ClientEarth

November 2021

Federal Insurance Office Request for Information on the Insurance Sector and Climate-Related Financial Risks

ClientEarth Response

ClientEarth is a charity that uses the power of the law to protect people and the planet. We are international lawyers finding practical solutions for the world's biggest environmental challenges. From our offices in London, Brussels, Warsaw, Berlin, Madrid, Beijing, Luxembourg and Los Angeles, we work on laws throughout their lifetime, from the earliest stages to implementation and enforcement.

1. We welcome the opportunity to respond to the Federal Insurance Office's ("**FIO**") request for information on climate-related financial risks (the "**Request**"). We agree with FIO's assessment that climate change poses risks to the insurance sector, as well as challenging the stability of the financial system more broadly. Extreme warming will increase the protection gap and lead to increasing amounts of uninsurable risks, and will also pose macro-economic and financial stability risks to insurers' asset portfolios. In addition, the necessary transition to a low carbon world can pose significant risks to insurers' asset portfolios. For further detail on these risks, see our letter dated 9 July 2021 to the Insurance and Pensions Unit of the European Commission.[1]

2. ClientEarth has signed a separate letter responding to the Request sent by Public Citizen and a coalition of NGOs. In addition to the points made in that letter, we want to raise three areas that FIO

[1] ClientEarth, Letter to the Insurance and Pensions Unit of the European Commission (9 July 2021) at paragraph 3.

should consider in its assessment of climate-related issues and gaps in the supervision and regulation of insurers.

Risks from fossil fuels and carbon-intensive activities

3. FIO should conduct an assessment of the risks posed to insurers from investments and underwriting activities related to fossil fuels and other carbon-intensive industries, including whether those risks are adequately reflected in existing prudential regulation (including through capital regimes). Regulators are undertaking such an assessment in both the EU and UK,[2] so FIO may wish to coordinate with those efforts.

4. ClientEarth and other NGOs have called for enhanced capital requirements in respect of fossil fuel investments and underwriting in the EU and UK, in order to properly reflect the degree of climate-related risks incurred by such activities. See in particular:

   a. our response to the UK Government's call for evidence as part of its review of Solvency II, in which we proposed (amongst other matters) that there should be enhanced capital requirements for fossil fuel investments and insurance; [3] and

   b. the letters dated 27 October 2021 from a coalition of NGOs (including ClientEarth) to the International Association of Insurance Supervisors and others calling for fossil fuel investments and underwriting to have the highest risk category under the EU capital regime, and for the financing and underwriting of new fossil fuel projects to be subject to a 100% capital requirement.[4]

Transition plans

5. The insurance sector can help achieve national emissions reduction goals by moving beyond the disclosure and management of climate-related risks towards adopting and implementing transition plans aligned with limiting warming to 1.5°C over pre-industrial levels. Climate risk management (where each insurer focusses only on managing its own individual financial exposure) is not sufficient to prevent the insurance sector contributing to warming in excess of the goals of the Paris Agreement, and instead the sector needs to actively target emissions reductions across both its investment and underwriting business. See our response to the UK Government's call for evidence as part of its review of Solvency II for further detail.[5]

6. We set out the minimum standards that any Paris-aligned or net-zero transition plan should meet in our Position Paper on Paris-Alignment.[6] In outline, transition plans should include science-based

[2] The EU Commission has submitted proposals for amending the EU's insurance prudential regime (Solvency II). These proposals include a requirement for the European Insurance and Occupational Pensions Authority to conduct an analysis of assets/activities with ESG impacts (which will cover insuring/investing in fossil fuels and other carbon-intensive activities) by June 2023. See the proposal at proposed article 304a and the EU Commissions webpage on its Solvency II review. In addition, The UK Prudential Regulation Authority plans to commission research on the interaction between climate change and capital, and then publish guidance by the end of 2022. See its Climate Adaptation Report 2021 at pages 42-43. That report also flags gaps in the capital assessment of climate risks.

[3] ClientEarth, Response to HM Treasury Call for Evidence: Review of Solvency II (February 2021).

[4] Finance Watch, ClientEarth and others, Letter to IAIS (27 October 2021) and associated press release.

[5] ClientEarth, Response to HM Treasury Call for Evidence: Review of Solvency II (February 2021).

[6] ClientEarth, Principles for Paris-Alignment: Position Paper (October 2020).

interim targets covering all scopes 1-3 emissions,[7] be transparently disclosed, and include effective accountability measures that hold individuals responsible for achieving targets. FIO should consider ways to encourage the setting of science-based emissions reduction targets and credible transition plans, including guidance on standards to ensure the comparability and credibility of such targets/plans.

7. Legislation and guidance from regulators can help ensure that companies disclose credible and comparable transition plans. We therefore welcome that the TCFD has updated its guidance to recommend that companies should disclose transition plans,[8] and that both the EU and UK are legislating to mandate the disclosure of transition plans by companies (including insurers).[9]

8. We also welcome that FIO is planning to consider ways to address the lack of a common methodology and standardisation in measuring financed emissions. Methodologies for measuring the emissions associated with underwriting portfolios are currently underdeveloped. A credible standardised methodology (including standards for measuring alignment of portfolios with the goals of the Paris Agreement and national emissions commitments) is a necessary first step for the insurance sector to be able to take action on its climate risks and impacts. We note that the Partnership for Carbon Accounting Financials is currently working with the Net Zero Insurance Alliance to develop a methodology for measuring portfolio emissions, and FIO may wish to cooperate with them.

Impact underwriting

9. The European Insurance and Occupational Pensions Authority has promoted the concept of *"impact underwriting"*, which is the use of risk-based pricing and contractual terms to contribute to climate change adaptation or mitigation.[10] We consider that impact underwriting can assist in both mitigating and adapting to climate change, and therefore encourage FIO to conduct an assessment of the role of impact underwriting in reducing climate risk and helping achieve national climate goals.

[7] For example, targets should reflect the reductions in fossil fuel emissions/production in 1.5°C aligned pathways modelled in the UN's Production Gap Report 2021 (which require annual reductions in coal, oil and gas production of 11%, 4% and 3% respectively) and the International Energy Agency's Net Zero By 2050 report (which require: net-zero electricity by 2040 globally and in OECD countries by 2035; all unabated coal and oil plants, and the vast majority of unabated gas plants, to close by 2040; and no investment in new fossil fuel supply beyond projects committed in 2021).

[8] TCFD, Annex: Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures (October 2021) at Strategy Recommended Disclosure (b).

[9] The UK Government has announced plans for the UK to be a net-zero aligned financial centre. This will include rules requiring asset managers, asset owners and listed companies to disclose (on a 'comply or explain' basis) transition plans aligned with the UK Government's target of net-zero emissions by 2050, as set out in its fact sheet. The EU is introducing a Corporate Sustainability Reporting Directive which will require insurance companies (as well as banks, listed companies and all large companies) to disclose their plans to ensure their business model and strategy are compatible with limiting warming to 1.5°C. See the proposed directive at proposed article 19a(2)(a)(iii) and the EU Commissions webpage on the directive.

[10] See EIOPA, Report on non-life underwriting and pricing in light of climate change (July 2021) which defines impact underwriting as: *"Consistently with actuarial risk-based principles, (re)insurers, as risk managers and underwriters, can contribute to climate adaptation and mitigation by applying their data, expertise and risk assessment capacity to incentivise policyholders to mitigate insured risks via risk-based pricing and contractual terms, and consider in their underwriting strategy measures that contribute to climate change adaptation and/or mitigation."*

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