May 16, 2023

Dr. Victoria Saporta
Chair, Executive Committee
Mr. Jonathan Dixon
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International Association of Insurance Supervisors (IAIS)
Bank for International Settlements
CH-4002 Basel
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Re: IAIS Public Consultation on climate risk supervisory guidance – part one

Dear Dr. Saporta and Mr. Dixon:

The IIF and its global insurance members are pleased to respond to the IAIS's public consultation on climate risk supervisory guidance – part one (consultation paper). Climate-related transition and physical risks pose significant challenges to the global economy, of which the global insurance market is a key component. Insurers[1] have long recognized the importance of climate-related transition and physical risks as drivers of underwriting, market, and credit risks that affect both sides of their balance sheets, as underwriters and as asset owners, managers, and investors. The IIF has been leading and supporting efforts within the broader financial services industry to advance sound risk management practices for climate-related risks.

Overarching Comments.[2]

Supervisory approaches should be practical, proportionate, and sequential, driven by data and risk analyses. At present, it is generally acknowledged that there is insufficient evidence and data to demonstrate a near-term material threat to the financial stability of the financial system as a result of climate-related risks.[3] This is consistent with views of the insurance sector in particular. In the September

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[1] References to insurers in this letter also apply to reinsurers unless specifically noted.

[2] We note that the following comments are, in addition to being overarching comments, responsive to Question 3 in the consultation paper with respect to the continuing appropriateness of the 2021 Application Paper related to corporate governance (ICP 7) and risk management and internal controls (ICP 8).

[3] In its 2021 report, *The Availability of Data with Which to Monitor and Assess Climate-Related Risks to Financial Stability,* the Financial Stability Board (FSB) noted that the effects of climate-related risks on the financial system are subject to substantial uncertainty and tail risk given the lack of data and metrics for the quantification of these risks. https://www.fsb.org/wp-content/uploads/P070721-3.pdf. See also the FSB's 2022 report on Climate Scenario Analysis by Jurisdictions - Initial findings and lessons: https://www.fsb.org/wp-content/uploads/P151122.pdf. "The overarching message of these initial exercises for financial stability is that, while the impacts of climate risks are not small, they seem to be concentrated in some sectors and overall, at least for now, contained from the perspective of domestic financial systems. However, the tail risks associated with climate change may not be as manageable, while the exercises are largely exploratory in nature at this stage and are therefore not comparable to traditional stress tests that assess resilience to tail risks."

2021 Global Insurance Market Report, the IAIS found that the insurance sector as a whole appears to be able to absorb climate-related investment losses.[4]

As such, we believe that the appropriate response by prudential supervisors and industry participants is to focus on ensuring a good assessment, management and mitigation of climate-related risks at the firm level within the framework of the Insurance Core Principles (ICPs), and to undertake additional analysis to better understand the dynamic and longer-term impact of climate-related risks on the insurance sector as a whole. However, it is important for the IAIS and insurance supervisors to place their focus on the supervision of prudential risks only, in line with their mandate, rather than pursuing non-prudential objectives in relation to climate or environmental goals.

Any new IAIS guidance to supervisors based on analysis of climate-related financial risks to the global insurance sector should be developed in a deliberate and iterative 'building block' manner. This reflects the comment we made on the *Draft Application Paper on the Supervision of Climate-related Risks in the Insurance Sector* in 2021 (referred to as the "2021 response")[5] – that prudential supervisory approaches should be practical, proportionate, and sequential, driven by data and informed by relevant expert advice and judgement.

Moreover, any IAIS initiatives should be risk-based, science-based, and reflect and leverage market-led approaches. In its guidance, the IAIS should also recognize the significant challenges in quantifying climate-related risks, including substantial conceptual and measurement uncertainties including about the evolution of climate change and related factors (including policy, technology and consumer preferences). Further, the IAIS should acknowledge the risks of relying on potentially inaccurate assumptions and estimates, which may increase, rather than decrease, climate-related risks to the sector, including by incentivizing herding behavior or by negatively impacting incentives for new investment and product development.

Given the significant work that remains to be conducted by both the industry and supervisors to address data gaps and the uncertainties surrounding climate change pathways and trajectories, we believe that it would be premature to revise the individual insurer monitoring assessment methodology or indicators, or to specify stress testing scenarios with respect to climate-related financial risks at this time. In general, supervisory exercises may distract management attention and action from developing more sophisticated modeling techniques and risk management tools that better reflect companies' individual risk profiles, product mixes, and markets. Insurers need to devote their resources to further developing tools and models to manage their material climate-related risks and to inform their business strategies and decision-making. We reiterate the IIF's comments on climate scenario analysis as expressed in our 2021 response, which will be further elaborated in our upcoming 2023 report on this topic: that supervisory climate-related stress tests or scenario analyses should be parsimonious, exploratory in nature, and aligned with the supervisory mandate.

[4] https://www.iaisweb.org/uploads/2022/01/210930-GIMAR-special-topic-edition-climate-change.pdf:: "Despite the significant losses shown in the four scenarios analysed, the insurance sector as a whole appears to be able to absorb these investments losses, in light of the high pre-stress capital levels. "

[5] https://www.iif.com/portals/0/Files/content/Regulatory/01_11_2021_iif_climate_response.pdf

To the extent that climate-related risk drivers impact the management of financial risks, such as investment or underwriting risks at a particular company, a microprudential supervisory approach to those prudential risks could be supported by the Insurance Core Principles (ICPs), which apply to the supervision of insurance risks more broadly. The management of risk in general, as well as the management of climate-related risk drivers in particular, is in the first instance the responsibility of senior management with appropriate board oversight. Insurers have developed a wide range of tools to manage all material risks, including important drivers such as climate-related financial risks, to their companies through existing risk categories. Insurers are best placed to understand and mitigate the potential impacts of those risks to their businesses.

Supervisors should take an outcomes-focused approach to insurers' ERM. In their supervisory approaches to any risk, supervisors should be encouraged to focus on the desired prudential outcomes, rather than on the path an insurer takes to reach that outcome, as the optimal path for a particular insurer may differ from its peers. As is well recognized, the insurance industry is characterized by a wide range of business models, business lines and products, and markets with different customer bases and demand profiles. As part of their enterprise risk management (ERM) frameworks, insurers and other financial firms need to manage the material impacts of climate-related transition and physical risks on their financial risks, recognizing that the materiality of these risks will depend upon a variety of factors, including the insurer's business model, its product mix, the markets in which it operates, and the political and economic environment in which it conducts its major operations.[6] These differences will inform the decisions that an insurer or insurance group makes to achieve a particular outcome. In addition, the impact of climate-related drivers on an insurer's financial risks varies considerably across jurisdictions and regions and these differences will also inform the path to a particular outcome.

Importantly, and as further elaborated in response to Question 5, to the extent that insurers develop discrete transition plans, these plans can serve a number of functions, but they should not be treated as a prudential tool or included in the supervisory framework. Insurance authorities should be focused on prudential outcomes, rather than climate outcomes.

Continued need for stakeholder engagement. We encourage the IAIS to continue its engagement with key stakeholders in the insurance industry as it develops final guidance on this topic. For example, the publication of an Application Paper later in 2023 on climate scenario analysis could benefit from stakeholder discussions as insurers in general, and many IIF members in particular, have engaged in significant efforts to advance their internal understanding of the impacts of climate-related risks on their business operations and have engaged in increasingly advanced climate scenario analysis exercises.[7]

Clarity of definitions of climate risk as one of many *drivers* of financial risk. We encourage the IAIS to clearly differentiate and clarify the use of the terms 'climate change,' 'climate risk,' and 'climate-related (transition and physical) risks' in a manner that is consistent with the use of those terms by the

[6] Insurers also have unique opportunities as long-term investors to support the transition to a lower carbon economy and to help less mature sectors and firms transition their activities. They provide innovative insurance products that support policyholders' climate-related goals and commitments and that facilitate resilience and adaptation to climate change.

International Sustainability Standards Board (ISSB), which is developing a global baseline of sustainability disclosures. The IAIS's guidance should clearly recognize the role of climate-related transition and physical risks as (one of many) *drivers*[8] of the financial risks (e.g. underwriting, market and credit risks) that insurers already manage in their day-to-day operations and reflect in their business and strategic planning. Climate change– i.e. long-term shifts in weather patterns and temperatures, which may arise from natural causes but, more recently, have increasingly arisen from anthropogenic causes, such as increases in greenhouse gas (GHG) emissions – is a phenomenon that the insurance industry historically has managed over time.

Comments on Section 1 – Importance of climate change risk to insurance supervision. We agree with the strong acknowledgment of the global threat of climate change as expressed in Paragraph 3 of the consultation paper and the need for robust climate-related risk management embedded in ERM, as expressed in Paragraph 4. However, Paragraph 4 appears to jump to a conclusion that climate-related risks will have an impact on financial stability. As noted above, at present, we do not believe that the evidence and data demonstrate anear-term material threat to the financial stability of the global insurance industry. Accordingly, we would reword the first sentence of this Paragraph as follows: *Climate-related risks are a driver of financial risks, having an impact on the resilience of individual financial institutions, including insurers, if not properly managed at the enterprise level and appropriately mitigated.* This proposed rewording would rightly place the focus on the need to address these risks through robust ERM strategies.

Paragraph 4 would also benefit from an acknowledgement that, at present, there are significant challenges to the quantification of climate-related risks and that qualitative information is needed to compensate for gaps in data. As we have found in the course of conducting a survey of IIF insurance members, which is enclosed along with this response, insurers have experienced challenges in obtaining consistent data across their asset portfolios, including consistent emissions data from counterparties and investees. There is a lack of consistent and comparable reporting from both counterparties and third-party data providers. A considerable degree of expert judgement is needed in order to make a meaningful assessment of the climate-related risks to which an insurer is subject. Given data shortcomings and the evolving nature of climate-related risk management, an overemphasis on quantitative analysis could result in a false sense of precision and security in the results. These data availability issues are compounded by the broader lack of certainty as to the future path of government and regulatory climate policies and differences in policies across jurisdictions.

Second-order effects of climate change, such as socio-economic impacts, are also subject to substantial political and regulatory uncertainty. We understand that the IAIS plans to publish a report at the end of 2023 on the role of supervisors in addressing natural catastrophe protection gaps.[9] We hope this report will consider market-led approaches to addressing climate-related protection gaps, since punitive or

[8] The IAIS May 2021 *Application Paper on the Supervision of Climate-related Risks in the Insurance Sector* (2021 Application Paper) recognizes climate-related transition and physical risks as drivers of financial risks. See e.g. Paragraph 2 of the 2021 Application Paper.

[9] https://www.iaisweb.org/uploads/2023/04/IAIS-statement-on-natural-catastrophe-protection-gap-2023.pdf
The European Insurance and Occupational Pensions Authority (EIOPA) is similarly focusing on this topic, with the recent publication of a discussion paper on the role of policy in reducing the climate protection gap:
https://www.eiopa.europa.eu/system/files/2023-04/ecb.policyoptions_EIOPA~c0adae58b7.en_.pdf

prescriptive regulatory approaches may have serious unintended socio-economic implications that are not yet well understood by prudential regulators and supervisors.

Comments on Question 1 – the ICP Introduction. The IAIS should retain the original title of the ICP Introduction, which appropriately reflects the concept of risk-based supervision that underlies the ICPs (see Paragraph 10 of the ICPs Introduction and Assessment Methodology). The focus of the ICP Introduction is on the risk management and governance frameworks of insurers, as noted in Paragraph 14. The issue of the interconnectedness of risks is well addressed in other ICPs, including ICP 16, which addresses ERM, and this issue does not need to be addressed specifically in Paragraph 12. Accordingly, we would reword Paragraph 12 as follows: *Climate-related transition and physical risks are drivers of, and may be interconnected with, traditional financial risks. Insurers should recognize and incorporate into the management of their traditional financial risks the material transition and physical risks to which they are subject. Moreover, strong governance practices should ensure appropriate board and senior management oversight of climate-related risk management.*

The reference to 'traditional as well as emerging risks' in proposed new Paragraph 11 to the ICP Introduction is imprecise. We propose that the second sentence of proposed new Paragraph 11 read as follows: *The ICPs are applicable to the full range of material risks to which insurers are subject and the IAIS endeavors to update the ICPs to reflect new and emerging drivers of those risks.*

Comments on Question 5 – Transition Planning. As noted in our overarching comments, the management of material climate-related transition risks is generally embedded in insurers' ERM frameworks and reflected in the ORSA. To the extent that insurers develop discrete transition plans, these plans can serve a number of functions, but they should not be treated as a prudential tool or included in the supervisory framework.

Based on our discussions with members across different parts of the financial industry, many firms view transition planning as a fundamentally internal strategic exercises that relates to issues (e.g. the path of (financed) GHG emissions) that reflect business decisions in response to the political and economic dynamics in the markets in which a firm operates. Firms often use transition plans in conjunction with their net zero commitments and to inform disclosures to stakeholders about how those commitments would be met. Some firms emphasize the relevance of transition plans as inputs to scenario analysis.

Guidance for transition plan development is being advanced by market-based initiatives and, in some jurisdictions, by legislative and non-prudential regulatory initiatives (e.g. by regulatory authorities charged with developing public disclosure standards). Insurance supervisors should not add to the complexity of the efforts underway by providing requirements that do not relate to their prudential supervisory mandates and may not reflect how transition plans are used by insurers. More generally, transition plans should be owned, developed and implemented by the financial firms that are responsible for their implementation and market-led efforts should be allowed to develop first before regulatory requirements are considered or proposed.[10]

[10] See https://www.iif.com/Publications/ID/5212/Financing-the-Net-Zero-Transition-From-Planning-to-Practice.

We appreciate the opportunity to comment on this consultation paper and look forward to continued industry/supervisor dialogue on climate-related risks in the insurance sector. We would be pleased to present to the IAIS and its members our views on these topics in greater detail.

Respectfully submitted,