WEBINAR on Climate-related Risks in the Insurance Sector

9 June 2020, 13.00 – 14.30 CEST

The International Association of Insurance Supervisors (IAIS) and the Sustainable Insurance Forum (SIF) welcome you to join their webinar supporting the development of an Application Paper on the Supervision of Climate-related Risks in the Insurance Sector.

This Application Paper aims to further support supervisors around the world in assessing and managing the impact of climate-related risks to the insurance sector, by describing how the IAIS Insurance Core Principles (ICPs) can be used to address risks associated with climate change. The focus is on supervisory review and reporting, corporate governance, risk management, investments, disclosures.

During the webinar, the IAIS and SIF will provide an update on the progress made in developing the Paper and, importantly, gather feedback from stakeholders on the proposed scope and outline. The draft Application Paper will be published for consultation later this year. To support the discussion, this document provides an outline of the draft Application Paper.

The event will be recorded and posted to the IAIS website afterwards.

AGENDA

Introductory remarks

- **Geoff Summerhayes**, SIF Chair, Member of the IAIS Executive Committee and Sustainability Champion. Executive Board Member at the Australian Prudential Regulation Authority (APRA)

Update on the development of the Application Paper

- **Peter Kohlhagen,** Co-chair of the SIF/IAIS drafting team and Member of the IAIS Policy Development Committee. General Manager, Advice & Approvals, APRA
- **Emmanuel Rocher**, Co-chair of the SIF/IAIS drafting team and Member of the IAIS Macroprudential Committee. Deputy Director, International Affairs, Autorité de contrôle prudentiel et de resolution (ACPR)

Closing remarks

- **Conor Donaldson**, Head of Implementation, IAIS

OUTLINE

To support the webinar, an outline of the Application Paper is shared below. It includes brief descriptions of the planned topics to be covered as well as issues for discussion on which stakeholder inputs are particularly welcomed.

Application Papers provide additional material related to IAIS supervisory material, including actual examples or case studies that help practical application of supervisory material. Application Papers can provide further advice, illustrations, recommendations or examples of good practice to supervisors on how supervisory material may be implemented.

Outline of the draft Application Paper on the Supervision of Climate-related Risks in the Insurance Sector

1. Introduction

Context and objective

Climate change, as well as the global response to the threats of climate change (eg the reduction of greenhouse gas emissions (GHG) and adaptability programs), may have wide-ranging impacts on the structure and function of the global economy and financial system. As such, climate change and climate-related risks are a source of financial risk which have an impact on the resilience of individual financial institutions, including insurers, as well as on financial stability.

It is thus within the mandate of insurance supervisors to assess, monitor and mitigate the impact of climate change on the insurance sector with the ultimate objective to protect policyholders and contribute to financial stability. The challenges related to climate change however do not only present risks, but also present opportunities for the insurance sector. Supervisors have a role to play in promoting resilience against climate risks and natural disasters.

This Application Paper will aim at supporting supervisors in their efforts to integrate a climate risk perspective into the supervision of the insurance sector. It will provide background and guidance on how the IAIS supervisory material can be used to face challenges and opportunities arising from climate-related risks. This Paper thereby also aims to promote a globally consistent approach to addressing climate-related risks in the supervision of the insurance sector.

Proportionality

Application Papers should be read in the context of the proportionality principle, as described in the Introduction to ICPs, which provides supervisors "the flexibility to tailor their implementation of supervisory requirements and their application of insurance supervision to achieve the outcomes stipulated in the Principle Statements and Standards". In particular, proportionality "allows the ICPs to be translated into a jurisdiction's resolution framework in a manner appropriate to its legal structure, market conditions and consumers; and allows the supervisor to increase or decrease the intensity of supervision according to the risks inherent to insurers, and the risks posed by insurers to policyholders, the insurance sector or the financial system as a whole."

Where appropriate, the forthcoming Paper will provide practical examples of the application of the proportionality principle.

Scope

Climate change may affect the supervision of insurers in many ways and therefore in theory this Application Paper could deal with a great number of ICPs. For the purpose of focusing the content of the Application Paper, the following topics are in scope:

- Supervisory review and reporting (ICP 9)
- Corporate governance (ICP 7)
- Risk Management (ICP 8 and 16)
- Investments (ICP 15)
- Disclosures (ICP 20).

The ICPs listed above all contain ComFrame standards (Common Framework for the Supervision of Internationally Active Insurance Groups), with the exception of ICP 20. ComFrame builds on, and expands upon, the high-level standards and guidance set out in the ICPs, which generally apply to the insurance sector as a whole, both on an legal entity and group-wide level, and both to primary insurers and reinsurers. The primary aim of the forthcoming Paper will be on providing guidance for supervisors in implementing the ICPs. However, as appropriate, specific considerations relevant to the supervision of reinsurers or IAIGs may be included in the Paper.

The SIF and IAIS recognise that several ICPs that are not in scope for this Paper, do have relevance for assessing and mitigating climate-related risks. These may be covered in future work. Topics that are of particular relevance, include:

- Macroprudential supervision (ICP 24)
- Valuation and Capital requirements (ICPs 14 and 17)
- Conduct of business (ICP 19)
- Issues around the protection gap.

Issues for Discussion

- **Proposed scope and outline of the Paper**
- **The impact of the disruption caused by Covid-19 on the focus and timing of this Paper**

2. Role of the supervisor

It is recommended for supervisors to assess the extent to which climate-related risks are likely to be material to insurers operating in their jurisdiction and to determine how these risks may be transmitted to their economies and financial sectors more broadly. Supervisors should identify how climate-related risks are relevant to their supervisory mandate, which includes the protection of policyholders and to contribute to financial stability, or may want to explicitly include sustainability into the supervisory mandate and/or objectives.

Preconditions and resources

An effective system of insurance supervision requires a number of preconditions to be in place, as they can have a direct impact on supervision in practice. Although beyond the influence of a supervisor, it can take them into account in the development of regulation and supervisory practices also as it relates to addressing climate-related risks.

It is also important to have sufficient resources to enable effective supervision of climate-related risks (see ICP 2 Supervisor).

Supervisory review and reporting

ICP 9 (Supervisory Review and Reporting) focuses on the general processes and procedures supervisors should have in place with respect to supervisory review and reporting and provides for a natural starting point for supervisors that want to integrate climate-related risks into their supervisory framework, in terms of:

- integrating climate risk into supervisory plans
- obtaining the necessary qualitative and quantitative information on climate-related risks
- methods for supervisory feedback and follow-up.

Issues for discussion

- **Incorporation of climate risks into supervisory plans**
- **How to best obtain information to form supervisory assessments**

3. Corporate governance

ICP 7 (Corporate Governance) sets expectations for insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognises and protects the interests of policyholders. An effective corporate governance framework enables an insurer to be flexible and transparent and to be responsive to developments affecting its operations. Climate change is an evolving risk area that is expected to be included in the corporate governance framework as well.

The Application Paper will discuss how climate-related risks can be integrated in the following important aspects of corporate governance:

- Appropriate allocation of oversight and management responsibilities
- Corporate culture, business objectives and strategies of the insurer
- The role of the Board
- Duties of Senior Management
- Remuneration policy.

Issues for discussion

- **Existing practice around the role of the Board and Senior Management in managing climate risks**
- **The role of the remuneration policy in providing incentives for appropriate management of climate risks**
- **The need for a supervisory requirement to nominate a responsible officer to be accountable for climate risk**

4. Risk management and internal controls

ICP 8 sets out supervisory expectations on how insurers establish effective systems of risk management and internal controls. ICP guidance 8.1.3 further specifies the scope of the risk management system: "The risk management system should cover at least the following risks: underwriting and reserving, asset-liability management, investments, liquidity, concentration, operational and conduct, as well as reinsurance and other risk mitigation techniques." As mentioned above, climate-related risks may translate into prudential risks to insurers and thus should be integrated into an insurer's risk management and internal control system as well.

Thereby, this section will provide background and examples of good practice on:

- Integrating climate-related risks into the scope of the risk management system
- Consideration of climate-related risks by the control functions (risk management, compliance, actuarial and internal audit function)
- Fitness and propriety of control functions on climate-related issues
- Integrating climate-related risks in the outsourcing decisions.

Issues for discussion

- **Existing practice around the role of the control functions, including on the need to build sufficient expertise**
- **The role of supervisors to promote the integration of climate change into the risk management system**

5. Enterprise Risk Management for solvency purposes

ICP 16 (Enterprise Risk Management for Solvency Purposes) sets out supervisory expectations on how insurers coordinate their risk management, strategic planning and capital management processes. This section will discuss how climate-related risks can be integrated in an insurer's underwriting policy and underwriting processes, as well as in the ORSA process. In relation to the ORSA, the focus will be on tools like stress testing and scenario analysis.

Issues for discussion

- **The extent to which climate risk is already incorporated in the ORSA and/or stress and scenario analysis, as well as capital / strategic planning**
- **Good practice around setting scenarios, including defining appropriate time horizons**

6. Investments

Physical and, especially, transition risks can have an impact on insurers' investments. These climate change risks may have a range of complex and non-linear impacts on financial markets and therefore insurers and supervisors need to understand them. This applies regardless of whether the insurer invests directly or uses a third-part investment advisor.

This section will cover an insurer's investment policy and strategies as well as asset-liability management (ALM).

Issues for discussion

- **The impact of climate risk on an effective ALM**
- **The need to attain relevant information for making investment decisions, including the reliance on external ratings or other information sources**
- **Expectations around stewardship**

7. Public disclosure

This section of the Paper will build on the IAIS / SIF Issues Paper on the Implementation of the Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), which was published earlier this year. Whereas the Issues Paper focused on how supervisors may encourage the implementation of the TCFD Framework, which is voluntary in nature, the Application Paper will describe good practices around implementation of ICP 20 (Public Disclosure). This includes public disclosures on how climate change may be material to an insurer's business.

Issues for discussion

- **Whether or not to transition towards a mandatory framework for disclosures**
- **Current challenges in implementing climate-related disclosures (and how to overcome these)**
- **The existence (or lack) of consistent taxonomies and scenarios to support public disclosure**