29 July 2022

Emmanuel Faber
Chair, International Sustainability Standards Board

[Transmitted via e-mail]

ISSB exposure draft on climate disclosure

Dear Mr Faber,

Please find attached the response from the International Association of Insurance Supervisors (IAIS) to your consultation on the IFRS S2 exposure draft.

The IAIS is the global standard-setting body responsible for developing and assisting in the implementation of principles, standards and guidance for the supervision of the insurance sector. The IAIS mission is to 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.

The IAIS welcomed the creation of the ISSB and is pleased to comment on the S2 exposure draft. The IAIS is an advocate for effective climate-related financial disclosures. As a member of the Financial Stability Board, we supported the creation of the Task Force on Climate-related Financial Disclosures (TCFD) and welcome the fact that S2 builds on the TCFD work. A globally consistent baseline climate reporting standard is important for insurers; both as users and preparers of climate-related disclosures. The IAIS sees the value of the proposed creation of a Sustainability Standards Advisory Forum, and a working group to consider the compatibility of the ISSB's standards with other standard-setting activity (eg US SEC and EFRAG) in the climate-related reporting and disclosures space. Bringing about greater alignment will significantly reduce the burden on preparers and make disclosures more comparable.

Subject to our comments set out in this response, we are in favour of timely implementation of the new standard as we see there is a pressing need to improve public disclosure of climate risk. In the event of a delay in the implementation of S1, we propose a climate first approach whereby S1 is implemented only in relation to climate together with S2. We aim for insurers to continue to improve the level and quality of disclosure in the clear direction as set by IFRS S2, in the meantime. We do however ask the ISSB to consider the specific characteristics of the insurance industry as investors and underwriters of other industries, as we feel this can be better reflected in the standard. Additionally, increased disclosure by companies in which insurers invest and underwrite will be necessary to support insurers in utilising and making public disclosures of sufficient quality and detail.

Climate risk is a strategic theme for the IAIS. We are undertaking considerable work to assess and address climate-related risks to the insurance sector, consistent with our mission of policyholder protection and contributing to the maintenance of global financial stability. The IAIS will continue to closely monitor progress made by the ISSB and will review the IAIS' own standards for supervisory disclosure requirements to assess whether there are any additional revisions needed to the IAIS materials. In terms of supervisory reporting, the IAIS is gathering climate related data as part of our annual Global Monitoring Exercise, which assesses risks in the global insurance sector. The ISSB disclosures are relevant here in that they may provide additional information in the public domain to assess these risks.

Yours sincerely,

Victoria Saporta

Chair, IAIS Executive Committee

Question 1: Objective of the Exposure Draft

Given the urgency of assessing and addressing climate change, the IAIS welcomes the objective of IFRS S2 (IFRS S2 Climate-related Disclosures) to disclose information about an entity's exposure to climate-related risks and opportunities to enable users of the entity's general purpose financial statements to assess these risks and opportunities to the entity's enterprise value. The IAIS also welcomes the ISSB approach to require such disclosures by entities that prepare general purpose financial statements, as described in IFRS S1 (General Requirements for Disclosure of Sustainability-related Financial Information).

The IAIS strongly supports the disclosure of risks and opportunities from climate change on both the asset and liability side of insurers' balance sheets. However, we note that this may present some challenges for insurers, at least in a transitional phase when the quality and reliability of the disclosures across industries will still be evolving. An insurer (both as investor and as underwriter) will have to obtain information from other companies in order to disclose information on the climate-related risks and opportunities of the insurer across its value chain. Therefore, the IAIS stresses the importance of global assurance standards developed by international assurance standard setters to drive reliability of disclosures across industries. Assurance standard setters will need clear requirements relating to the applied metric, methodology and procedures applied within the ISSB standards to ensure there is reliability, quality and comparability with disclosures across insurers. The reliability of these disclosures is a key aspect to support an effective prudential framework. Insurers should be in a position to rely on publicly disclosed climate information by the companies in which they invest and underwrite without the need for their own additional verification.

Question 2: Governance

The IAIS agrees on the importance of disclosures on the governance of climate-related risks and opportunities as an essential tool for users of general purpose financial reporting to assess the impact of these risks and opportunities. The IAIS also encourages the integration of climate-related risks into other aspects of an entity's governance. The IAIS Insurance Core Principles (ICPs) require insurers to have a risk management system to identify, assess, monitor, mitigate and report all risks of the insurer in a timely manner, which includes material climate-related risks. When addressing climate-related risks, it is expected that insurers integrate these risks into the overall corporate governance framework, which includes the systems of risk management and internal controls.

The IAIS emphasises that disclosures regarding the governance of setting climate-related targets and monitoring progress towards them is essential. As the climate disclosure landscape is characterised by many different metrics and methodologies still under development, the application – and hence disclosures – of these metrics might vary for future reference periods compared to current ones. Robust requirements are therefore imperative.

On a specific point, the IAIS requests the ISSB to clarify how the requirements of paragraph 5(b) to (g) are applicable to an individual that is responsible for oversight of climate-related risks and opportunities as per paragraph 5(a).

Question 3: Identification of climate-related risks and opportunities

The IAIS agrees that the appropriate identification of climate-related risks and opportunities is a key element in understanding how an entity's future value is affected. Disclosures on the process of identification of risks and opportunities should provide users (including supervisors) with a clear understanding of how an entity manages these risks and opportunities.

Paragraph 2 of IFRS S2 refers to the general principles in IFRS S1. IFRS S1 paragraph 51, read in conjunction with paragraph 19 of the same standard, could be interpreted to mean that if material information exists on a climate-related risk or opportunity, then this risk or opportunity should be identified and disclosed regardless of whether it is significant or not. However, this could also be interpreted by some entities to mean that only material risks and opportunities should be disclosed, resulting in variability in disclosure outcomes. Paragraph 51 could be redrafted to make these points clearer.

The exposure draft proposes in S2 paragraph 8 (a) that firms only disclose those risks and opportunities that are both significant and reasonably expected to affect the entity "over time". It would be helpful if ISSB could clarify its expectations here. The standard is unclear on the boundaries of significance or reasonable expectations. Climate risks and opportunities potentially develop gradually over time, while significance or reasonable expectations of impact on the organisation are changing from reporting period to reporting period. The IAIS is of the view that useful information would be provided to the users of the climate related disclosures if entities provide insight into the development of these risks and opportunities over time.

Within financial reporting, practical yardsticks are available to guide decisions on recognition, materiality and therefore the effect transactions and events have on the reporting, thus guiding required disclosures. It would be important to align climate-related risk disclosures with financial reporting concepts. Probable (more likely than not) climate risks could be "recognised" and, accordingly, reflected in individual assets or liabilities on the balance sheet and related disclosures. Consistent with the IFRS S1 disclosures, possible climate-related risks should be disclosed to the extent that the impact they have on the enterprise value is material. The IAIS sees benefits in particular for insurers in the requirements set out in S2 para 8 on the disclosure of the extent to which an entity's strategy is resilient to climate risk.

IFRS S2 requires insurers to identify the significant climate-related risks and opportunities using B17 "insurance industry" disclosure requirements of Appendix B. The IAIS supports the decision of the ISSB to integrate the SASB Standards into its body of work. The IAIS welcomes the IFRS' continued additional work to ensure these industry-based standards meet the reporting objectives of the ISSB standard. However, there are a number of references to non-climate disclosures which at this stage should not be included given the climate first approach being pursued by ISSB. For instance, in the metrics section in B17 there is a reference to disclosing "ESG" factors and later in the chapter there are references to disclosures on "human capital risk" and "cybersecurity risks". Other references to requirements that are not applicable in all jurisdictions/regions are also in B17 but should not be included.

The IAIS understands that both IFRS S2 and B17 are based on materiality (which is a common approach for disclosure standards) and that B17 provides suggested disclosures where climate is considered to be material. Given the focus on materiality, if investee companies and clients of insurers do not classify climate risk as material, then they will not be included in climate disclosures and hence insurers will not have access to this information. This is likely to make it more difficult for insurers to assess the climate risks to which they are exposed, even though climate risk is likely to be a material issue for them. The ISSB may wish to consider how this issue can be addressed.

Although the IAIS supports the division of climate-related risk into physical risks and transition risks as this is helps to better understand climate risk, we believe that climate change is a key driver of existing risks and therefore do not expect to change our risk taxonomy. The nature of the insurance industry results in climate-related risks materialising as underwriting risk (as part of technical provisions) or investment risks (as part of asset holdings). These risks could be both physical risks (risks of climate change to asset values or technical provisions) or transitional risks. It seems that B17 only describes physical risks as part of the technical provisions and transitional risks as part of the assets. A further question is whether physical chronic climate-related risk is given sufficient emphasis in the disclosures, which are currently focused on natural catastrophes and man-made disasters that can be exacerbated by climate change. It is important for both acute and chronic risks to be captured, as per the TCFD framework.

The IAIS would expect insurers to proceed on a best-efforts basis to estimate the exposure and financial impact from transition risks. Recognising the uncertainty and the evolving data availability, some IAIS members have suggested that a safe harbour is provided for the estimation in the early years.

The IAIS supports the requirement of paragraph 14 of IFRS S2 (Financial position, financial performance and cash flows) and would suggest this principle is applicable to the climate risk disclosures of an insurer on both sides of its balance sheet. As such, B17 would benefit from insurance industry specific guidance on the application of paragraph 14.

The IAIS is supportive of insurers providing insight into financed transition opportunities using a proportionate approach. The effect of the disclosures should therefore not focus only on the status quo or possible transition but also on the transition target. Also, the disclosures should enable users to track progress made against the target on a consistent basis from one reporting period to the next.

Question 4: Concentrations of climate-related risks and opportunities in an entity's value chain

As insurers and supervisors take a full balance sheet approach, it is imperative from the IAIS perspective that IFRS S2 reflects climate-related risks and opportunities on both sides of the balance sheet. Supervisors translate a full balance sheet view into a risk-based approach for establishing capital requirements. Concentration risk is one of the important risks for insurance supervisors. As such, the IAIS supports the requirements of paragraph 12 (b).

However, it appears that paragraph 12 (a) (effect on value chain) should be read in conjunction with the requirements of paragraph 14 (effect on financial position) for a full balance sheet approach. This would require insurers to assess the impact of climate-related risks and opportunities on the value chain over the last reporting period, and those foreseen in the coming reporting period and in future periods (short, medium, long term). Given the complexities involved in this assessment, the IAIS would expect that it will be sufficient for insurers to rely on the public disclosures made by investee companies and clients rather than insurers having to conduct additional due diligence along the value chain. It would be helpful if ISSB could clarify this point.

The IAIS favours an approach that would see alignment of the boundaries of the value chain for investments of insurers with the principles of IFRS 3 business combinations and IFRS 15 revenue.

Question 5: Transition plans and carbon offsets

Insurance supervisors are focused on effective risk management of climate-related risk by insurers. Given this focus, transition plans will be relevant indicators of effective climate-related risk management and therefore will be of interest to insurance supervisors.

In the IAIS' view, IFRS S2 and B17 insurance industry disclosure requirements may need to be further expanded or enhanced to incorporate the unique characteristic of insurers as investors in various other industries. B17 Policies Designed to Incentivize Responsible Behaviour seems to only focus on the insurance liabilities of an insurer, and does not consider any potential effect that the investment behaviour of insurers might have on climate change. The IAIS supports the view that the insurance industry has a unique and important position in the global effort to transition to a carbon neutral economy.

Setting effective climate-related targets or reporting on carbon offsets is complex for insurers as it is typically not their own offsets or targets that are relevant but that of their clients and investee companies. As our understanding is that paragraph 13 should be read in conjunction with paragraph 20, our assumption is that insurers have to report on the scope 3 emissions of their investments (assets) over the value chain of the various industries that these investments relate to. Insurers may face extensive costs in gathering reliable, verifiable information based on this scope. As such, the IAIS asks that careful consideration be given to whether the benefits outweigh the cost (including reputational cost) in such a scenario.

It is important that insurers disclose key assumptions about their views on climate-related risks, where it will materially impact their business. For instance, some key assumptions in scenario analysis can materially impact outcomes. As an example, model assumptions about the availably of carbon capture and storage can materially reduce transition risks. Such assumptions should be explicitly disclosed.

Question 6: Current and anticipated effects

The IAIS is in favour of there being a link to financial reporting (ie a reporting period looking backwards a financial year with a comparative period, a forward view on the impact on assets and liabilities for a financial year and reporting on risks and opportunities in the short, medium and long term). The IAIS recommends that this fundamental boundary of reporting should also be included in IFRS S1 as an overarching principle.

A strong linkage between disclosures and accounting (and the finance/reporting function) would likely support higher quality practices and processes around identification and measurement of climate risks. This could benefit the quality of insurers' (and other entities') own disclosures, as well as supporting risk management processes. The strong linkage may also benefit the quality of information used for supervisory assessment purposes (if not now, then potentially in the future).

The IAIS expects that some of the climate-related effects will also have to be within the accounting requirements for financial reporting. The IAIS supports therefore the close relationship between the ISSB and the IASB to ensure complete and appropriate disclosures on climate-related risks and opportunities. ISSB should attach importance to the concept of "fair value hierarchy" enshrined in IFRS 13 (Fair Value Measurement) to categorise the basis of disclosure for better consistency and comparability.

The IAIS agrees on the importance of being able to quantify the impacts of climate-related risks and for insurers to avoid boiler plate disclosures. Quantification will be important to enable insurers to understand the financial impact of the climate-related risks and opportunities they face.

Quantification could be both in absolute amounts or in percentages and metrics, in line with paragraph 21 of the standard. Although insurance supervisors appreciate there are many difficulties in quantifying the data at present, it is essential that quantification is achieved over time in order to better assess and address risks from climate change. This reflects the IAIS' approach that climate risk needs to be integrated into enterprise risk management.

Development of best practices and guidance (potentially from supervisors) over time on this quantification will be an ongoing area of interest where such reporting strengthens risk management.

Question 7: Climate resilience

The IAIS welcomes the focus on climate resilience and the disclosure of scenario analysis results. The approach set out in the document appears proportionate.

Insurers have significant experience in conducting scenario analysis, although the purpose and structure of that scenario analysis is different. The IAIS sees the importance of climate scenario analysis and is currently undertaking work to support insurance supervisors as they develop frameworks for this analysis. The IAIS recognises that the most appropriate approach to scenario analysis may differ depending on the nature, scale, and complexity of the insurer.

The draft calls for at least one scenario to represent the latest international agreement on climate change. In our view, this approach makes sense, especially for transition risk. However, the intended aims set out by policymakers may not reflect the progress that is being achieved in action to address climate risks. Preparers of disclosures will need to consider at the time of disclosure which international agreement on climate change is scientifically representative of the risks they face at the moment of reporting and ensure disclosure against the international agreement is not misleading. The ISSB may therefore wish to consider whether, when disclosing against such scenarios, entities may also need to reference authoritative sources such as the Intergovernmental Panel on Climate Change (IPCC) to assess if the aims set out in the international agreement are reflected in the emerging climate risk science. Furthermore, the IAIS would like to suggest the inclusion of a limited meaningful transition scenario where physical risks are significant, given the relevance to insurers. This warrants including a scenario where no meaningful transition happens, with significant physical risks. The ISSB is encouraged to include guidance on such a scenario to facilitate comparability across disclosures.

The IAIS believes that increased high quality disclosures can provide additional information to assess climate-related risk from a micro and macroprudential perspective. The Exposure Draft proposes that an entity be required to use climate-related scenario analysis to assess its climate resilience unless it is unable to do so. The IAIS notes the risk that the inclusion of ‘it is unable to do so’ could result in a widespread absence of disclosure on scenario analysis. We would therefore welcome further guidance from the ISSB in this regard, to reduce the risk of capable entities not disclosing this information. It may be appropriate for this disclosure to have a rebuttable presumption that scenarios will be disclosed unless an entity can provide a valid reason for non-disclosure.

Question 8: Risk management

The IAIS welcomes the proposed approach for disclosure of risk management processes, which helps reinforce the IAIS’ standards related to risk management.

Question 9: Cross-industry metric categories and greenhouse gas emissions

Overall, the IAIS is supportive of cross-industry disclosure requirements, as these provide a mechanism for insurers to better understand the climate risks that they are exposed to from both an underwriting and an investment perspective.

The IAIS welcomes the requirement to measure Scope 1, 2 and 3 emissions; however, we would like to draw attention to the potential application issues specific to Scope 3 reporting. The definition of Scope 3 emissions under the GHG protocol may require further clarity on materiality definitions for insurers as the underwriters and investors of other industries. The availability of relevant data may be a challenge, especially given that insurers act as investors in, and underwriters of, other industries, and as such are exposed to reporting risk arising from the dependency on aggregate information reported by other sectors. As an example, if an insurer held investments in a number of firms within the retail sector, it would need to collate the necessary information from each and every retail firm – but there is a risk that some of the retail firms make a materiality judgment that is non-binding at the firm level. As a result, the insurer would not have access to the relevant Scope 1 and

2 data at a retail firm level, and would therefore find difficulty in performing their own determination of material and significant, unless all data at retail firm level was made accessible to the insurer. We recognise that this could, to an extent, also be resolved through the use of external data providers, though it is our view that this will ultimately be dependent on a similar availability of relevant information in the public domain.

We note the broad range of metrics and methodologies under development, including the work by the Partnership for Carbon Accounting Financials and the Net-Zero Insurance Alliance on measuring and disclosing insured GHG emissions in underwriting portfolios. We welcome further guidance from the ISSB to facilitate comparable reporting by insurers.

We recognise that there may be a significant gap between issuance of the final standards and their endorsement/implementation, and we ask the ISSB to ensure the standards correctly direct towards the most appropriate methodologies at the reporting date to maximise comparability and verifiability. As an example, we seek further clarity on whether the ISSB will define the appropriate basis for translation of the seven named greenhouse gases to their CO_2 equivalent, and further to this, whether any specification of global warming potential factors will be sufficiently flexible to take into account the latest IPCC assessment report, for example.

The IAIS welcomes the application of existing climate standards in the interim, i.e. TCFD, ahead of the full implementation of S2. Before the implementation of S2, insurance supervisors will expect insurers to continue their efforts to improve the disclosure of their climate-related disclosures.

Question 10: Targets

The IAIS welcomes the approach to the disclosure of climate-related targets as proposed by S2. With reference to the proposed definition, IAIS appreciates the benefits of linking targets to the latest international agreement on climate change and sees also specific benefit in gaining a better view of insurer performance against globally aligned strategic objectives.

The IAIS asks the ISSB to consider extending this proposal to include additional scenarios, to provide users of the climate-related reporting with benchmarks against science-based metrics.

Question 11: Industry-based requirements

The IAIS welcomes the proposal to have an industry specific approach. However, it is the IAIS' view that IFRS S2 and B17 need further attention to reflect insurers as both underwriters and investors in other industries. It is our view that further discussion may be needed to explore topics in Appendix B in sufficient detail. We have outlined our preliminary views below, but these are not exhaustive and we would welcome further discussion in this regard.

As noted in our response to Q3, the IAIS places significant importance on the definition of an appropriate boundary of the value chain. With this in mind, any requirements in Appendix B need to consider the reporting risk specific to insurers (whereby the availability of data is highly dependent on the reporting of other industries). This concern is also relevant to requirements on disclosure of financed and facilitated emissions.

The IAIS understands the urgency of responding to climate change through improved disclosure; however, we encourage the ISSB to consider: (i) to what extent Appendix B is operable for insurers, and (ii) to what extent the requirements will provide helpful information from a supervisory lens. In considering the operability of reporting, the IAIS would welcome further attention to the compatibility of Appendix B with existing reporting standards – for example, net written premiums will not exist as a line item in the Statement of Profit and Loss under IFRS 17.

Further to this, we note some references to sustainability-related metrics within Appendix B. With reference to Q14, we seek clarity on whether the ESG-related metrics would be retained within Appendix B in the case that S1 and S2 will not be implemented simultaneously. We support a climate first approach to the implementation of the standards and do not believe that S2 should be delayed should further work be required to develop S1.

Question 12: Costs, benefits and likely effects

We agree with the ISSB's focus on assessing the costs and benefits of the disclosures to the users of climate-related reporting. The IAIS places a priority on understanding the risks to which insurers are exposed, on both an individual and industry-wide basis. We therefore welcome the introduction of disclosure requirements that further this aim.

In our view, convergence to an industry-specific list of disclosures will be important in reducing the cost of data gathering and data validation. Having a limited set of uniform data will focus the efforts of data providers and allow them to have strong governance processes for a limited number of data points.

We recognise the importance of taking into appropriate consideration measures to ensure costs of compliance are not increased significantly as a result of these proposals, particularly where the disclosures cannot easily be integrated into an existing financial reporting or regulatory reporting process. As an example, modelled losses, particularly under stress, might require additional assurance to allow audit committees to be comfortable with the disclosures. This is likely to result in increased costs, particularly where these numbers are not part of audited processes for the annual report or related regulatory reporting. However, we continue to see significant benefit in these amounts being disclosed, as they provide useful forward-looking insight into an insurer's liability exposure to climate-related risks that historic loss information does not provide.

The exposure draft is silent on application to SMEs. It would be helpful to understand the extent to which ISSB believes the standard should apply to SMEs and if so what whether steps will be taken to make the framework proportionate for SMEs.

Question 13: Verifiability and enforceability

The IAIS supports the focus on verifiability and effective governance around the disclosure, including the ability of auditors to assess and verify these disclosures. We welcome IOSCO's work on ensuring assurance providers are able to effectively assess climate-related disclosures, as well as the work of the International Auditing and Assurance Standards Board (IAASB) to develop an assurance standard on sustainability. It is our view that a balance needs to be sought between the need for verifiability and the development of useful disclosures.

We include suggestions below which we believe would better address some of the challenges in verification:

- Rather than specifying "at a minimum, three likelihood of exceedance scenarios", an IAIS member suggested that the wording could provide a best estimate of losses and the regulatory biting level of losses. This will allow harmonisation within jurisdictions, allow for verifiability of the data within regulatory models and improve ease of verifiability. It was also suggested that the TCFD approach, which was to "use a range of scenarios that illuminate future exposure to both transition and physical climate-related risks and opportunities" seems like a more proportionate approach.

- "Gross exposure" should be consistent with accounting measurement concepts.
- For funds, the use of limited look-through should be allowed on materiality grounds to reduce cost of compliance, particularly for high-churn funds. This will support compliance, particularly given tight reporting deadlines might overlap between funds and insurers.

Further to the above, with reference to our response in Q9, we recognise an increased dependency of insurers' reporting on the reporting within other sectors. It is our view that ISSB should also consider the boundary of verifiability and enforceability of disclosures, ie whether auditors will be required to perform incremental work against the disclosures of the investee to better address the risk that items material at an insurance underwriting level are not necessarily the same as those at an investee level.

Question 14: Effective date

Given the importance of this new disclosure regime, the IAIS welcomes an effective date for S2 to be set at the earliest possible time that would facilitate high quality disclosures of an entity's climate-related risks and opportunities. We look to the ISSB to make best efforts to ensure S1 implementation will not be significantly behind S2, since there are relevant definitions in S1 which will support disclosure in line with S2. We likewise look to the ISSB to consider how to ensure the comparability for S2 implementation, given that the effective date for S2 is presently set earlier than that for S1. However, we also hope that any delays in S1 implementation do not significantly delay the implementation of S2.

Question 15: Digital reporting

The IAIS is supportive of proportionate digital disclosure that allows for efficient data aggregation and enhanced risk assessment. When developing the taxonomy, the ISSB should consider methods that allow for ease of aggregation and analysis across sectors.

Question 16: Global baseline

The IAIS supports the creation of ISSB standards to set a minimum global baseline based on TCFD recommendations, which other jurisdictions are able to build on. We welcome the increased level of disclosure overall, noting that supervisors may in the future wish to supplement disclosure requirements or undertake additional data requests. However, the IAIS will only consider whether any such additional disclosures are necessary in the insurance sector once the ISSB has issued its final requirements. Any additional IAIS standards would be subject to the normal IAIS consultative processes.