Public Consultation on climate risk supervisory guidance – part one

Survey response 1

Information

Please provide your information:
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Do you agree with your responses being made public on the IAIS website?
Yes

Do you have any comments on the proposed text referencing climate-related risk within the ICP Introduction?
No response.

Do you have any comments on the location of the proposed text?
No response.

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?
As set out in our response to question 5, the IAIS's upcoming consultations on climate risk should cover transition planning, as insurers need to adopt transition plans in order to properly mitigate the climate risks to which both individual insurers and the insurance sector as a whole are exposed. The 2021 Application Paper does not address how transition planning should be reflected in insurers' corporate governance or risk management and internal control processes, and it would therefore be helpful for the IAIS to develop guidance in relation to this. A transition plan will only effectively mitigate the climate transition risks faced by an insurer if it is actually implemented by the insurer across all parts of its organisation and internal control functions. Transition plan regulation and supervision will therefore need to address insurers' corporate governance, risk management and internal control processes. We outline below some key principles on how transition planning should be addressed in both these areas. Corporate governance Insurers should be required to embed their transition plans in their governance systems, in order to ensure there is adequate accountability for the design and implementation of their plans. This will also help supervisors hold the board and senior management of insurers accountable for transition planning. The IAIS should therefore clarify how the corporate governance processes for climate risk outlined in the 2021 Application Paper apply to transition planning. This affects each of the five areas set out at sections 3.1-3.5 of the 2021 Application Paper, as addressed in turn below. (1) There should be clear and appropriate allocation of oversight and management responsibilities for producing and implementing transition plans across the board, senior management and control functions. (2) Transition plans should be reflected in annual financial planning, as well as long and short-term strategic planning processes. (3) The board should maintain effective oversight of the transition plan's production and implementation, including approving the written transition plan and reviewing it at least annually. In order to do so, the board must have appropriate understanding of, and opportunity to discuss, the transition plan. (4) Senior management should be made responsible for implementing the transition plan across the business, including in relevant operational and business policies. (5) Remuneration policies should promote the effective implementation of the transition plan through incentives set at a level to influence behaviour. The alignment of remuneration with prudent risk-taking should take into consideration that the implementation of the transition plan is key part of prudent risk management. Risk management Section 4 of the 2021 Application Paper provides guidance on how insurers' risk management and internal control systems should incorporate climate-related risks. Those risk management and control systems should also incorporate any risks identified in the transition planning process. In addition, internal audit should evaluate the adequacy and effectiveness of the insurer's governance arrangements and internal controls in relation to transition planning. This is necessary to ensure that insurers take the necessary steps to successfully deliver their transition plans and to mitigate any risks associated with their plans. The IAIS should therefore clarify how transition planning should be considered within the risk management and internal control systems, including in particular by the risk management function and internal audit function.

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?
No response.

Should the IAIS' work and upcoming consultations on climate risk also cover considerations related to transition planning by insurers?
Transition planning is increasingly being recognised as an essential tool for mitigating climate risk. Investors are calling for corporate transition plans which include the adoption of emissions targets aligned with global climate goals and a credible plan to achieve those targets, as the most effective method to protect businesses from the risks of the transition to a lower carbon world (see for example the Net-Zero Company Benchmark by ClimateAction 100+, and the Investor Expectations of Corporate Transition Plans: From A to Zero by the Institutional Investors Group on Climate Change). Within the insurance sector, transition planning should cover emissions reductions across insurers' investment and underwriting portfolios and operations. The IAIS should introduce standards for transition planning by insurers within the ICPs, for three reasons: (1) to mitigate the climate risks faced by individual insurers; (2) to mitigate the systemic risks climate change poses to the insurance sector and the wider economy; and (3) to ensure that transition plan regulation for insurers is introduced by supervisors in a manner that is effective and globally consistent. Risks to individual insurers Transition plan regulation and supervision is an essential prudential tool to mitigate the climate transition risks faced by individual insurers. The 2021 Application Paper summarises the climate changes that insurance companies are exposed to. In particular, the necessary transition to a lower carbon world poses risks to insurers' asset portfolios. Investments in carbon-intensive assets are at risk of being re-priced, for example due to regulation or policies affecting carbon-intensive activities (such as the production or use fossil fuels) or due to the commercial effects of the transition and shifting consumer preferences (such as reducing demand for fossil fuels and lowering cost of low-carbon technologies). Such regulation and policy action is likely to increase as countries set increasingly ambitious emissions reduction commitments under the Paris Agreement and implement domestic policies to achieve them. Insurers which do not adopt transition plans to reduce the emissions of their investment portfolios in line with the goals of the Paris Agreement will therefore inevitably face material risks, as new law, regulation and policies are introduced by countries across the world to align the economy with global climate targets. Systemic risks The adoption of transition planning across the economy is vital to avoid the severe systemic risks caused by climate change and support an orderly transition to net-zero. All sectors, including the insurance sector, need to align with global climate pathways in order to avoid extreme warming and disorderly transition, and the severe financial risks they would cause. As noted in the consultation paper, climate change can affect the insurability of assets. This is a significant risk for the whole insurance sector, as extreme warming could lead to certain types of risk (in particular, natural catastrophe cover) becoming uninsurable, either due to premiums becoming unaffordable or due to insurers being unable to accurately price unpredictable and rapidly changing risks. For example, the CRO Forum considers that 3°C warming "creates real insurability challenges and could therefore challenge the sector" (see The Heat Is On, 2019). Warming in excess of the Paris Goals would also pose significant macro-economic risks to insurers' asset portfolios which cannot be effectively managed through portfolio construction and asset allocation. Such macro-economic impacts will be irreversible and far-reaching in breadth and magnitude, causing a substantial reduction in global GDP compared to a Paris-aligned scenario. For example, analysis by Swiss Re models that global GDP could be 10% lower if the goals of the Paris Agreement are not met (see The Economic of Climate Change: No Action is Not An Option, 2021). Climate change poses global risks to financial stability, as noted in the consultation paper. Insurance supervision has a role to play in mitigating such macroprudential climate risks affecting the financial system, as recognised by the IAIS in its Commitment to Amplify Response to Climate Change (October 2021). The only way to fully mitigate these systemic risks to the insurance sector and the broader economy is to avoid extreme warming through an orderly transition. Supervisors should therefore ensure that the insurance sector does not contribute to extreme warming or disorderly transition by requiring insurers to align their investment and underwriting activities with global climate targets. IAIS role in developing transition plan regulation Governments and supervisors are already introducing transition plan regulation. For example, in the EU, the Corporate Sustainability Reporting Directive requires in-scope companies (including insurers) to disclose transition plans compatible with limiting warming to 1.5C (see Article 19a(2)(iii)). In addition, in 2021 the UK Financial Conduct Authority introduced rules for listed companies and asset owners (amongst certain other financial institutions) to make climate-related disclosures in line with the Task Force on Climate-Related Disclosures' recommendations, including in relation to transition planning (see FCA Listing Rules 9.8.6, 14.3.27-14.3.32 and ESG Sourcebook 2.2.1-2.2.2). It is likely that more jurisdictions will similarly introduce regulation for transition planning by companies (including insurers) in order to meet their nationally determined contributions under the Paris Agreement and national emissions targets. It is vital that the IAIS adopts principles and standards in the ICPs for transition planning, to help guide the developing regulation. ICP standards could help ensure high standards and consistency in transition plan supervision, which would support the IAIS' mission to promote effective and globally consistent supervision of the insurance industry and contribute to global financial

stability, as well as the IAIS' commitment to supporting an orderly transition to net-zero.

Do you see anything missing from the current IAIS workplan on climate risk, as outlined in the IAIS 2023-2024 Roadmap [https://www.iaisweb.org/uploads/2023/01/iais-roadmap-2023-2024.pdf]?
The workplan notes that the IAIS plans to update certain ICP guidance and develop further supporting material in relation to climate-related risk, and also to consult on good supervisory practices in relation to climate change. In line with our response to questions 3 and 5, we consider that these activities should address transition planning. In particular, the development of standards and best practices for transition plan regulation and supervision should be a key project for the IAIS in 2023.