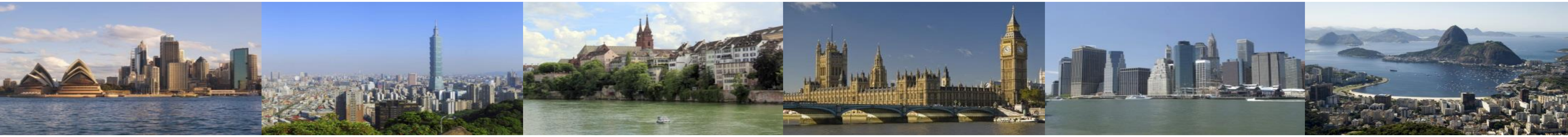
Public Background Session on Draft Application Paper on the Supervision of Climate-Related Risks in the Insurance Sector

26 October 2020, 12.30 – 14.00 CET



Agenda

Introductory remarks

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

Background on 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), France

Closing remarks

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

Introductory Remarks

Geoff Summerhayes

Background on the Paper

Peter Kohlhagen & Emmanuel Rocher

Introduction to the SIF

Network of insurance supervisors

- **What is it?**
  - Global network of insurance supervisors and regulators working together to strengthen responses to sustainability challenges facing the insurance sector
- **What does it do?**
  - Platform for international collaboration among supervisors, facilitating knowledge sharing, dialogue, and uptake of policy innovation
  - Convenes supervisors, makes consensus statements on sustainability optics, expert input on sustainability topics, produces research outputs
- **How does it work?**
  - Convened by UN Environment’s division working on policy and regulatory aspects of sustainable finance (following from Inquiry Project 2015-2018)
- **Who are its members?**
  - The SIF has 30 jurisdictions from all over the world as members

Introduction to the IAIS

- Voluntary membership organisation of insurance supervisors and regulators established in 1994

- It is the international standard-setting body responsible for developing and assisting in the implementation of principles, standards and other supporting material for the supervision of the insurance sector

- The IAIS has more than 200 Members from 130+ jurisdictions

- Mission:
  - Promote **effective and globally consistent** supervision of the insurance industry in order to **develop and maintain** fair, safe and stable insurance markets **for the benefit and protection of policyholders**; and to
  - Contribute to **global financial stability**

IAIS Application Papers

- As a standard setting body, the IAIS develops supervisory material and supporting material

- Supervisory material include:
  - Insurance Core Principles (ICPs), which apply to insurance supervision in all jurisdictions and to all insurers
  - ComFrame, which focuses on the group-wide supervision of Internationally Active Insurance Groups (IAIGs) only

- Supporting material include:
  - Application Papers
  - Issues Papers
  - These supporting materials do not create new standards

- Role of the proportionality principle

Draft Application Paper on Climate-related Risks

Development process

- Joint development by SIF and IAIS

- Building on previous joint publications:
  - 2018: Issues Paper on Climate Change Risks to the Insurance Sector
  - 2020: Issues Paper on the Implementation of the TCFD Recommendations

- Incorporating good practices from SIF / IAIS members

- June 2020: stakeholder webinar to gather feedback on the proposed scope and outline of the Paper (link)

Draft Application Paper on Climate-related Risks

Scope and objective

The draft Application Paper provides background and guidance on how the IAIS supervisory material can be used by supervisors to manage the challenges and opportunities arising from climate-related risks. The focus is on the IAIS ICPs.

Scope:

- Supervisory review and reporting (ICP 9)
- Corporate governance (ICP 7)
- Risk Management and internal controls (ICP 8)
- Enterprise risk management for solvency purposes (ICP 16)
- Investments (ICP 15)
- Disclosures (ICP 20)

➢ The recommendations for each section are discussed on the following slides

➢ Next to that, most sections in the Paper include a Box with examples of supervisory practice

Draft Application Paper on Climate-related Risks

Climate-related risks for insurance

- Insurers may be impacted by climate change, as well as by the global response to the threats posed by climate change, in the following ways:

Risk	Definition	Examples
Physical risk	Risk arising from increased damage and losses from physical phenomena associated with both climate-related trends and events.	• Severe weather events could lead to operational risk, for instance if it affects the premises of outsourced business functions • Sea level rise (flood risk) may lead to damage to collateral, such as real estate, • Sudden unexpected increase in claims as a result of a natural catastrophe or pandemic
Transition risk	Risk arising from disruptions and shifts associated with the transition to a low-carbon economy, which may affect the value of assets or the costs of doing business.	• Exposures to more carbon intensive sectors may lead to market risk due to a change in the value, trend, or volatility • Loans or mortgages related to commercial real estate with low energy performance labels may lead to increased counterparty default risk
Liability risk	The risk of climate-related claims under liability policies, as well as direct actions against insurers, for failing to manage climate risks.	• Certain non-life policies may face increased liability risks as a result of evolving legal approaches and increased litigation linked to climate-related risks

QUESTIONS

Supervisory review and reporting (ICP 9)

- Supervisors should:
  - Assess the materiality of climate-related risks to insurers operating in their jurisdiction; and how these risks may be transmitted to their economies and financial sectors more broadly
  - Identify how climate-related risks are relevant to their supervisory objectives
  - Collect qualitative and quantitative information from insurers on climate risk exposures and management
    - The Paper provides concrete examples of qualitative and quantitative indicators that can help support the supervisory assessment.

- As it relates to the supervision of insurance groups, information sharing and cooperation with other involved supervisors on climate-related risks is crucial (also to promote a consistent approach)

- Two-way communication between the supervisor and the supervised entities is essential, for instance by setting up a supervisor-industry platform

Corporate governance (ICP 7)

- Roles and responsibilities of the Board, Senior Management and Control Functions should continue to adapt to emerging(ed) risks like climate change:
  - Role of the Board to maintain effective oversight of climate-related risk management, including incorporating climate-related considerations into the insurer’s risk appetite, strategies and business plans
  - Senior Management and Control Functions to establish relevant tools, models and metrics to monitor exposures to climate-related risks provide advice on the management of risks

- Remuneration policy can be used as an incentive to integrate climate-related risks in the risk management framework.

Risk management and internal controls (ICP 8)

- When addressing climate-related risks, it is expected that insurers fully integrate these risks into the systems of risk management and internal controls
  - Importance of having sufficient resources and expertise on climate-related risks, for instance within the Control Functions.

- Given the potential impact of climate-related risks on an insurer’s solvency position, it would be expected that they are considered within the existing categories of risks and lead to a review of the risk management framework in case of material change in these risks.
  - in particular in the investment and underwriting policies

- Importance of consideration to potential physical risks impacting any outsourced material activities
  - For example, risk of severe weather events to affect the premises of outsourced business functions.

ERM for solvency purposes (ICP 16)

- When material, supervisors should expect insurers to identify the relevant physical, transition and liability risks and develop policies and procedures to integrate the management of these risks as part of their enterprise risk management (ERM) framework.

- Climate-related risks should be integrated in ERM tools, including:
  - Risk appetite statement (RAS)
  - Underwriting policies
  - Own Risk and Solvency Assessment (ORSA)
  - Scenario analysis and stress testing

- Finally, insurers should adopt the appropriate risk management actions to mitigate the identified risks accordingly.

Investments (ICP 15)

- Physical and, especially, transition risks can have complex and non-linear impacts on insurers' investments. These risks must be taken into account regardless of whether the insurer invests directly or through a third-party asset manager or investment advisor.

- Insurers should also consider the impact of climate change on their asset and liability management.

- To properly assess the risks in the investment portfolio, insurers may use forward-looking scenario analysis:
  - Different time horizons: impacts may only fully materialise over an extended period, but transition risks may also lead to a sudden price shock
  - Such analysis may help overcome potential limitations of using only historical and market data

Public disclosure (ICP 20)

- Public disclosures by insurers on emerging(ed) risks, including climate change, are of primary relevance to enhance market discipline

- When material, information on climate-related risks and the management thereof must be disclosed. The level and type of information disclosed may depend on the line of business.

- When considering mandatory climate risk disclosure requirements, a range of approach may be taken. For example:
  - Supervisors may use the Financial Stability Board (FSB) TCFD Framework when designing best practises or as input for setting their own supervisory requirements
  - Insurers could be allowed to meet any standards through public general-purpose financial reports

QUESTIONS

CLOSING REMARKS

Conor Donaldson

Next steps

- The draft Application Paper was issued for public consultation on 13 October with the **comment period** ending on **12 January 2021 24:00 CET**.

- All comments provided via the [IAIS consultation tool] will be considered and could result in revisions to the Application Paper.

- The final Paper will be published along with a Resolution of Comments document.

Save the date:

- **4 December**: Panel on Embedding Climate Risk Management in the Insurance Sector, as part of the IAIS virtual Annual Conference