Public Consultation on Climate risk supervisory guidance – part one

Consultation Document

March 2023

About the IAIS

The International Association of Insurance Supervisors (IAIS) is a voluntary membership organisation of insurance supervisors and regulators from more than 200 jurisdictions. The mission of the IAIS 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.

Established in 1994, the IAIS is the international standard-setting body responsible for developing principles, standards and other supporting material for the supervision of the insurance sector and assisting in their implementation. The IAIS also provides a forum for Members to share their experiences and understanding of insurance supervision and insurance markets.

The IAIS coordinates its work with other international financial policymakers and associations of supervisors or regulators and assists in shaping financial systems globally. In particular, the IAIS is a member of the Financial Stability Board (FSB), member of the Standards Advisory Council of the International Accounting Standards Board (IASB), and partner in the Access to Insurance Initiative (A2ii). In recognition of its collective expertise, the IAIS also is routinely called upon by the G20 leaders and other international standard-setting bodies for input on insurance issues as well as on issues related to the regulation and supervision of the global financial sector.

For more information, please visit http://www.iaisweb.org and follow us on LinkedIn: IAIS – International Association of Insurance Supervisors.

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This document was prepared by the Climate Risk Steering Group in consultation with IAIS Members.

This document is available on the IAIS website (www.iaisweb.org).

Content Overview

Executive Summary

1. Climate change is a source of financial risk, which impacts the resilience of individual insurers as well as financial stability. Therefore, climate change is a key strategic theme for the IAIS. In May 2021, the IAIS published an initial Application Paper on the Supervision of Climate-related risks in the Insurance Sector ("2021 Application Paper").[1] Since then, the IAIS has closely monitored developments in global climate change mitigation efforts, climate science and how supervisory practices to manage climate-related risks have evolved. In 2022, the IAIS performed a gap analysis of existing IAIS supervisory material to assess how climate risk is already captured and to identify possible further work in terms of standard-setting and/or providing further guidance on supervisory practices. In consideration of the gap analysis outcome, the IAIS intends to publicly consult on limited changes to guidance related to various ICPs and to develop supporting material (see section 4) in several consultations over the next 18 months.
2. This document provides an update on the overall work programme of the IAIS in promoting a globally consistent supervisory response to climate change within the insurance sector. The current consultation also outlines proposed changes to the ICP Introduction, which positions climate risk within the global framework for insurance supervision. Additionally, the IAIS discusses whether it is necessary to make changes to the existing supporting material related to governance, risk management and internal controls (ICP 7 and 8). Finally, the consultation includes questions seeking stakeholder feedback on the overall climate-related work as it relates to supervisory guidance.

1 Importance of climate change risk to insurance supervision

3. Climate change is recognised as an overarching global threat. It impacts human, societal, environmental and economic systems, through rising temperatures and their consequences, including rising sea levels and an increasing frequency/ severity of natural catastrophes and extreme weather events. Climate change, as well as the global response to the threats posed by climate change (eg the reduction of greenhouse gas emissions (GHG) and adaptation programmes) may have wide-ranging impacts on the structure and functioning of the global economy and financial system.
4. Climate change and climate-related risks are a source of financial risk, having an impact on the resilience of individual financial institutions, including insurers, as well as on financial stability. Climate-related risks are material for the insurance sector as they impact the insurability of policyholders' property and assets as well as insurers' underwriting, operations and investments. Therefore, supervisors should identify, monitor, assess and contribute to the mitigation of the risks from climate change to the insurance sector. The insurance industry plays a critical role in the management of climate-related risks in its capacity as an assessor, manager and carrier of risk, and as an investor and steward of financial resources, while being uniquely qualified to understand the pricing of insurance risks. Notably, through risk-based pricing and the development of suitable insurance policies and products, insurers provide critical economic signals regarding this changing risk environment. Insurers can also help build resilience through (inclusive) insurance.

[1] The Application Paper was developed in partnership with the UNDP Sustainable Insurance Forum (SIF) and is available here: https://www.iaisweb.org/uploads/2022/01/210525-Application-Paper-on-the-Supervision-of-Climate-related-Risks-in-the-Insurance-Sector.pdf.

5. An adequate response from supervisors to both the risks and business activity related to climate change will support the objectives of insurance supervision of protecting policyholders, contributing to financial stability and promoting the maintenance of a fair, safe and stable insurance market (see Insurance Core Principle (ICP) Standard 1.2). As the global standard setting body for insurance supervision, the IAIS is committed to supporting its members to further strengthen their focus on actions taken by insurers to assess and address climate-related risks and to support an orderly transition to net-zero.[2] To support these supervisory objectives, the IAIS is taking forward work in different areas. A vital stream of work is promoting a globally consistent supervisory response to climate change, by developing guidance on supervisory practices, which is the focus of this document. Other IAIS climate-related workstreams include data collection and analysis as part of our Global Monitoring Exercise and furthering the design and use of scenario analysis and in capacity building and training exercises.

1.1 Implications of recent climate changes developments

6. Since the publication of the 2021 Application Paper the societal challenges around addressing climate change have increased. As the IAIS highlighted in the 2022 edition of the GIMAR[3], according to the UN, mitigation pledges to date are insufficient to achieve the Paris Agreement. Enhanced action is needed to prevent the continued warming that is increasing the likelihood of irreversible changes to the climate system. However, the near-term supply-side energy shortage is causing many countries to continue with or revert to fossil fuel sources, thereby making it more challenging to meet net zero targets. These developments may lead to delayed and divergent transitions across jurisdictions. This in turn may have considerable impacts on the insurance industry by increasing physical, transition, liability and reputational risks as well as widening the protection gap. Therefore, it is critical for insurance supervisors to strengthen their understanding of the nature and magnitude of climate-related exposures of the insurance industry, in order to effectively identify, monitor and reflect climate change risks in their supervisory responsibilities and expectations for licensed insurers.

2 IAIS response to recent developments

7. The IAIS' work on climate change spans across many of its activities, ranging from financial stability risk assessment, developing supervisory and supporting material and capacity building.

2.1 Supervisory practices

8. Building on the 2021 Application Paper, the IAIS aims to continue to help supervisors in their efforts to integrate climate risk considerations into the supervision of the insurance sector by updating and expanding the content of climate risk related Application Papers. The goal is to provide background and guidance on how the IAIS supervisory material can be used to manage the challenges and opportunities arising from climate-related risks. Application Papers do not establish standards or expectations, but instead provide additional guidance to assist implementation and provide examples of good practice. These papers aim to promote a globally consistent supervisory approach to address climate-related risks in the insurance sector.

[2]See https://www.iaisweb.org/uploads/2022/01/211028-IAIS-Statement_Commitment-to-amplify-response-to-climate-change_October-2021.pdf

[3] See https://www.iaisweb.org/uploads/2022/12/GIMAR-2022.pdf

9. In 2022, the IAIS performed a gap analysis of IAIS supervisory material to assess how climate risk is already captured and to identify possible further work in terms of standard-setting and/or providing further guidance on supervisory practices. Considering the outcome of the gap analysis, the IAIS intends to publicly consult on proposed changes to the ICP Introduction, guidance relating to ICPs 15, 16 and develop supporting material related to various topics. While the final scope of these consultations is still to be determined, it will possibly cover the following ICPs in several consultations over the next 18 months:

ICP	Expected scope for consultation
Introduction and Assessment Methodology	Add text to the ICP Introduction that highlights the interconnection of risks and the relevance to multiple topics discussed in the ICPs.
ICP 7 Corporate Governance	Review the need to update content in the 2021 Application Paper.
ICP 8 Risk Management and Internal Controls	Review the need to update content in the 2021 Application Paper.
ICP 9 Supervisory Review and Reporting	Further to the content of 2021 Application Paper, consider whether additional supporting material may be appropriate as climate related reporting, scenario analysis and stress testing advance.
ICP 14 Valuation	Consider whether including specific supporting material is warranted.
ICP 15 Investments	Taking into account the content of the 2021 Application Paper, consider whether additional supporting material is warranted.
ICP 16 Enterprise Risk Management for Solvency Purposes	Further to the content of 2021 Application Paper, consider whether additional supporting material is warranted, for instance related to Own Risk and Solvency Assessment (ORSA) and climate scenario analysis.
ICP 19 Conduct of Business	Develop supporting material related to the conduct of business, including related to the risk of greenwashing and considerations for natural catastrophe insurance.
ICP 20 Public Disclosure	As further work develops on scenario analysis and stress testing, as well as the work of the International Sustainability Standards Board, to consider whether further material of the IAIS is needed.
ICP 21 Countering Fraud in Insurance	The abovementioned supporting material on ICP 19 and the risk of greenwashing may possibly also consider the risk of fraud.
ICP 24 Macroprudential Supervision	Develop supporting material related to macroprudential supervision and climate-related risks, such as related to data collection and/or climate scenario analysis.
ICP 25 Supervisory Cooperation and Coordination	Consider developing supporting material as it relates to specific issues for group-wide supervision, eg the role of supervisory colleges.

2.2 Climate scenario analysis

10. Climate scenario analysis is a key tool to better understand climate-related risks in the insurance sector. At both domestic and international level supervisors are making significant leaps forward in this area. Last year the IAIS held capacity building workshops which supported more than 200 insurance supervisors as they look to develop work in this area. Despite the significant advance in this new and emerging area, more work needs to be undertaken to share good practices and to develop more common practices. To this end, later this year the IAIS will release an Application Paper that describes supervisory considerations and good practices on scenario analysis building on previous work the IAIS has already developed. The IAIS is also working closely on these issues with colleagues at the Network for Greening the Financial System and the Financial Stability Board.

2.3 Climate risk data collection and analysis

11. The Global Monitoring Exercise (GME) allows the IAIS to monitor and assess global insurance market trends and developments, such as climate change, and their potential impact on insurance markets and global financial stability. In relation to climate change, in September 2021 the IAIS published a special topic edition of the Global Insurance Market Report (GIMAR) on the insurance sector's investment exposures to climate-related risks. This report provided the first quantitative global study on the impact of climate change on the insurance sector.
12. As a follow-up, climate data elements were added to the GME in 2022 and are also to be included in the GME in 2023. These elements have become a regular feature of the IAIS' annual assessment of insurance sector risks and provide a global baseline of climate risk data for the insurance sector. The outcomes of the analysis from 2022 were published as part of the regular GIMAR at the end of 2022.[4]

3 Issues for Consultation

13. In the current consultation, the IAIS outlines proposed changes to the ICP Introduction, which position climate change risk within the global framework for insurance supervision. Also, the IAIS discusses whether it is necessary to make changes to the existing supporting material related to governance, risk management and internal controls (ICP 7 and 8). Finally, the IAIS provides questions seeking stakeholder feedback on the overall package of climate-related work as it relates to supervisory guidance.

4.1 Changes to ICP Introduction

14. Following the outcome of the gap analysis, the IAIS proposes changes to the ICP Introduction for example that include adding text that highlights as an overarching concept, the interconnection of risks and the relevance to multiple topics discussed in the ICPs. In this context, climate risk is mentioned as an example because it has an amplifying effect on the other risks an insurer is exposed to and has consequences for both assets and liabilities on insurer balance sheets. Therefore climate-related risks need to be adequately reflected in the risk management and governance frameworks of insurers.

[4] See https://www.iaisweb.org/uploads/2022/12/GIMAR-2022.pdf.

15. The two proposed new paragraphs will be inserted under the "Proportionality and risk-based supervision" sub-heading of the ICP Introduction. Additionally and with a view to aligning the sub-heading with its contents, it is proposed that the sub-heading be updated to "Proportionality and risks".

16. The proposed text is shown in redline below:

Proportionality and risks ~~risk-based supervision~~

9. The ICPs establish the minimum requirements for effective insurance supervision and are expected to be implemented and applied in a proportionate manner. Therefore, proportionality underlies all the ICPs. Supervisors have 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.

- Implementation – proportionality allows the ICPs to be translated in to a jurisdiction's supervisory framework in a manner appropriate to its legal structure, market conditions and consumers.
- Application – proportionality 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. A proportionate application involves using a variety of supervisory techniques and practices which are tailored to the insurer to achieve the outcomes of the ICPs. Such techniques and practices should not go beyond what is necessary in order to achieve their purpose.

10. Risk-based supervision is a related concept but distinct from proportionality; it means more supervisory activities and resources are allocated to insurers, lines of business or market practices that pose the greatest risk to policyholders, the insurance sector, or the financial system as a whole.

11. The ICPs are written to address the broad variety of risks related to insurance and its supervision. The ICPs are applicable to traditional as well as emerging risks. Accordingly, the ICPs, in general, refer simply to risks in order to be able to capture those that may be relevant within the given context; where specific risks are described, this is typically for illustration or when particularly relevant to a certain topic.

12. Individual risks are often interconnected and may have an amplifying effect on other risks. This is the case, for example, with climate-related risks. Supervisors and insurers should consider how to assess and address issues such as risk management and governance, valuation of assets and liabilities, and conduct of business in light of such interconnectedness.

Terminology

(…)

Consultation questions to stakeholders

Q1. Do you have any comments on the proposed text referencing climate-related risk within the ICP Introduction?

Q2. Do you have any comments on the location of the proposed text?

4.2 Review of supporting material related to Corporate Governance, Risk Management and Internal Controls

17. Overall, the IAIS considers that the supporting material related to ICP 7 Corporate Governance and ICP 8 Risk Management and Internal Controls in the 2021 Application Paper remains appropriate in the context of climate risk management and there is no need to expand the material.
18. Since the publication of the IAIS' 2021 Application Paper, the Basel Committee on Banking Supervision (BCBS) published its 'Principles for the effective management and supervision of climate-related financial risks'[5] ("Principles document") The IAIS recognises the importance of cross sectoral coordination and collaboration on supervisory approaches relating to climate risk given the interlinkages between the banking and insurance sectors, including through financial conglomerates that operate in both sectors. In this regard, the IAIS compared the material from its 2021 Application Paper on governance and risk management approaches, against the BCBS' Principles document. Arising from this comparison, the IAIS is of the view that the content in the respective documents are congruent and consistent even though some areas might be expressed differently in certain instances. Also, to the extent there are any differences, these reflect the specificities of each sector, such as the role of actuaries (see Annex).

Consultation question to stakeholders

Q3. 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?

4.3 Overarching questions

19. The IAIS will continue its climate risk related work through its established workstreams, liaise with other standard setting bodies and international organisations, and develop materials for the next sets of consultations. In order to feed into that work at an early stage, the IAIS is inviting feedback from stakeholders on the following overarching questions.

Consultation questions to stakeholders

Q4. 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?

[5] Published in June 2022, see https://www.bis.org/bcbs/publ/d530.htm.

Q5. Should the IAIS' work and upcoming consultations on climate risk also cover considerations related to transition planning by insurers?

Q6. Do you see anything missing from the current IAIS workplan on climate risk, as outlined in the IAIS 2023-2024 Roadmap?

Annex: Comparison of recent publications by the IAIS and BCBS on governance and risk management in respect of climate-related financial risk.

Topic	IAIS Application paper on the supervision of climate-related risks in the insurance sector (May 2021)	BCBS Principles for effective management and supervision of climate related financial risks (June 2022)
High-level comment	Provides guidance and instances of good practice in relation to managing transition and physical risk for insurers (current focus on prudential risks).	Provides a 'principles-based approach' to improving risk management and supervisory practice in relation to climate-related financial risks. Relevant for prudential supervision of banks. High degree of commonality with IAIS application paper regards governance and risk management.
Board responsibility	The Board has a role in maintaining effective oversight of climate-related risk management, including incorporating climate-related considerations into the insurer's risk appetite, strategies and business plans. Board should consider potential threat to the insurer's business risks, fair treatment of customers, and duty to act in a socially responsible manner (para 28). Control functions should determine whether the insurer's operations and results are consistent with the **risk appetite** approved by the board (para 41).	Board and senior management should clearly **assign responsibilities** for managing climate-related responsibilities to members and/or committees, and exercise effective oversight (Principle 2, paras 15-17). Board and senior management should ensure strategy and **risk appetite** statement are consistent with publicly-stated commitments (Principle 1, para 14). Supervisors should maintain sufficiently frequent contact with board and senior management and be able to address climate risk in a **forward looking** manner (Principle 13, para 51).
Management responsibility	Senior management is responsible for implementing policies on climate risk and incorporating into business and operational decisions (para 31). Assigning responsibility leads to greater accountability (para 24).	See above. Banks should clearly define and explicitly **assign roles** and responsibilities (paras 17).
Remuneration	Remuneration can be used as one of several incentives to integrate climate-related risks into the risk management system (para 33).	Board and senior management should consider whether incorporating climate-related risks into a bank's strategy and risk management frameworks warrant changes in compensation policies (Principle 1, para 13).
Risk identification and monitoring	To identify, manage and monitor climate-related risks, insurers should develop tools to collect reliable **qualitative** and **quantitative** data. Expected that analysis will continue to improve as data quality improves (para 38).	Banks should develop and implement a **sound process for understanding and assessing** the potential impact of climate-related risk drivers on their businesses and the environments in which they operate (Principle 1).
Risk management	Recommended that insurers i**ntegrate climate-related risks into their overall**	**Banks should incorporate climate-related risks into their internal control framework**

and mitigation	**governance, risk management and control frameworks** (para 34). Risk management function should **update methods and metrics** regularly to support decision taking by the board (para 42). Control functions should properly consider the effect of climate change on existing risk categories and should have **appropriate resources** and **expertise.** Such functions need to continue to develop tools and approaches (para 40). Need for **dedicated experts** (paras 49-51). Outlines the separate roles of risk management, compliance, actuarial and internal audit functions (paras 42-48). Two-way communication between firm and supervisor essential and transparency of supervisory expectations (para 22).	**across three lines of defence** to ensure effective identification, measurement and mitigation (Principle 4). Supervisors should determine that a bank's incorporation of climate risk into strategy, corporate governance and internal controls is sound (Principle 13). Supervisors should determine that banks can adequately identify, manage and monitor climate-related risks as part of their **risk appetite** and risk management frameworks (Principle 14). Senior management should be equipped with **appropriate skills** and experience (Principle 2, para 16). Banks should consider engaging with **clients** and **counterparties** (Principle 7, para 32).
Risk reporting	**Board relies on senior management for information**, metrics and setting out options/recommendations (para 31).	Risk data aggregation and capabilities and internal risk reporting practices should account for climate-related risks – need for **timely information** for board and senior management to take decisions (Principle 7).
Scenario analysis	Stress testing and scenario analysis noted in context of **ORSA** (paras 64-66). Use of **heat maps** (para 44). Given changes in weather patterns, actuarial function may find **historical data inadequate** and may draw on **catastrophe modelling** (para 47).	Where appropriate, banks should make use of scenario analysis to assess resilience (Principle 12). Banks should have sufficient capacity and expertise to conduct climate scenario analysis (para 46). Board and senior management should take a long-term view of climate-related risks (para 9); and should apply a range of time horizons (para 47).
Outsourcing	Insurers that outsource material activity should preserve the ability to manage risks (para 52).	Principle 11 covers operational risk, and references critical functions and business continuity (paras 42-43).
Disclosure	Disclosures should describe board's oversight and senior management's role in managing climate-related risks and opportunities (para 89).	Less focused on public disclosure and more on internal reporting.