November 12, 2021

Mr. Steven Seitz
Director
Federal Insurance Office
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20005

Re: Federal Insurance Office Request for Information on the Insurance Sector and Climate-Related Financial Risks, 86 Fed. Reg. 48814, August 31, 2021

Dear Director Seitz,

The Institute of International Finance (IIF) is pleased to respond to the Federal Insurance Office's (FIO) request for information (RFI) on the insurance sector and climate-related financial risks issued on August 31, 2021. This response reflects the input of the IIF's Insurance and Sustainable Finance Working Groups.

We note the October 14, 2021 Executive Order 14030, *U.S. Climate-Related Financial Risk*, which directed the Secretary of the Treasury to engage the members of the Financial Stability Oversight Council (FSOC) on the topic of climate-related financial risk and consider key actions. EO 14030 also emphasized the important role of the insurance industry in combatting climate change. On October 21, 2021, the FSOC released its *Report of the Financial Stability Oversight Council on Climate-Related Financial Risk* (FSOC Report). The IIF welcomes the FSOC Report and acknowledges its clear recognition that climate change has significant implications for the financial services sector.

The FSOC Report noted the efforts of FIO and several States (both individually and through the National Association of Insurance Commissioners (NAIC)) to address climate-related financial risk including through climate-related disclosures, supervisory activities, and, importantly, through encouraging insurers to take steps to foster mitigation of climate-related financial risks and facilitate adaptation to a low-carbon economy. As further elaborated below, insurers, as well as Federal and State authorities, have engaged proactively in important climate risk mitigation and resilience efforts and continue to consider new avenues for expanding that important engagement.

The IIF has conducted substantial research and work on climate risk considerations for the financial services industry and on the issues surrounding climate-related financial risks across the sector. Earlier this year, the IIF published *Prudential Pathways: Industry Perspectives on Supervisory and Regulatory Approaches to Climate-related and Environmental Risks* (the IIF Prudential Pathways Paper), a copy of which is attached to this response. This paper reflects the perspectives of the IIF's broader membership of financial services firms including insurers and banks and offers insurance-specific considerations for regulatory and supervisory policy on climate-related financial risks.

The IIF would be pleased to follow up with FIO and other authorities to discuss the observations and recommendations contained in the *IIF Prudential Pathways Paper*, as well as the broader work of the IIF's Sustainable Finance Working Group as it relates to the insurance sector.

General Comments

We welcome FIO's action on climate-related financial risk, including through its membership in the UN-convened Sustainable Insurance Forum (SIF), and its engagement in international forums including the International Association of Insurance Supervisors (IAIS). We note that the U.S. Treasury is the co-chair of the G20 Sustainable Finance Working Group, a key organization for addressing climate-related financial risks and, in particular, climate-related financial risks that could pose a threat to global financial stability. We encourage continued engagement by FIO and U.S. Treasury in these forums. Importantly, FIO's international engagement, including its ongoing discussions through the G20, the SIF, the IAIS, the OECD, and the EU-U.S. Insurance Project, can help ensure that any global framework that emerges properly reflects U.S. perspectives and considerations, and builds on the pillars of the existing U.S. regulatory framework, while seeking to draw upon best practices and innovative approaches in other jurisdictions where appropriate. Shared standards are also key to supporting market-based solutions that will properly account for the costs of climate change. It is important for FIO to contribute to global solutions, acting with deliberate speed, to address climate challenges. We are pleased to see the enhanced contributions of U.S. authorities to these international discussions.

More broadly, we agree that the unprecedented nature of climate risk presents unique challenges and requires a strategic response by the insurance industry. We support FIO's efforts to analyze the systemic implications of climate-related risks in a rigorous manner that focuses on how those risks propagate to other market participants and the real economy through established transmission channels, and how they might be mitigated through insurer's existing enterprise risk management frameworks.

A focus on climate-related financial risk ties to the FIO mandate to monitor the insurance industry and to consult with the States regarding insurance matters of national importance and prudential insurance matters of international importance. FIO has identified three initial climate-related priorities and our comments focus on these important areas: (i) assessing climate-related issues or gaps in the supervision and regulation of insurers, including their potential impact on U.S. financial stability; (ii) assessing the potential for major disruptions of private insurance coverage in U.S. markets that are particularly vulnerable to climate change impacts and to facilitate mitigation and resilience for disasters; and (iii) increasing FIO's engagement on climate-related issues.

Insurers, in their role as risk managers, are uniquely positioned to help address climate-related risks and to facilitate mitigation of, and resilience for, disasters. Measuring and underwriting all types of risk, including climate-related physical and transition risks, is at the core of insurers' business models. Members of the insurance industry have been, and continue to be, proactive in incorporating consideration of climate-related financial risks into their enterprise risk management frameworks, assessing the materiality of these risks to policyholders across business lines and activities, and sharing best practices with key stakeholders, including promoting climate change mitigation and resilience

measures. Notably, a number of insurers have also made strategic plans and commitments to reduce their emissions, as well as to reduce the carbon footprint of their underwriting and investment portfolios. Insurers' efforts to better understand climate-related risks and to incorporate them into enterprise risk management and disclosures supports both policyholders and the corporate community in its transition to more sustainable business models and a net-zero future. A better understanding of climate-related risks can also contribute to enhancing the resilience of insurers themselves.

States, both individually and through the NAIC, have expended considerable efforts to proactively address climate-related financial risks. As acknowledged in the FSOC Report, the NAIC has identified climate change as a key regulatory priority and has focused its discussions on (i) climate-related financial disclosure, (ii) supervisory activities on risk and solvency, (iii) market conduct and mitigation activities, and (iv) data, measurement and metrics, including scenario analysis. The NAIC has also established a Climate and Resiliency Task Force with five workstreams focused on pre-disaster mitigation, solvency, climate risk disclosure, innovation, and technology. We believe that FIO should allow these initiatives time to mature before drawing firm conclusions on regulatory or supervisory gaps.

Given that climate change is a global phenomenon not constrained by national borders, there is tremendous value in striving for alignment in approaches to climate risk across jurisdictions. In its statutory role of coordinating Federal efforts and developing Federal policy on prudential aspects of international insurance matters, FIO can advance coordination with financial services regulators, supervisors, and standard setting bodies in developing an approach to climate risk policymaking. In our view, this approach should reflect a goal of alignment within the constraints of differences across insurance markets and even among insurers within a particular market. Many authorities, including some of the States as well as other jurisdictions in which U.S. insurers operate, are already adopting policies and regulations and adjusting their supervisory practices to account for climate-related financial risks. This has so far led to the issuance of somewhat different guidance on disclosure, stress testing and scenario analysis and risk management. As well, authorities have issued multiple but often very similar requests for data to insurers. Regulatory fragmentation – at both the domestic and international levels – poses challenges to the development of harmonized frameworks and distracts from the important tasks of climate risk management and mitigation.

Specific Comments

Climate-Related Data and FIO's Data Collection and Data Dissemination Authorities

Given the evolving state of climate and environmental impact science, the quantification of climate-related financial risks is still a developing area with, in many cases, low data availability and quality, and a high degree of modeling uncertainty. We agree with the statement in the recently released White House Roadmap to Build a Climate-Resilient Economy (White House Roadmap)[1] that a lack of perfect information should not be a justification for inaction. Yet it is important to note that the current lack of good, comparable data, and the ongoing work to develop appropriate, consistent methodologies for risk assessment and reporting frameworks limits the decision-usefulness of this information and, at worst, could render undue reliance on potentially misleading information to inform insurers' risk tolerances. While quantitative analyses and risk modeling can be enhanced over time, considerable qualitative and subjective elements will remain necessary for a complete risk analysis, as is the case for the management of any risk.

We agree with the recommendation of the FSOC Report to enhance climate-related data availability and coordination across Federal agencies[2] and with international counterparts and the need for greater standardization of terminology, metrics, and definitions. This recommendation will support greater international alignment on climate-related risk assessment and disclosure.

As noted in the RFI, to date, no Federal authority is responsible for collecting climate-related financial data specific to the insurance sector. We understand that FIO has statutory data collection authority and that U.S. Treasury's Office of Financial Research (OFR) is working to collect data to support the assessment and identification of climate-related financial risks to financial stability. We urge FIO and OFR to collaborate with the NAIC on the study of insurance climate data and on any development of a centralized database for climate-related information on the insurance sector. We encourage FIO to leverage the NAIC's extensive data sets when conducting analyses of, and assessing issues or gaps in, insurance climate-related supervision and regulation and to anchor its analysis of climate-related financial risks to the industry in robust data and metrics in order to provide the best estimates of the size and scope of these risks. The limitations of historical data to predict a non-linear path of future events should be recognized.

As the FSOC Report notes, the number of States requiring insurers that write more than $100 million in direct premiums to complete the NAIC Insurer Climate Risk Disclosure Survey (NAIC Survey) has expanded to encompass 15 states and approximately 78 percent of U.S. direct premiums written. The NAIC's Climate and Resiliency Task Force is currently working with several States to redesign the Survey questions to align with the framework developed by the Financial Stability Board's (FSB) Task Force on Climate-Related Financial Disclosures (TCFD). For reports filed for 2020 and thereafter, insurers have the option to submit a TCFD report in lieu of completing the NAIC Climate Risk Disclosure Survey, an option

[1] https://www.whitehouse.gov/wp-content/uploads/2021/10/Climate-Finance-Report.pdf

[2] Another area where FIO may be able to promote Federal agency coordination and information sharing is to promote wider dissemination of Environmental Protection Agency ratings of commercial buildings to stakeholders, such as insurers and other financial institutions, with an interest in those properties.

that we strongly support. The NAIC is also expected to release recommendations for enhancing existing financial surveillance and reporting tools, such as Own Risk and Solvency Assessment (ORSA) reports and the *Financial Condition Examiners Handbook*, to ensure that climate-related risks are appropriately addressed. FIO may consider exploring with the NAIC additional avenues to promote the integration of material climate change risks into existing regulatory and reporting tools and processes.

We would also be in favor of FIO providing input to the NAIC and the U.S. Securities and Exchange Commission (SEC) on their respective efforts to enhance climate-related disclosures. We believe that the SEC and the NAIC should continue to pursue frameworks that are based, to the greatest extent possible, on the core elements of the TCFD framework in order to promote both domestic and global alignment on disclosure standards as this has been and is likely to continue to be an important input to future international sustainability reporting standards. We also note the proposal for an International Sustainability Standards Board, which is expected to facilitate a consistent and widely adopted framework for the disclosure of financially material climate-related risks that is fit for purpose for financial firms across the world.

Insurance Supervision and Regulation

We encourage FIO to approach climate-related risk through a resilience approach that is focused on policyholder protection and the prudent management of risks. As noted in the *IIF Prudential Pathways* paper, IIF members generally are of the view that prudential tools, particularly any measures that could restrict finance to companies most in need of support for transition, are not the most appropriate means of achieving alignment with national and international climate goals. These measures could generate unintended effects that actually hamper the transition to a low-carbon economy, including by producing destabilizing bubbles in 'green' assets.

At the global level, we support an approach that promotes alignment to the greatest extent practical and possible among insurance and financial services standard setters, including the development of a harmonized insurance climate risk disclosure framework supported by a common lexicon, both of which are designed to be dynamic in order to reflect the changing understanding of climate-related risks. As the White House Roadmap recognizes, a lack of clarity or consistency in terms of good market practices for climate or sustainability-aligned investments creates barriers to progress on building a climate-resilient economy.

It is important to consider the differences in the insurance business model from other financial services business models, and these differences need to be taken into account in designing a regulatory and supervisory framework to address climate risk in the insurance sector. Further, the fact that the materiality and impact of climate-related risks is likely to vary substantially among insurers and among insurance markets calls for a proportionate approach. Companies should be expected to adapt their enterprise-wide risk management frameworks to those climate-related financial risks that are most material to the firm, and to those risks that are most likely to have systemic implications, recognizing that some risks may be immaterial and/or unlikely to give rise to broader financial stability concerns.

It is important that insurers have the flexibility to adapt their existing risk management frameworks for climate risks, as they have for other risks over the years. For instance, insurers should be offered greater

latitude to adapt their ORSA reports in a manner that reflects those risks most material to the firm and is most appropriate for informing responses to climate change across regulators and industry, with due consideration given to data availability constraints. This may include adjusting material time-horizons to account for the long-term climate scenarios, rather than the capital-relevant short-term scenarios that are traditionally applied in ORSAs. FIO should recommend to the NAIC and the States, as well as to international standard setters, a principles-based approach to the supervision and regulation of climate risk that allows the insurance industry to innovate and develop (or adapt) appropriate tools and methodologies for managing the climate risk exposure of underwriting and investment portfolios. The development of these tools and methodologies would provide the board and management of insurance companies with decision-useful information that is critical to facilitating the transition to a low-carbon future. Each insurer should take an approach to managing climate risks that reflects its unique exposures and the nature, scale, and complexity of the risks to its business.

More broadly, the design of scenario analyses should be industry-driven, providing firms with the flexibility to develop scenarios (or adapt publicly available scenarios such as those developed by the Network for Greening the Financial System) that best reflect their business models and risk profiles. Given the early stages of scenario analysis development, we believe that any regulatory scenario analysis exercises should be performed in a "regulatory sandbox" environment – differentiating them from other prudential activities – until climate data, tools, and understanding have improved to the point where results are more meaningful and comparable across firms. Moreover, it is critical that supervisory exercises do not "crowd out" insurers' own internal analysis and resiliency efforts.

A good example of collaborative public-private sector climate risk exercises is the UK's Climate Financial Risk Forum (CFRF), which is convened by the UK PRA and FCA to bring together technical working groups on disclosure, scenario analysis, risk management, and innovation. The objective of the CFRF is to build capacity and to share best practices across industry and financial regulators to advance the sector's response to the financial risks from climate change. FIO could consider engaging with the State insurance regulators and the NAIC to convene a similar forum in the U.S.

Moreover, a study by FIO on how drivers of the transition to a low-carbon future could impact the insurance industry could contribute to a smooth, rather than disorderly, transition by promoting an appropriately structured, incremental and phased approach to climate-related changes to public policy and insurance regulation and supervision. A sudden and/or unexpected change in policy or regulation raises the prospect of disorderly price adjustments in various asset classes, which would directly impact the investment portfolios of the financial services sector, including insurers, which would likely impact negatively the functioning of financial markets in the U.S. and globally, including through disruptions to liquidity or financial markets utilities.

Insurance Markets and Mitigation/Resilience

As noted in our general comments, insurers, in their role as risk managers, are uniquely positioned to help address climate-related risks and to facilitate mitigation and resilience for disasters. Measuring and underwriting all types of risk, including climate-related physical and transition risks, is at the core of insurers' business models and enterprise risk management framework and at the heart of their strategic

plans and commitments to reduce their emissions, as well as to reduce the carbon footprint of their underwriting and investment portfolios. The IIF encourages FIO to engage the industry in order to understand more fully the private sector contributions to climate change and climate risk mitigation and resilience, and the future challenges to and opportunities for expanding those contributions. We would be pleased to facilitate those conversations with IIF members.

Risk finance instruments that strengthen climate resilience and enable better disaster recovery for customers and local communities, are a critical channel through which the insurance sector can help mitigate physical climate risks. Market-led, customer-centric innovative financial solutions from insurers and reinsurers should be paired with a policy and regulatory environment that supports commercial opportunities, as well as with progress on systematically pricing climate risk into financial markets

On the domestic front, FIO and FSOC could encourage a supportive policy and regulatory environment through active engagement and dialogue with the U.S. Congress on the importance of market-based carbon pricing that would incentivize investment in new technologies and innovations that support a net-zero emissions economy. FIO could also spearhead collaboration with other Federal agencies that have efforts underway to address climate resilience, such as the Department of Housing and Urban Development (HUD) and the National Oceanic and Atmospheric Administration (NOAA). For example, we note that HUD has developed a resilience toolkit to assist communities in enhancing their resilience to climate-related natural hazard risks.[3] These collaborations could also help to address the disproportionate impact of climate change on financially vulnerable populations. NOAA promotes community resilience through its Environmental Literacy Program and grants to communities to develop collective environmental literacy and enhance community resilience efforts.[4]

Federal initiatives can also play a role in enhancing climate resiliency and supporting insurance markets through increased, targeted investment in pre-disaster mitigation funding. Such initiatives include the Federal Emergency Management Agency's (FEMA) Building Resilient Infrastructure and Communities (BRIC) program, as well as Build Back Better federal and state post-disaster funding. Investment in pre-disaster mitigation has historically yielded significant savings. The National Institute of Building Sciences found that public-sector investment in mitigation since 1995 by FEMA, the Economic Development Association, and HUD cost $27 billion, but will ultimately yield savings of $160 billion, meaning $6 saved per $1 invested in federal mitigation grants.[5]

We understand that FIO plans to consider ways to address the lack of common methodologies and standardization in measuring financed emissions, particularly those of non-public companies in which the insurance sector underwrites and invests. Addressing these issues could be part of the outreach to and collaboration with the SEC on disclosure, perhaps through a working group of the FSOC. Industry-led initiatives for assessing and disclosing financed emissions are already underway, such as the Partnership for Carbon Accounting Financials (PCAF), a global consortium of financial institutions focused on developing a common framework for measuring and disclosing emissions. PCAF recently collaborated with the UN-convened Net Zero Insurance Alliance (NZIA) to launch the Insured Emissions Working Group, which is developing a standardized methodology for measuring the emissions profile

[3] https://www.hudexchange.info/manage-a-program/community-resilience
[4] https://www.noaa.gov/office-education/elp
[5] http://2021.nibs.org/files/pdfs/ms_v4_overview.pdf

and climate risk exposure among (re)insurers and their underwriting portfolios.[6] While these efforts continue to develop and mature, the limitations of methodologies for measuring financed emissions should be recognized and reflected in any FIO recommendations.

In the course of evaluating potential impacts on the industry and their implications for financial stability, FIO could consider how insurance regulation and supervision may incent/disincent investments in particular sectors or instruments and/or the underwriting of certain sectors, companies or risks, with significant ramifications for the availability and cost of insurance.

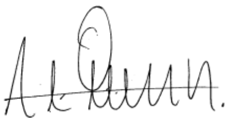
Insurance Sector Engagement

At the national level, we believe that there is considerable value in striving for alignment in approaches to assessing and mitigating climate-related risk across state insurance regulators through the NAIC, which was created by the State insurance regulators to set standards and best practices. We welcome the fact that FIO will consult with individual State insurance regulators and the NAIC during its assessment of supervisory practices and resources. FIO should continue to engage actively with both the NAIC and the U.S. insurance sector in analyzing how the sector may be impacted by, and help mitigate, climate-related risks. We welcome FIO's statements in the RFI that it will engage with the insurance sector to assess how the sector may help achieve national climate-related goals.

We also encourage FIO and U.S. Treasury to continue and expand its proactive engagement through international forums that are shaping global climate policy, including the G20 and the standard setting bodies, including the IAIS. Active participation in these consequential international discussions will allow FIO to promote transparency in policymaking and help shape international systems and standards under development, ensuring that these are also consistent with domestic policy objectives.

We appreciate the opportunity to provide comments to this RFI and we look forward to continued dialogue between industry and insurance supervisory authorities on climate-related risks in the insurance sector. We would be pleased to present to FIO and other authorities our views on these topics in greater detail.

Respectfully submitted,



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[6] https://carbonaccountingfinancials.com/newsitem/partnership-for-carbon-accounting-financials-collaborates-with-un-convened-net-zero-insurance-alliance-to-develop-standard-to-measure-insured-emissions#newsitemtext