risks in the Insurance Sector" - Date: 12.01.2021, Time: 17:11

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Treat my comments as confidential	No

	Question
	Q1 General Comment on the draft Application Paper
Answer	The IAA understands that the Application Paper (AP) is aiming at the integration of new evolving risks from climatic change into the supervision of the insurance sector. While doing this, it is important to distinguish between the risks insurers have traditionally dealt with, like natural hazards, and from new evolving climate change risks. The AP could be improved by striving for clarity with regard to the core terminology. Throughout this AP the terms “climate risk" and “climate-related risk" are defined and used interchangeably, and on occasion “climate change risk" is mentioned. The IAA suggests that “climate-related risks" is a very wide-ranging collection of risks broader than (but inclusive of) the topic of “climate change risk". The IAA suggests that the AP might appropriately define “climate change risks" in order to avoid confusing the reader with the concept that “climate change risks" and “climate-related risks" are one and the same. The IAA understand that the term "climate change" is restricted in this paper to changes resulting directly or indirectly from human activity (anthropogenic driven change). The IAA recommends using the term climate change without the restriction to anthropogenic change, because this restriction is not relevant for insurers’ as they need to think more broadly when conducting their risk and solvency assessments. Overall, the IAA believes it is important that any supervisory framework takes into account the macro-prudential risk arising from the financial consequences of climate change. For example, depending on the holdings of specific fossil fuel firms and/or financial institutions exposed to the fossil fuel and/or extraction sectors, there could arise a situation where massive financial disruption occurs in the financial system of a country which is reliant on a small number of insurers and/or banks (via transition risks). The inter-connected nature of the global financial system exacerbates certain dislocations, in terms of access to affordable capital, renewing and/or availability of credit, squeezes in liquidity in general, and disruption to global financial systems. Finally, the insurance sector is naturally in a position to set measurable environmentally friendly targets for their own operations. In this context a clear policy from supervisory authorities is needed as soon as possible. The IAA suggests that supervisors could usefully provide guidelines to the insurance sector regarding sustainable measures and targets within their own operational activities, such as reducing CO_2 emissions in e.g., Motor and Building Insurance claims repairs. In non-life insurance, the entities could also set out requirements for other procurements activities. This could be done in several ways and these could be disclosed in their annual reports.
	Q2 Comment on section 1.1 Context and objective

Answer

This section provides a good understanding of the context and objective of the paper. As climate change is a global threat, the IAA suggests that members of IAIS be encouraged to report back on local initiatives and the extent to which the measures presented in the report are put in force.

Q3 Comment on paragraph 1

Answer

Q4 Comment on paragraph 2

Answer

Following on from the IAA answer to Q 1, the IAIS glossary could be mentioned here (in respect of the definition of “financial risk").

Q5 Comment on paragraph 3

Answer

Q6 Comment on paragraph 4

Answer

A "globally consistent" approach is desirable but the IAA is concerned that any approach should facilitate making progress quickly.

Supervisors could consider taking a building block approach for the industry to break down the issue of climate risks into parts, for example around understanding and addressing data availability, addressing the climate risk landscape and requirements, then tools, methodologies and principles. This would involve local regulators, local actuarial associations and academic bodies coordinating their training and research. Given that many insurance companies are still in the early stage of managing climate risks, taking a building block approach enables the gradual roll out of standards or guidelines phase by phase. This may help the industry implement initiatives more effectively.

Q7 Comment on section 1.2 Related work by the SIF and IAIS

Answer

Q8 Comment on paragraph 5

Answer

Q9 Comment on section 1.3 Proportionality

Answer

Q10 Comment on paragraph 6

Answer

Q11 Comment on section 1.4 Terminology

Answer

Q12 Comment on paragraph 7

Answer	Further to the response to Q1: The definition of “climate change" is restricted to just that attributable to human activity. For solvency purposes the distinction between climate change attributable to human activity and that attributable to other causes is irrelevant. The IAA suggests not restricting the definition of climate change in this way. If liability risk is to include the legal risk (as defined in Table 1), “Legal risk" may be a better label as the term “liability risk" may be more naturally understood to be restricted to insurance liabilities. However, it may be better to define “Legal risk" and “Insured Liability risk" separately, so that the former excludes the latter.
	Q13 Comment on section 1.5 Scope
Answer	
	Q14 Comment on paragraph 8
Answer	
	Q15 Comment on paragraph 9
Answer	
	Q16 Comment on paragraph 10
Answer	The IAA notes that it will be important to update ICP 19 in the future as “greenwashing" is likely to be an important issue.
	Q17 Comment on paragraph 11
Answer	
	Q18 Comment on section 2 Role of the Supervisor
Answer	
	Q19 Comment on paragraph 12
Answer	Table 2: Underwriting risk: The current wording doesn’t actually say what the underwriting risk is – for example this could be reworded to say “climate change increases the level of uncertainty of weather-related claims, not just the frequency and severity. If the impact of climate change is not properly allowed for, underwriting may mis-estimate the risks to which an insurer may be exposed in writing a particular insurance policy". Table 2: Liquidity Risk: the wording could be made clearer to include claims effects, as well as general market effects. For example, it might also include: “In addition, the uncertainty in future experience that may result from climate change could lead to a volatile claims experience leading to inadequate liquid resources and the potential need to dispose of assets on unfavourable terms". Whilst extreme claim events can cause some liquidity issues if the insurer’s risk is improperly managed, on balance, the IAA believes that climate risk is unlikely to affect the existing risk sufficiently materially to warrant it being called out specifically in this context. For example, snowstorms or hailstorms are not predictable months in advance, and in many cases aren’t predictable more than a day or two in advance, yet non-life insurers need to be ready for how those events will impact cash demands. Also, the payout of non-life claims in such circumstances is generally not instantaneous with the event, but may take days, weeks, months or longer for the claim settlement process. The IAA suggests that climate change may not have a big impact on insurers’ existing short term liquidity planning. Table 2: Operational Risk: The AP mentions “inhibited claims management capacity", and, while including that reference does no harm, the IAA observes that the insurance industry has been forced to insulate their claims management function from such disruptions due to Covid-19. It should already be a consideration for insurers exposed to catastrophes (man-made or otherwise).

The IAA notes the terms “prudential risk" and “environmental risk" are used in the AP and could be defined in this section.

Q20 Comment on section 2.1 Preconditions and resources

Answer

Q21 Comment on paragraph 13

Answer

The impact of a supervisory regime is impacted by the extent of any governmental policies in this area. Clearly it is easier for supervisors if the supervisory regime is aligned with government policy.

The first bullet point in this paragraph addresses ’sustainable … policies" and it may be helpful if this term is explained further, and the example given could be more helpfully focused for this purpose.

Q22 Comment on paragraph 14

Answer

This paragraph mentions the need for “sufficient resources" - presumably in both quantity and necessary expertise/experience. While this requirement is a valid and necessary one for effective supervision (whether generally or specifically to climate risks), it can be extremely challenging or practically impossible for supervisors in some jurisdictions where resources are very limited and constrained by government budgets. Some of the alternative mechanisms stated (e.g., NGO’s) may only be viable if they have no impact on supervisory budgets. This might need to be more specifically recognized in this paragraph.

Q23 Comment on paragraph 15

Answer

Q24 Comment on paragraph 16

Answer

Q25 Comment on section 2.2 Supervisory review and reporting

Answer

Q26 Comment on paragraph 17

Answer

Q27 Comment on paragraph 18

Answer

It would be clearer if Table 2 could be signposted to paragraph 12.

The term “evolving risk" is used here, in other parts of the paper (e.g., para 77) the term emerging risk is used. It would be helpful to explain the difference in these terms.

Q28 Comment on section 2.2.1 Information gathering

Answer

Q29 Comment on paragraph 19

Answer	Box 1 should be signposted to "paragraph 22". Another source of valuable information on climate-related risk is the Actuarial Function as this control function is closely involved with, inter alia, claims, liability valuation, asset/liability management and scenario testing.
	Q30 Comment on paragraph 20
Answer	
	Q31 Comment on paragraph 21
Answer	The IAA notes there is also great potential for cooperation (streamlining of climate change information request), not just cross-border but also with market regulators and encompassing other market requirements.
	Q32 Comment on section 2.2.2 Supervisory feedback and follow-up
Answer	
	Q33 Comment on paragraph 22
Answer	Box 1: A general comment is that the supervisory questions will be more effective if they are "open" questions – for example, the second General Qualitative question could be restated as "What substantive changes has your organisation implemented or planned to its business model…" Box 1: Qualitative) Liability risk: The IAA suggests adding "directly or indirectly". For example, an indirect claim could relate to a failure to properly disclose climate risks. It is also relevant for an organisation to consider legal judgements and lawsuits in other jurisdictions, particularly where they have written business in those jurisdictions. The IAA also suggests adding "or Professional Indemnity Insurance". Box 1: Physical risk: Why should this be limited to "fossil-fuel based power-plants"? For example, what about a flooded nuclear power-plant? Box 1 (Quantitative) Liability risk: whilst these are illustrative questions it may be worth widening the quantitative question which asks only about energy operations. One example of widened liability would be architects' professional liability risks for a new commercial development that did not anticipate the increased risk of flooding.
	Q34 Comment on section 3 Corporate Governance
Answer	The guidance in this section could more explicitly bring in the concept of proportionality, to highlight the general points made in paragraph 6. Climate risk will be a material risk for some business models and products, but not for all (e.g., pet insurance is unlikely to be affected). Therefore, the IAA cautions against prescriptive guidance that forces action that is not proportionate to the exposure. The guidance should be risk-focused, without presuming universal exposure to all risks.
	Q35 Comment on paragraph 23
Answer	
	Q36 Comment on section 3.1 Appropriate allocation of oversight and management responsibilities
Answer	
	Q37 Comment on paragraph 24
Answer	

	Q38 Comment on paragraph 25
Answer	
	Q39 Comment on paragraph 26
Answer	
	Q40 Comment on section 3.2 Business objectives and strategies of the insurer
Answer	
	Q41 Comment on paragraph 27
Answer	
	Q42 Comment on section 3.3 The role of the Board
Answer	Climate-related risk is an important risk to be considered by insurers and their Boards as part of their governance and risk management responsibilities. In executing this responsibility, the Board should consider the threat to the insurer’s own business risks, the fair treatment of customers and the duty of the insurer to conduct its business in a socially responsible manner.
	Q43 Comment on paragraph 28
Answer	
	Q44 Comment on paragraph 29
Answer	
	Q45 Comment on paragraph 30
Answer	
	Q46 Comment on section 3.4 Duties of Senior Management
Answer	
	Q47 Comment on paragraph 31
Answer	Senior management’s actions will be important to ensuring there is real action and progress as opposed to ignoring the issue or greenwashing. The IAA suggests making the wording in this paragraph stronger.
	Q48 Comment on section 3.5 Duties related to remuneration
Answer	
	Q49 Comment on paragraph 32
Answer	
	Q50 Comment on paragraph 33
Answer	

	Q51 Comment on section 4 Risk Management and Internal Controls
Answer	The IAA strongly supports the inclusion of climate risks as part of risk management and internal control systems. The examples and guidelines given in section 4 are very useful. They are given in a way that is suitable for different companies, both with respect of scale and type of business.
	Q52 Comment on paragraph 34
Answer	Signpost Box 2 “in paragraph 51"
	Q53 Comment on paragraph 35
Answer	As many insurers throughout the world are impacted by climate change, the IAA believes there is merit in developing basic principles for appropriate techniques and tools for gathering and analyzing relevant data. Thus, insurers would consider their exposure on their own, but in recognition of supervisory expectations as devised by IAIS. The expectations for insurers to “fully integrate" climate risks into the overall governance framework needs to retain the concept of proportionality. This could be done by changing the word “fully" to “appropriately", and to add “as appropriate" to the last sentence.
	Q54 Comment on section 4.1 Integrating climate-related risks into the scope of the risk management system
Answer	
	Q55 Comment on paragraph 36
Answer	It could be said that “Climate risks … can affect the valuation of various insurer assets and liabilities to a significant degree", but the current wording is not true to the extent implied for every insurer. Besides the effects on assets and liabilities, climate-related risks might affect the correlation between different risks which can lead to gaps between the actual risk exposure and the expected one.
	Q56 Comment on paragraph 37
Answer	The requirement in the last sentence to “consider and document … how climate-related risks could materialise…" (emphasis added) may be overly broad and should allow for materiality. The IAA suggests that this is changed to “…. could materialise and have a material impact in any area covered by the risk management system, in particular …" .
	Q57 Comment on paragraph 38
Answer	Further to the comments on Q53, because of the difficulty in gathering a large enough data set, regional collaboration of insurers might be considered. In addition, as this document refers to both insurers and reinsurers (paragraph 9), it may also be helpful for reinsurers to make regional data available to insurers in the same region.
	Q58 Comment on paragraph 39
Answer	
	Q59 Comment on section 4.2 Consideration of climate-related risks by the Control Functions
Answer	

Q60 Comment on paragraph 40

Answer

Q61 Comment on paragraph 41

Answer

This paragraph gives wide responsibility to the risk management control function for “the following risk management areas may be particularly affected by climate-related risks: asset-liability management (ALM), investment risk management, underwriting and reserving, reinsurance and other risk-mitigating techniques" etc. Typically, the Actuarial Function (AF) is heavily, or primarily, involved with many of these yet no mention is made of the AF role. It is equally important (if not more so) that the actuarial function is adequately resourced.

Q62 Comment on paragraph 42

Answer

Q63 Comment on paragraph 43

Answer

This paragraph goes straight to examples without covering the process that is needed. The IAA believes there is a need to indicate a process that starts with existing risk management in the investment area and then considers how that should be modified to recognize climate risks - for example trends in carbon intensity of key portfolios, what percentage of the portfolio has an intensity exceeding x.

Q64 Comment on paragraph 44

Answer

The IAA suggests replacing the final seven words with “climate change that the insurer is obliged or committed to respect". In other words, drop reference to ESG principles, which are undefined and go beyond the scope of climate-related risks.

Q65 Comment on paragraph 45

Answer

This paragraph provides a very narrow view of the role of the Actuarial Function (AF) and does not mention their involvement in ALM, pricing, underwriting, stress and scenario testing, risk mitigation etc. The work, reports, analysis etc., of the AF with respect to climate risk can be most useful in informing the supervisor with respect to these risks. The wording appears to downplay the value that a supervisor can derive from the AF.

The IAA also notes that financial instruments valued on the basis of market value generally would not require actuarial involvement in their valuation.

Q66 Comment on paragraph 46

Answer

The IAA believes that the Actuarial Function should be involved in the review of climate risk scenarios that are part of the ORSA-process. By use of both internal and external data the Actuarial Function may give valuable support to the building of realistic models showing the variability in expected results for the next years. This will be a valuable input in capital stress scenarios. The IAA suggests adding in capital requirements – i.e., “… calibration of premiums, reserves and risk-based capital requirements… “

This para refers to data quality and completeness. The IAA points out that traditional criteria to assess data quality will not be sufficient when dealing with climate change related risks. Climate change related information is subject to higher uncertainties than usual. There might be no full agreement in the scientific community on past or future developments. Whether or not there is agreement, the Actuarial Function should be involved in the development of future scenarios – either globally or locally.

The last section of this paragraph refers to “fast-evolving risks". This is not the right term to use in relation to climate-related risks. Instead, the focus should be on avoiding the use of overly long data sets that do not incorporate the change in climate over time. (For example, using a 20-year history of past wildfires would lag in its reflection of current risks due to a changing climate).

Q67 Comment on paragraph 47

Answer

Q68 Comment on section 4.3 Fitness and propriety of Control Functions on climate-related issues

Answer

Q69 Comment on paragraph 48

Answer

Q70 Comment on paragraph 49

Answer

Q71 Comment on paragraph 50

Answer

In some countries it may be difficult to find a person with appropriate skills and knowledge in climate risks as described. So, it may be appropriate for the CRO or other person in an insurer takes responsible for this and a plan is developed to obtain training and support so that their experience builds over time.

Q72 Comment on section 4.4 Integrating climate-related risks in outsourcing decisions

Answer

Q73 Comment on paragraph 51

Answer

This paragraph seems to focus on the continuity of business functions due to outsourcing whereas the examples in Box 2 (e.g., BaFin and PRA) appear to focus on the more important issue that insurers cannot outsource their ultimate responsibility for understanding the risks (e.g., climate risks) they undertake. The IAA suggests that para 51 be re-written, or an additional paragraph be added that fits with the Box 2 examples.

Q74 Comment on section 5 Enterprise Risk Management for Solvency Purposes

Answer

Q75 Comment on paragraph 52

Answer

Q76 Comment on section 5.1 Underwriting policy

Answer

Q77 Comment on paragraph 53

Answer

Q78 Comment on section 5.1.1 Consideration of climate-related risks in the underwriting policy

Answer

Q79 Comment on paragraph 54

Answer

The proposed absolute requirement for insurers “to incorporate the consideration of climate-related risks in the underwriting policy" is overly broad. This requirement should be applied “as appropriate given the exposure of their individual products to those risks".

Q80 Comment on section 5.1.2 Consideration of climate-related risks in the underwriting assessment

Answer

Q81 Comment on paragraph 55

Answer

The IAA suggests the word “thorough" may be inappropriate, given the uncertainty involved in current models for some perils (such as wildfire and tornado/hail models). To date, the tail values for those models may not be viewed as sufficiently reliable for the “thorough understanding" being suggested. Perhaps this could be reworded as “Insurers strive to understand the potential losses …"

Q82 Comment on paragraph 56

Answer

Given the early stage of development of firms’ management of climate-related risks, the IAA suggests changing the requirement to examine an insurer’s “track record" with “evidence" instead.

Footnote 17 mentions the adherence to relevant environmental certification standards as a potential underwriting condition – which presumably envisages application to some specific risks. However, this wording may be an over-generalisation. For example, an organic farmer’s risk exposure to hailstorms is not different from that of a traditional farmer.

Q83 Comment on paragraph 57

Answer

This paragraph should be linked to paragraph 73 with regard to reliance on the use of external ratings.

Q84 Comment on section 5.1.3 Monitoring of underwriting exposure to climate-related risks

Answer

Q85 Comment on paragraph 58

Answer

Q86 Comment on paragraph 59

Answer

Q87 Comment on section 5.2 Own Risk and Solvency Assessment (ORSA)

Answer

The IAA supports the consideration of climate-related risks in the ORSA-process. The ORSA-process is owned by the Board and the ORSA-report is useful in supervisory work.

Q88 Comment on paragraph 60

Answer	As noted in the IAA response to Q19, climate risk is not likely to materially affect the existing liquidity risk sufficiently to warrant it being called out specifically in this context.

	Q89 Comment on paragraph 61
Answer	The IAA recognizes that the time horizon issues presented in this paragraph require further elaboration. This issue was also previously identified in the November 2019 FSI report “Turning Up the Heat". The IAA is currently working to develop further educational material on this topic.

	Q90 Comment on section 5.2.1 Stress and scenario testing of climate-related risks
Answer	The examples given in this section are illustrative and useful. This could be used as background for the supervisor’s expectation of insurers’ ORSA-reports. As climate risk will affect both the liability and asset sides of the balance sheet, this section could be split out as a separate chapter. This could be a new chapter 7, after the description of underwriting and investment risks. For entities regulated by Solvency II, the ORSA process and report has become a very important part of the insurers work in describing the risk situation. The capital situation is shown under different stress scenarios giving the Board valuable insight.

	Q91 Comment on paragraph 62
Answer	

	Q92 Comment on paragraph 63
Answer	

	Q93 Comment on paragraph 64
Answer	The IAA has some concern with the proposal in this paragraph, as it is not proportionate to have a requirement to “clearly document" all immaterial risks. Any such requirement should consider the principle of proportionality with regard to what constitutes “clear documentation".

	Q94 Comment on section 6 Investments
Answer	

	Q95 Comment on paragraph 65
Answer	

	Q96 Comment on paragraph 66
Answer	

	Q97 Comment on paragraph 67
Answer	With regard to the mention of “liquidity risk … as a result of a sudden increase in claims as a result of a natural catastrophe" the IAA notes that a sudden increase in claims is not the same as a sudden increase in cash outflow, although this viewpoint depends on how “sudden" is defined. In general, the larger the catastrophe the slower the cash payout, so for large events the relevant outflow occurs over many quarters or even years. As noted in the IAA response to Q19, climate risk is not likely to materially affect the existing liquidity risk sufficiently to warrant it being called out specifically in this context.

Q98 Comment on paragraph 68

Answer

The last part of this paragraph says that it is "… always prudentially relevant to enquire … " about the impact of climate change on an insurer's investments. This statement needs some qualification. For example, an investment portfolio of only investment grade bonds of short duration is highly unlikely to be materially impacted by climate change. The IAA suggests instead guiding supervisors as to what would make such an impact most likely, and therefore most relevant to their oversight and review. (This is likely to be largely a function of the duration of such investments and their concentration in certain industry sectors.)

Q99 Comment on section 6.1 Asset liability management

Answer

Q100 Comment on paragraph 69

Answer

Q101 Comment on paragraph 70

Answer

The statement that "many insurers use longer-term bonds to match the liability cash flows" is overly broad as it lacks context. It is probably true for insurers of long duration products, but likely to be far less true for non-life insurers with an ALM policy that tries to match asset and liability portfolio durations.

The comment on correlation could be expanded. For example, the correlation between different asset classes is important but there is also a correlation between asset and liabilities when holding both a bond of an enterprise and insuring that enterprise for climate risks.

Q102 Comment on paragraph 71

Answer

There is a minor typo in the first sentence – this should be "… insurers' investment portfolios…"

Q103 Comment on section 6.2 Risk assessment of investments

Answer

Q104 Comment on paragraph 72

Answer

Q105 Comment on paragraph 73

Answer

Q106 Comment on section 6.3 Stewardship

Answer

Q107 Comment on paragraph 74

Answer

Q108 Comment on paragraph 75

Answer

Q109 Comment on paragraph 76

Answer

Q110 Comment on section 7 Public Disclosure

Answer

The introductory paragraph for this section acknowledges concerns with confidentiality and proprietary information, yet many of the following paragraphs suggest disclosures inconsistent with those concerns (e.g., in paragraph 85, which includes disclosure of climate-related products under development). The IAA suggests that the rest of this section needs to be reviewed to be more consistent with the concerns raised in the introductory paragraph.

This section also appears to be very prescriptive, with little mention of proportionality.

Public disclosure of climate risk is important. The examples given from other stakeholders are relevant and must be aligned with local requirements. It is important that the insurance sector manages to describe climate risks in a meaningful and similar manner to its customers and other stakeholders.

Q111 Comment on paragraph 77

Answer

Q112 Comment on paragraph 78

Answer

Q113 Comment on paragraph 79

Answer

Q114 Comment on paragraph 80

Answer

Q115 Comment on paragraph 81

Answer

Q116 Comment on section 7.1 General disclosure requirements

Answer

Q117 Comment on paragraph 82

Answer

Q118 Comment on paragraph 83

Answer

Q119 Comment on section 7.2 Company profile

Answer

Q120 Comment on paragraph 84

Answer

Q121 Comment on paragraph 85

Answer	
	Q122 Comment on paragraph 86
Answer	
	Q123 Comment on section 7.3 Corporate governance framework
Answer	
	Q124 Comment on paragraph 87
Answer	
	Q125 Comment on section 7.4 Insurance risk exposures
Answer	
	Q126 Comment on paragraph 88
Answer	Much of this paragraph is very prescriptive, and overly detailed for public disclosure of topics that in some cases are proprietary.
	Q127 Comment on section 7.5 Financial investments and other investments
Answer	
	Q128 Comment on paragraph 89
Answer	
	Q129 Comment on paragraph 90
Answer	Beyond requiring insurance companies to comply with rules, supervisors can also reward and incentivise companies that do more than basic compliance. For example, if companies invest in "green bonds" and such investments have lower physical risk or transition risk, the investment risk charges could be lowered under the capital framework. The IAIS (or SIF) is well-placed to explore the potential for this approach in more depth.