

Public Consultation on climate risk supervisory guidance – part one

Survey response 1

Information

Please provide your information:
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Do you agree with your responses being made public on the IAIS website?
Yes

Do you have any comments on the proposed text referencing climate-related risk within the ICP Introduction?
<p>The International Actuarial Association (IAA) notes the change to the title of this section, and given the relatively short discussion on risks, think that a better title might be “Proportionality and risk considerations”.</p> <p>The IAA believes the new wording could be expanded to make the distinction between different types of emerging risk. Some such risks may be risks that are gaining prominence, but when they crystallise, are not enduring - an example may be cyber risk which has come to the fore recently and has become a more significant peril. However, climate risk has different characteristics - it is long term in nature and is not so easy to mitigate, particularly as many of the mitigating actions will take years to have any effect. Consequently, the impact on insurers is different for these different types of emerging risks.</p> <p>The IAA also notes that there is a different onus on supervisors for those risks which are systemic and those which are not. Systemic risks are primarily the focus for supervisors while non-systemic risks are primarily the focus of insurers, with supervisors more concerned that insurers are properly managing those risks.</p> <p>We note that there may be a tension between the insurance system’s use of risk-based pricing and the affordability of insurance for at risk policyholders. While accurate risk assessment provides economic signals to promote investment in resilience activities, the potential effect of risk assessment on all stakeholders should be considered.</p> <p>In paragraph 12 (redlined text on page 8 of the consultation document) we suggest that an example may help clarify the statement, such as by adding “Individual risks are often interconnected and may have an amplifying effect on other risks. This is the case, for example, with climate-related risks.”</p>
Do you have any comments on the location of the proposed text?
The IAA’s view is that this is a good place to include some overarching commentary of this nature.

The IAIS considers that the 2021 Application Paper material related to ICP 7 Corporate Governance and ICP 8 Risk Management and Internal Controls remain appropriate in the context of climate risk management. Are there any issues related to corporate governance and/or risk management and internal controls from a climate perspective that are not addressed in the 2021 Application Paper that would be helpful for the IAIS to develop?

The IAA notes that in ICP7 paragraph 7.10, the supervisor requires the insurer to ensure that Senior Management “... carries out the day-to-day operations of the insurer ...in line with the insurer’s long-term interests and viability”. However, the Board is to be provided with “adequate and timely information ... including the monitoring and review of the performance and risk exposures of the insurer”. Given the nature of climate risks, the IAA believes it could be made clearer that consideration needs to be given to the future risk position of the insurer through forward-looking assessments. Whilst this is noted in the Application Paper on the Supervision of Climate-related Risks in the Insurance Sector (2021 Application Paper), the IAA believes this should be made clearer in ICP7. Similar comments apply to the reporting on key risks by the risk management function outlined in ICP 8.4.

The 2021 Application Paper also includes a number of useful examples of supervisory practice. However, it is not surprising that supervisory practice has continued to develop in this area and the IAA believes that it would be particularly helpful to update a number of these examples, and/or add in additional examples of current practice.

One omission in relation to ICP 8 is an explicit mention of double materiality. External impacts from insurance activities (e.g., financing/insuring carbon-intensive activities) can quickly come back as risks for insurers:

- For an individual company (micro-prudential consideration) e.g., reputation & litigation risk.
 - For the financial system’s stability (macro-prudential consideration) e.g., a 4-degree world will not be insurable.
- Double materiality is now integrated in an increasing number of legal and regulatory frameworks, e.g., EU, Switzerland, and the IAA believes this should be included in ICP 8.

Do you have suggestions on issues or themes to explore in the forthcoming consultations to improve the usability of the climate risk related Application Papers?

The IAA believes that it would be helpful for there to be specific guidance on asset valuation (particularly during transition) and asset rating giving the need for insurers to match investments to policyholders' requirements in terms of “green” ratings.

The IAIS has indicated that there will be a further paper on the design and use of scenario analysis. It will be helpful if this includes guidance on how scenarios, such as those produced by NGFS, can be adapted for use by smaller jurisdictions.

Another general observation is that it might be helpful to define the terms “mitigate” or “mitigation” which could cause some confusion given the IPCC definition refers to GHG reduction as “mitigation” and efforts to adapt to climate change as “adaptation”.

Similarly, the term “climate risk” could be defined as it can be construed to mean only physical risk or a broader concept including transition and litigation issues.

Should the IAIS’ work and upcoming consultations on climate risk also cover considerations related to transition planning by insurers?

The IAA believes that transition planning should be covered in the IAIS’ work and consultations as there are different considerations that come to bear for insurers to deal with in transition planning than the longer term management of climate risk. The IAA believes that transition risk should be given at least equal weight with physical risk in regulatory thinking as transition issues are far more important and near term to most insurers (e.g., reducing investment risk in emissions intensive activities, investment on transition financing, underwriting strategies on potentially stranded assets, employment shifts as decarbonization occurs, insuring electric vehicles, etc.). The IAIS should be emphasizing the need for proper transition planning by insurance enterprises.

Many people who work on “climate risk” immediately jump to physical risk from extreme weather as the key issue (and it is critical, particularly for affordability and protection gaps) but from an insurer (and regulatory) risk management standpoint it often turns out that the transition and litigation risks are the more pressing.

Do you see anything missing from the current IAIS workplan on climate risk, as outlined in the IAIS 2023-2024 Roadmap [<https://www.iaisweb.org/uploads/2023/01/iais-roadmap-2023-2024.pdf>]?

The IAA believes that the Roadmap could be expanded in two key areas in HLG3:

- Climate-related risk: whilst the Roadmap has actions related to climate-related risk, there is no mention of the work being undertaken by the ISSB which is considering climate-related risk as part of its wider sustainability work. In addition, the TNFD has recently published its final beta framework for nature-related risk management and disclosure. The IAA believes there would be merit in the IAIS bearing this work in mind in its review of the ICPs and related guidance given the inter-connection between climate-related risk and sustainability more generally. In a similar way, the IAA has started work on a new International Standard of Actuarial Practice (ISAP 8) for actuaries providing actuarial services in connection with IFRS S2- Climate Related Disclosures, which is taking the approach of taking into account the wider sustainability disclosures which are being developed.
- Insurance protection gaps: the focus currently is on NatCat and disaster risk protection. Whilst the IAA does not currently know the details of the scope of this work, the IAA believes there would be merit in further work being undertaken on the role of supervisors in participating in initiatives to minimise protection gaps more generally.