Position Paper

Comments on IAIS draft application paper on supervision of climate-related risks in the insurance sector

Our reference:	ECO-LTI-21-005		
Referring to:	IAIS draft application paper on the supervision of climate-related risks in the insurance sector		
Related documents:			
Contact person:	Ecofin	E-mail:	ecofin@insuranceeurope.eu
Pages:	14	Transparency Register ID no.:	33213703459-54

Summary

Europe's insurers remain as committed as ever to supporting the transition to a more sustainable society and to tackling climate change. The insurance industry believes that these fundamental policy ambitions must be pursued despite the significant, new challenges created by the COVID-19 pandemic. The industry can play a key role in the sustainability transition by both investing in sustainable assets and providing insurance coverage to help society to deal with sustainability risks.

Insurance Europe welcomes the opportunity to comment on the IAIS draft application paper. As sustainability is a global issue, it needs to be addressed through a global approach and international coordination. Insurance Europe therefore welcomes the IAIS's facilitation of a coordinated approach between jurisdictions. Coherent policymaking between jurisdictions will avoid duplicative or contradictory standards.

The ICPs/ComFrame framework does not currently represent an obstacle to the integration and measurement of sustainability risks, including climate-related risks. The IAIS paper will help further strengthen the integration of climate-related risks into jurisdictional supervisory frameworks in a consistent and efficient manner.

Insurance Europe has the following comments on the draft application paper:

- The European insurance industry fully supports the assessment of the **materiality** of climate-related risks to individual insurance companies as well as to the insurance sector as a whole. Nevertheless, it is key that supervisors strike the right balance without putting excessive focus on climate-related risks at the expense of other risks.
- Sound **sustainability/ESG ratings** should be acknowledged as a key precondition for supervisory review and reporting. It is paramount that supervisors adequately deal with such challenges without setting expectations that insurers solve such challenges.
- While seeking consistency and comparability can be of significant value, care must be taken to ensure that supervision does not discourage or prevent **rapid and innovative developments in the private sector to address new risks and changes in the business and risk environment**. Insurance Europe stresses therefore the importance of flexible approach based on strong stakeholder engagement in developing effective frameworks for supervision in uncharted areas. The fast emerging and evolving nature of climate-related risks warrants an approach that ensures the framework fits markets that are different in nature and are at different levels in developing policy relevant to climate-related risks.

Insurance Europe aisbl
Rue Montoyer 51, B-1000 Brussels
Tel: +32 2 894 30 00 • Fax: +32 2 894 30 01
E-mail : info@insuranceeurope.eu
www.insuranceeurope.eu

- Insurance Europe agrees that all companies should integrate sustainability in their **corporate governance framework**. It is important that supervisors monitor the impact of the measures enacted so far and consider existing legislation before proposing new regulatory requirements. In any case, supervisors should make sure that prescribed governance models do not pre-empt or deny other governance structure intended to address evolving risks and take into account that materiality of climate risks differs across entities and may change over time.
- Being supportive of sustainability objectives, Insurance Europe recognises that explicit references in legislation and other tools such as guidelines should help integrate sustainability risks, including but not limited to climate risk, consistently and more efficiently in the **risk-management function**.
- Insurance Europe also agrees that the actuarial function takes into account material climate-related risks, provided this is done at the same level as other considerations. Consideration of climate-related risks in **underwriting policies** is supported as long as there is a right balance between all risks, and no excessive focus is put on climate risks at the expense of other risks.
- Consideration of the effect of sustainability risks including climate-related risks should also be included in the **ORSA** as long as these risks are financially relevant and material for the undertaking. As the analysis of climate-related risks is dependent on the company-specific strategy and risk assessment, the ORSA should continue to represent the undertaking's own view of its risk profile. A prescriptive approach should therefore be avoided, and the undertaking should be able to decide for itself how to perform the climate risk assessment on the basis of the nature, scale and complexity of the risks in its business.
- Insurance Europe supports the inclusion of material sustainability risks including climate-related risks in **investment policies**. In this respect, it notes that stewardship is only one of the broad sustainability-related strategies used by insurers. Other investment strategies are available, sometimes more effective to manage climate-related risks.
- Increased **transparency on sustainability** is welcome, but care must be taken to avoid overlapping and/or duplication in regulatory requirements and overload for businesses and consumers. It is important that:
    - insurers have flexibility in disclosures while respecting consistency and comparability.
    - insurers have access to good quality sustainability-related information at asset level and mandatory reporting is not imposed before the necessary data is available. Sound sustainability/ESG ratings should be acknowledged as a key precondition for supervisory review and reporting.
    - while a globally coordinated approach to general company ESG data reporting is the objective, it does not slow down faster progress within Europe where ESG related requirements are already well advanced and the access to data from investee companies is very urgent.

Comments on section 1: introduction.

Section 1.1 Context and objective

- Insurance Europe agrees that climate change is a global threat. It takes the view that insurers should appropriately consider sustainability risks, including climate-related risks, especially when these risks are expected to have a future material impact on the balance sheet of the insurance company.
- Insurance Europe believes that, in integrating sustainability risk, including climate-related risks, undertakings should be given sufficient flexibility to reflect their specific business model and to integrate sustainability risks in their business processes and decisions. The principle of proportionality also needs to be reflected in the consideration of sustainability risks: the type and maturity of the undertakings' obligations, as well as the nature, the regionality and the risk exposure connected to those obligations need to be adequately considered.

Paragraph 1:

- European insurance companies agree that climate change is a global threat that requires a global response. It is essential that the paper stresses that collective efforts involving all economic stakeholders. Cooperation between policymakers and market players is needed to tackle climate change. Insurance Europe suggests adding a following sentence:

  "Making a successful transition to a sustainable economy is the collective responsibility of all humanity and requires enhanced cooperation between the public and private sector."

Paragraph 3:

- Policymakers, businesses and consumers must understand the scope and scale of the impact of climate change. The most significant contribution that regulators and insurers can make is through risk-based pricing, as this can provide the right set of incentives and economic signals regarding the impact of climate change. In this respect, Insurance Europe strongly calls for regulators to support risk-based pricing. After the second sentence, Insurance Europe suggests adding the following:

  "Risk-based pricing helps deliver appropriate economic signals in line with real risks."

Paragraph 4:

- The emerging and evolving nature of climate-related risks warrants more than supervisors' efforts to integrate climate risk into the supervision of the insurance sector. It requires supervisors' active engagement and cooperation with policymakers to develop an environment that helps insurers fully contribute to the transition to a more sustainable economy. There are several challenges that cannot be solved by insurers alone and need policy actions. Supervisors have a key role to play in this respect.
- The paper should facilitate a broader exchange of experiences between supervisors. One possibility would be to include for each ICP a dedicated section highlighting "dos and don'ts". While the paper pays a lot of attention to the supervisory "dos", it could benefit from more emphasis on the "don'ts". This is key, as the paper will be useful material for both supervisors and insurers to share their experiences and inform the sound development of appropriate supervisory practices, which is particularly important when dealing with fast-emerging and evolving risks.

Section 1.3 Proportionality

- Insurance Europe welcomes the importance attributed to the principle of proportionality. It should be fully reflected in the supervision of climate risk: the type and maturity of the undertakings' obligations, the risk level connected to those obligations, as well as the nature and the regionality of the insured risks are all elements that need to be considered.
- Proportionality is particularly important to avoid an excessive burden on insurers with low exposure to climate-change risks. A number of tools can be used to apply the principle of proportionality and avoid unnecessary, burdensome requirements. For example, in the case of stress-testing and scenario analysis, the industry believes that maximum flexibility should be given to insurers to assess financially material climate risks in their processes, either in a quantitative or qualitative way.

- This paper should include explicit recommendations to supervisors to allow insurers to have sufficient flexibility in how to consider material climate-change risks, in line with their specific characteristics and risk profiles. Such flexibility is also key to adequately dealing with the inherent uncertainty related to the use of some climate-risk assessment tools, especially in the long term. Many assessment methodologies are still under development and this does not justify rigid and prescriptive approaches to supervision. Good practices and high-level principles are most effective in providing guidance on the best way to consider climate risk.

Section 1.4 Terminology

Paragraph 7:

- The definitions are generally clear. Insurance Europe suggests:
  - Clarifying the link between climate-related, environmental and sustainability risks, ie that environmental risks are a subset of sustainability risks, including but not limited to climate-change risks.
  - Adding a clear definition of environmental, social and governance factors.
- It would be useful to acknowledge not only the financial impact of sustainability on insurers, but also insurers' effect on sustainability. Currently, the risks considered in Table 1 only take into account an "outside-in" approach of climate risks (ie how do climate risks impact insurers' activities). In Europe, an increasing number of companies, including insurers, also recognise an "inside-out" approach (ie how a company's activities affect climate change) when identifying, managing and reporting on climate risks.

Section 1.5 Scope

Paragraph 10:

- Insurance Europe welcomes the decision to exclude ICPs 14 and 17 from the scope of the paper, as climate risk management is at too early a stage of development to be adequately incorporated in ICPs 14 and 17 following a risk-based approach. While tools such as scenario analysis and stress-testing can be used to investigate the impact of climate change, their results are not yet reliable enough to be used to assess the solvency of insurers. Their use could produce ill-informed market signals, which would be inconsistent with a stable transition to greater financial sustainability. Insurance Europe suggests adding the following sentence at the end of the paragraph:

  " In addition, the use of ICP 17 to assess climate-related risks might be premature as it is particularly difficult to assess potential risk differences based on sustainability, especially as the valuation and the risk profile of assets are influenced by many factors."

Paragraph 11:

- Insurance Europe reiterates the importance of cooperation between different players, and specifically the public and private sector, in tackling climate change. Therefore, the European industry appreciates the possibility of exploring new forms of public-private partnership in order to improve the availability and affordability of insurance, while providing best practices and lessons learnt to improve adaptation to climate change and mitigation of the financial impact of weather-related events. In this respect, policymakers should invest in broad mitigation strategies. They could:
  - Subsidise insurance premiums of certain products and services with low penetration rates on the condition that they are related to resilience and prevention measures.
  - Develop a clear framework for identifying and classifying activities that enhance policyholder resilience.
  - Anchor climate resilience in planning standards and building regulations to improve resilience to natural hazards.
  - Facilitate public-private partnerships in cases where there is a lack of insurability through the private sector alone: eg due to an absence of diversification and resulting pricing issues.
- However, it is important that these are not only temporary solutions but real fixes of the issue at stake. Insurers are only one component in a wider effort to make the economy sustainable. And they can only play their part in the transition to a sustainable economy if other companies and governments are willing to fulfil their own roles.

Comments on section 2: role of the supervisor

Paragraph 12:

- Insurance Europe agrees that supervisors should assess material climate-related risks to insurers alongside other material risks. In this respect, it needs to be acknowledged that climate-risk assessment tools are still under development and the reliability of their outcomes are affected by current uncertainties, eg in terms of data availability and methodologies. Therefore, it is important that the supervisory process considers the current situation and avoids rigid and prescriptive approaches.

Section 2.1 Preconditions and resources

Paragraph 13:

- Insurance Europe agrees that an effective system of insurance supervision requires a number of preconditions to be in place and welcomes the commitment from the supervisory community to consider such preconditions. While it is true that some are not directly under the influence of the supervisor, it is worth noting that the supervisor often has the ability to influence them precisely because such preconditions affect the supervisory practices. In this regard, Insurance Europe suggests the following amendments:
  - *"Although not directly under the influence of the supervisor, such preconditions can be taken into account..."*
  - After the last sentence: *"The supervisor can have a voice in suggesting to its government what changes are required to achieve an effective system of insurance supervision."*
- Sound sustainability/ESG ratings should be acknowledged as a key precondition alongside other examples in this paragraph. Sustainability/ESG ratings will unavoidably affect the market value of assets insurers invest in. Therefore, a regulatory framework should ensure that sustainability ratings, which are provided by independent assessors, are comparable, reliable for investors, but also available freely or at an affordable price. As the coverage of ESG rating agencies expands, the large majority of insurers risk being dependent on external, third-party data providers for their sustainability assessment as well as for their sustainability risk assessment. This is increasingly likely when ESG ratings and data providers develop into oligopolistic structures, which lead to an increase in the costs of accessing ESG ratings and data. Existing issues with the availability and reliability of ESG data should not force market participants to rely on third-party providers to obtain them (see comment on paragraph 38).
- The IAIS should take this opportunity to assess how effectively supervisors can make policymakers aware of the listed shortcomings. Insurance Europe is also of the opinion that some examples are not fully connected with the precondition and therefore suggests the following clarifications:
  - *~~Efficient financial markets~~ Clarity on sustainable investment practices, eg ~~the adoption of~~ a shared taxonomy or classification of assets or activities against a set of sustainability goals; or*
  - *Effective transparency ~~discipline~~ in financial markets, eg the extent to which non-financial private sector participants have implemented climate-related disclosures, or the availability of reliable and comparable sustainability ratings.*
- When supervisors do not have the means to overcome the challenges related to the lack of adequate preconditions to guarantee an effective supervisory system, it is paramount that supervisors adequately deal with such challenges without setting expectations that insurers solve such challenges. For example, if data availability at asset level is considered a challenge, the supervisor should not expect insurers to be able to disclose granular information about the sustainability of its portfolio.

Paragraph 16:

- Insurance Europe takes the view that maintaining regular dialogue and consultation with stakeholders on these new issues is key to understanding the challenges and approaches to deal with climate change in different business functions and areas. For instance, in France, the supervisors created a working group aimed at developing feasible and meaningful climate-scenario analysis in cooperation with industry representatives.

Section 2.2 Supervisory review and reporting

Paragraph 18:

- Insurance Europe appreciates the guidance in ICP 9.1 on the consideration of evolving risks such as climate risk. The industry fully supports the assessment of the materiality of climate-related risks to individual insurance companies as well as to the insurance sector as a whole. Nevertheless, it is key that supervisors strike the right balance without putting excessive focus on climate-related risks at the expense of other risks.

Sub-section 2.2.1 Information gathering

Paragraph 19:

- Insurance Europe welcomes the fact that the paper acknowledges the possibility that relevant data is available in the public domain in various forms. It is important that supervisors encourage the availability of reliable public data, which can be useful to evaluate an insurer's exposure to physical and transition risk, as well as the sustainability of its portfolio. This will also reduce the burden for insurers.
- The paper should include an explicit reference to the possibility that the exposure to physical, transition and liability risks is described qualitatively. This may be supported by quantitative analyses (eg ranges, directions) when appropriate (see comment on Q33 (paragraph 22) and Q91 (paragraph 62)).

Paragraph 20:

- Insurance Europe welcomes the acknowledgment of the fact that there is a lack of available and reliable ESG data. This is one of the major challenges in assessing risks and making decisions, especially in relation to long-term sustainable investment given the global scale of insurers' investment portfolios.
- When it comes to ESG data, European insurers are under increasing pressure to disclose ESG information, but they cannot be required to provide the solution to the lack of such data. Before shifting to periodic disclosures, supervisors should focus on supporting appropriate policy actions at the asset level to improve ESG data. European insurers have strongly supported such policy actions and are keen to help policymakers outline specific data requirements. This would allow insurers to have access to ESG information, including on climate risks. Insurance Europe suggests adding the following:

  "Before using ad hoc information requests, supervisors should consider whether they can achieve their objectives through information already collected from insurers."
- While the European insurance industry acknowledges the need to have ad hoc information on climate-change risk, full integration of climate-risk information into the regular reporting requirements might be difficult due to the very nature of climate risk, often materialising via other risks.

Paragraph 21:

- Insurance Europe welcomes supervisors' cross-border cooperation to avoid multiple information requests. Where an insurer is subject to group-wide supervision, information requests and other assessments should be conducted by the applicable supervisor on a group-wide basis to avoid multiple overlapping procedures which would add an unnecessary burden on insurers.
- While cooperation is appreciated, it should be clear that information-sharing between the group-wide and other relevant supervisors should be subject to confidentiality requirements (ie ICP 9.1.3, CF9.2.a.7). The paper should include a clear and strong reference on this point.

Sub-section 2.2.2 Supervisory feedback and follow-up

Paragraph 22:

- Insurance Europe fully supports clear two-way communication between supervisors and insurers. Close collaboration and communication with the industry at both global and local levels is also vital to ensure the feasibility of data requests and potential requirements. Insurance Europe suggests adding at the end of the paragraph the following sentence highlighting the importance of supervisors understanding the approaches taken by insurers with regard to climate risks:

  "Such communication is also essential to better understand the challenges faced by insurers and find adequate long-term solutions to overcome them, building on varying and dynamic developments in the market."

- The examples of quantitative indicators provided in Box 1 should not be understood as individual key performance indicators (KPIs). They should rather be understood as underlying information for a range of KPIs and/or heatmaps.

Comments on section 3: corporate governance

Section 3.1 Appropriate allocation of oversight and management responsibilities

Paragraph 25:

- Insurance Europe agrees that all companies should integrate sustainability in their corporate governance framework, including consideration of sustainability risks in their remuneration practices. It is important that supervisors monitor the impact of the measures enacted so far and consider existing legislation before proposing new regulatory requirements. For example, in the EU there is also already an increasing amount of overlapping legislation spelling out sustainability requirements in corporate governance frameworks.
- Given this, supervisors should:
  - Make sure that proposals do not pre-empt or deny any form of governance structure intended to address evolving risks including, but not limited to, climate risks, unless any critical flaws are identified.
  - Take into account that materiality of climate risks differs across entities and may change over time. Insurance companies that do face material climate risks should not be forced to adopt dedicated governance structures. While voluntary guidance on climate-risk governance is useful, it should not prescribe one approach over another. Insurance Europe therefore proposes the following change in the last sentence of the paragraph:

    "Supervisors ***could provide voluntary guidance on how to*** *~~may want to encourage insurers to~~ establish such a committee or other suitable structures with appropriate expertise, if they do not have one already."*

Section 3.2 Business objectives and strategies of the insurer

Paragraph 27:

- It is important that insurers are given flexibility to rely on the tools they consider the most appropriate to manage climate risks when incorporating and assessing climate risks as part of their financial/strategic planning. Insurance companies are best positioned to perform this task.

Section 3.3 The role of the board

- The IAIS should encourage supervisors to provide voluntary guidance on best practices, while clarifying that there is no obligation to adopt certain prescribed governance models. It is important that insurers are permitted flexibility to manage climate-related risks within the governance structure that they consider the most appropriate depending on the materiality of the risks and their business models.

Section 3.5 Duties related to remuneration

- In general, the European insurers are of the opinion that any regulation must be sufficiently flexible to allow insurers to embed climate-related risks within their risk management framework, reflecting the differences in sustainability risks and factors associated with various companies' characteristics.
- With respect to the consideration of climate-related risks in remuneration policies, it is important to avoid putting excessive focus on climate-related risks at the expense of other risks. It is equally important that the integration of climate-related risks does not jeopardise the existing functions of remuneration.
- The paper should note that particular reference to climate-related risks in remuneration policies should not be understood to suggest that other risk areas are less important for remuneration purposes.

Paragraph 33:

- The example provided in the last sentence may work for sustainability in general, but it is not necessarily directly related to climate issues. The last sentence should include "in some cases" to clarify this.

Comments on section 4: risk management and internal controls

- Being supportive of sustainability objectives, Insurance Europe recognises that explicit references in legislation and other tools such as guidelines should help integrate sustainability risks, including but not limited to climate risk, consistently and more efficiently in the risk-management function. This is appreciated especially given the importance of this subject and its relevance in the years to come. In fact, the prudential framework should not be an obstacle to the integration of sustainability risks. On the contrary, it can support such integration, eg by explicitly integrating sustainability risks in the risk management and control functions.

Section 4.1 Integrating climate-related risks into the scope of the risk management system

Paragraph 37:

- Insurance Europe agrees that sustainability risks, including climate-related risks, should be considered at the same level as other risks and that they should be included in risk management policies, provided that these risks are financially relevant and material. It is essential that the assessment of sustainability risks considers materiality and allows sufficient flexibility for undertakings to deal with their risk exposures within their organisational structure.
- Insurance Europe supports the statement that climate-related risks should be considered within the existing categories of risks as they can materialise via the existing risk categories. For this reason, it is important to consider such risks at the same level as other risks. It is also key that the analysis of climate risk is dependent on the company-specific strategy and risk assessment, based on financial materiality.

Paragraph 38:

- Some key challenges, such as the availability of good quality and reliable data, are outside insurers' control. Even with the best processes and tools, while insurers can make reasonable efforts to gather data, they cannot collect reliable quantitative and qualitative sustainability information for all assets in their portfolios. For example, there are instances when insurers cannot be held accountable for gathering the information necessary to fully evaluate physical risks related to the specific locations of assets: this is the case for bonds and equities, for which issuers do not disclose climate-related information that could help insurers identity and assess climate-related risks.
  For this reason, Insurance Europe recommends deleting this paragraph or rephrasing it to avoid putting unreasonable pressure on insurers. At a minimum, the paper should clearly state that supervisors need to acknowledge that the data availability issue is a larger and shared responsibility of the wider economy. Supervisors should fully recognise this challenge and help develop appropriate solutions that do not force insurers to rely on third-party data providers to obtain such data (see also comments on paragraph 19).

Section 4.2 Consideration of climate-related risks by the control functions

<u>Risk-management function</u>

Paragraph 41:

- It is important to strike the right balance of risk consideration in risk-management practice and supervisory review, without putting excessive focus on climate-related risks at the expenses of other risks.

Paragraph 42:

- Insurance Europe notes that the current sparseness of ESG data represents an obstacle to monitoring exposures from a sustainability viewpoint and to the extensive use of qualitative methodologies. Equally importantly, Insurance Europe wishes to emphasise the need for proportionality with respect to the information requirements associated with the integration of climate-related risks. An excessive additional burden on small insurers with respect to any new information requirements should be avoided.

- Regarding aligned criteria between underwriting and investment functions, Insurance Europe points out that such aligned criteria may not produce aligned outcomes given the difference in the available data between these two functions. Criteria cannot be the same at this stage due to the data availability issue. This paragraph should acknowledge the lack of available data.

<u>Actuarial function</u>
Paragraph 45:

- Insurance Europe agrees that the actuarial function takes into account material climate-related risks. In doing so, it should be done at the same level as other considerations, such as inflation, legal risk, etc. The paper should note this point to ensure that the consideration of climate-related risks will not prevail over other equally important risks/considerations and vice versa.

Section 4.3 Fitness and propriety of control functions on climate-related risks

Paragraph 48:

- It should be made clear that the assessment of fitness and propriety should take into account the respective duties allocated. While the proportionality principle is highlighted in the introduction section, the last sentence highlighting insurance policies and associated investments can be misleading. It should be amended to read:

  "Insurers should ensure that persons who perform Control Functions have relevant experience in understanding the climate risk ***as appropriate to the respective duties allocated*** *~~in insurance policies they underwrite and associated investments.~~"*

Comments on section 5: enterprise risk management for solvency purposes

Section 5.1 Underwriting

- Insurance Europe generally supports the consideration of climate-related risks in underwriting policies. In this respect, it is important to strike the right balance between all risks, without putting excessive focus on climate risks at the expense of other risks.

Subsection 5.1.1 Consideration of climate-related risks in the underwriting policy

Paragraph 54:

- Insurance Europe supports the IAIS statement on the incorporation of climate-risk considerations in insurers' underwriting policies. Insurers should be able to do so by including references to climate-related risks in other risk management policies other than the underwriting policies. Therefore, Insurance Europe suggests including "where relevant" in the wording of the second sentence.
- Insurance Europe also warns against prescribing simplified information in the risk policies and suggests leaving insurers flexibility in how to integrate climate risk in their policies. For example, the description of economic sectors assessed to have higher climate-related risks might be strongly dependent on individual companies and their transition plans. Similarly, transition risks can manifest themselves abruptly, eg due to technological breakthroughs or unexpected legislation. Therefore, this information might not be necessary in such policies.

Paragraph 55:

- It should be noted that forward-looking natural catastrophe models can be used to assess the likelihood of certain weather events in the future but not their loss potential, as other factors, such as the exposure at the time of the event, change in land use and vulnerability, as well as mitigation efforts, will significantly influence such losses.

Subsection 5.1.2 Consideration of climate-related risks in the underwriting assessment

Paragraph 56:

- The IAIS noted that climate-related risks are not necessarily material. The IAIS should consider making this clearer to avoid any misunderstanding that could lead to an undue burden on insurers. Insurance Europe suggests clarifying the wording of the second sentence with the following:

  "For material climate-related risks, supervisors should encourage insurers to include, as relevant, their assessment as part of their underwriting assessment for each client"

Subsection 5.1.3 Monitoring of underwriting exposure to climate-related risks

Paragraph 59:

- The paper should acknowledge the dynamic relationship between underwriting and reserving. The need for this clarification is even more relevant for the liabilities of non-life insurers, with the effects of climate change possibly becoming more evident over time. If time-series trends in the technical provisions show an increase in the claim expectations, insurers will normally react by means of premium adjustments — possibly because of the short-term nature of insurance contracts — or by adjusting their reinsurance programmes.
- As enablers of economic activities and financial transactions, insurers can mitigate risks whenever technically and economically feasible. Awareness of all sectors about their mid- to long-term risk exposures is key to enable them to take adequate action and for insurers to be able to fully contribute to a more sustainable economy.

Section 5.2 Own risk and solvency assessment (ORSA)

- European insurers believe that consideration of the effect of sustainability risks including climate-related risks should be included in the ORSA as long as these risks are financially relevant and material for the undertaking. This is because sustainability risks should get the same treatment as other risk types.
- The link between climate-related risks and the ORSA is critical, but the analysis of climate-related risks is dependent on the company-specific strategy and risk assessment. Therefore, the measurement and quantification of the effects of climate-related risks is necessary only when these effects are financially material for the undertaking's ORSA.
- A prescriptive approach should be avoided, as it would contrast with the very nature of the ORSA, which is company-specific and with a unique time horizon. Insurance Europe notes that it might be useful for the sector to have access to a set of non-binding high-level principles to help each insurer determine whether and how to incorporate climate-related risks in its risk management, governance and ORSA, in line with its specific business profile and without impeding a company-specific ORSA.
  - In general, the insurance industry notes that, given the long-term horizon of climate-related risks, a qualitative approach is equally valuable for their analysis in risk management, governance and the ORSA. While financially material climate-related risks can be considered both from a qualitative and quantitative view, the undertaking should decide which quantitative or qualitative tools are most appropriate for considering climate-related risks. In particular, while the ORSAs may have a forward-looking perspective, each insurer should decide whether it is the right instrument to capture climate-change risks that will materialise over a longer time. This will depend on the insurer's strategy, which usually provides for a longer-term perspective than the business plan.
  - There are a number of issues associated with the development of a standardised set of quantitative scenarios in the ORSA, including the lack of consensus among experts regarding the choice of scenarios and their evolution in the future. Therefore, the ORSA would not be the right place to introduce a standardised set of quantitative scenarios.
  - Insurance Europe believes that some of the issues associated with quantitative scenarios may be better addressed through qualitative scenario analysis. Climate-related scenarios should ideally cover a wide range of plausible climate-change conditions, but also consider fixing other boundary conditions (as variables or assumed constants) relevant to population development, urbanisation

and concentration, land use, migration to coasts, early adaptation measures, changes to the built environment, ie factors currently changing the physical risk landscape at a fast pace. This broad and dynamic approach may be better addressed through qualitative analysis.

Paragraph 60:

- Insurance Europe strongly agrees with the wording of this paragraph, as the ORSA is a particularly useful tool for insurers because it is able to reflect the unique characteristics, portfolio and risk profile of each insurer. This is also consistent with ICP 16.12.1, which already states that the insurer should consider in its ORSA all material risks. Each insurance company is best placed to consider whether its climate-related risks are material for its ORSA and, based on its assessment, find appropriate solutions to deal with them.

Paragraph 61:

- European insurers recognise the importance of including climate-risk considerations in the ORSA and agree that climate scenarios are a useful tool to deal with climate risk. However, both short-term and long-term climate-change risks are relevant to the ORSA. The emphasis of this paragraph on the long-term risks overshadows the importance of the short-term management of climate risks in the ORSA. While the effects of climate risks are probably more severe in the long-term, the risks should be addressed in the short-term first.
- The ORSA should continue to represent the undertaking's own view of its risk profile, and the capital and other means needed to address these risks. The undertaking should decide for itself how to perform this assessment on the basis of the nature, scale and complexity of the risks in its business. Therefore, each undertaking should be able to choose appropriate scenarios and time horizons for material risks for ORSA purposes.
- Insurers should be able to choose the time horizon most relevant to assess their material climate-related risksin their ORSA. Scenarios with long time horizons risk being not very reliable as the strategic planning and business strategies are not usually longer than 5-10 years.
- For these reasons, the following wording is suggested:

  "It might be expected that the ORSA includes appropriate climate-related scenarios. For material climate-change risks that may materialise in the long term, insurers might also include scenarios with a more extended time horizon, where relevant for their ORSA."

Paragraph 62

- While a forward-looking perspective with regard to sustainability risks is useful, insurers should be able to decide what is the right instrument to capture climate-change risks over time, in line with their specific business profile. While the paper acknowledges the benefits of stress-testing and scenario analysis, it should also acknowledge their limitations. There is a risk that these analyses result in ill-informed market signals. Specifically, the paper should highlight that:
  - The results of climate-scenario analyses might not be fit for the solvency assessment because there are many uncertainties relating to climate change itself, its impact on the environment and its complex interactions with economic and social systems.
  - A forward-looking perspective can be useful for strategy decisions, but stress-testing of future physical risks may not always be operationally necessary. Continued and intensified qualitative or semi-quantitative scenario analysis might be more useful and provide better guidance, also given that physical risks are usually underwritten on an annual basis. Insurers can also apply adjusted pricing and choose different portfolio management options.
- While Insurance Europe does not disagree, the first sentence may be inaccurate where it describes the requirement of continuity analysis as it combines elements of both ICP standard 16.14 and guidance under it.
- In the same vein, the second sentence is misleading as it seems to disregard the optionality of scenario analysis and stress-testing under ICP 16. With regard to proportionality, it should be possible for small insurers with simple risk profiles not to prepare scenario analyses at all. Insurance Europe proposes the following amendment:

  "when identified as material by the insurer, this analysis should include the identification and assessment of the direct and indirect impact of climate-related risks, ***where relevant*** *including as part of the scenario analysis and (reverse) stress-testing process."*

- With respect to the last bullet point on liability risks, it should be noted that general exclusions are considered as a last resort solution.

Paragraph 63:
- Regarding the fact that "supervisors should encourage insurers to adopt the relevant models", Insurance Europe warns about standardisation and suggests putting more emphasis on the relevance aspect. While standardised set of scenarios might be useful guidance, there should be no requirement to include them in the ORSA, especially as there are outstanding issues among experts regarding the choice of scenarios and their evolution over time. Modelling work by regulators are welcome provided such models are not mandatory and do not conflict with the own nature of the ORSA.

Comments on section 6: investments

- Insurance Europe agrees that sustainability risks including climate-related risks should be included in policies relevant for investment, provided that these risks are financially relevant and material.

Paragraph 66:
- An insurer should identify, assess and manage climate-related risks only when these risks can have material financial impacts on the insurance undertaking. The second sentence should be amended to read as follows for clarification and coherence with ICP 16.1:

  "***Where material****, these risks must be taken into account regardless of whether the insurer invests directly or through a third-party asset manager or investment advisor*"

Asset/liability matching

Paragraph 70:
- Insurance Europe agrees that asset/liability matching is a key factor to consider in investing. In this respect, it notes that the concept of the materiality of transition risk on longer-term bonds is not sufficiently elaborated and therefore invites the IAIS to better elaborate on this concept, taking into account other transmission factors and mitigation actions that the insurer might take to minimise such risks.
- In addition, Insurance Europe believes that diversification is a key risk-management strategy for dealing with any kind of risk. A well-diversified portfolio with different kinds of assets in terms of geography, sector and other considerations will, on average, have a lower risk than concentrated portfolios. Any part of the portfolio that has a higher degree of concentration, eg sovereign bonds or real estate, may require a more in-depth risk analysis. A global investment strategy is the best and most efficient way to support the sustainability transition and deal with climate-related risks.

Stewardship

Paragraph 74:
- Insurance Europe recognises the importance of stewardship and appreciates the IAIS acknowledgment of the engagement efforts of insurers to encourage the sustainability transition.
- Insurance Europe notes that stewardship is only one of the strategies used by insurers. For this reason, it suggests moving paragraph 74 to 76 under Box 4 and considering also other investment strategies, especially when more relevant from the prudential angle. A good description of common practices, also used by insurers to include sustainability risks in insurers' investment decisions, is provided by Eurosif (a European association for the promotion and advancement of sustainable and responsible investment across Europe) and includes best-in-class investment selection, exclusion of holdings, norms-based screening, engagement and voting on sustainability matters, etc.

Paragraph 75:
- Insurance Europe notes that stewardship is a broader investment strategy. Its objective goes beyond the management of climate-related risks to push investee companies to move their business towards a

more sustainable approach in general. When considered from a prudential point of view, exclusion strategies can be more effective to manage climate-related risks.

- Should this section be kept at the same level as other sections such as supervisory guidance, then the paper should also acknowledge the limitation of "stewardship": the impact of investment decisions on sustainability factors (eg via engagement) can be very costly and its effectiveness can be questionable depending on the types of portfolio (eg equity versus bonds) and the size of the investing undertaking.
- It should be noted that insurers face challenges in measuring the impact of investment decisions on sustainability factors (eg via engagement). At this stage, the financial sector does not have a commonly accepted approach to how to capture the effects of investments on sustainability factors. In addition, some financial players do not have the resources to adequately build up the necessary tools (for small undertaking coordination with other investors is the only viable means of achieving effective stewardship).
- When promoting engagement strategies and stewardship activities, it should also be avoided that stewardship serves as implicit investment restrictions and limitations, which would conflict with insurers' freedom of investment.

Comments on section 7: public disclosure

- Increased transparency on sustainability, including climate-related information, is welcome, provided that it avoids information duplication and overload for businesses and consumers. It is important that:
  - Insurers have flexibility in disclosures while respecting consistency and comparability.
  - Insurers have access to good quality sustainability-related information at asset level based on a globally coordinated approach to general company ESG data reporting.
- The industry recognises that climate-related disclosure is important for a number of reasons (eg to improve awareness of the effect of climate change, understanding of climate-change risks, market discipline, etc). In fact, most European insurers already publish a dedicated climate report or provide some form of climate-related risk disclosures, eg following the TCFD recommendations.
- Insurance Europe thus welcomes the IAIS facilitating a coordinated approach between jurisdictions. Coherent policymaking between jurisdictions will avoid duplicative or contradictory standards, while also reducing requests for information.
- The European industry is of the opinion that the convergence of potential requirements to disclose information on climate-related risks, from both financial and non-financial perspectives, should be promoted through a global approach and international coordination given the cross-border nature of the risks. Sustainability disclosures should be strengthened for all sectors as well as for public entities, and they should be publicly available.

Paragraph 77:

- Insurance Europe welcomes the clear statement on the need to protect proprietary and confidential information. It is essential that disclosure requirements do not compromise fair competition.

Paragraph 79:

- Increased transparency on climate risk is welcome, provided that it is efficient. To this end, it is important that any disclosure requirements would permit insurers flexibility over how they fulfil their responsibilities on climate-related public disclosures, while recognising the importance of consistency and comparability of information. Flexibility will allow insurers to meet the varying and evolving interests of the audience.
- Flexibility in disclosure is particularly relevant for communication to customers. It is vital that insurers are able to communicate climate impact to their policyholders in a flexible and clear manner. Overly detailed disclosure leads to lack of interest and disengagement. Therefore, disclosures to customers should be distinguished from those to experts (eg regulators, investors, other relevant market experts) and be less detailed and technical.
- In addition, it is key to consider the flow of information for insurers. In fact, insurers' disclosure will have to depend on information disclosed by other entities, particularly invested companies and asset managers for investment-related information. The IAIS should better recognise the implications of

limited data quality and availability of climate-related information. The lack of quality data creates significant obstacles to the preparation of consistent public disclosures by insurers. For example, this is clear with investment-related information, where it is vital that insurers' disclosure requirements are aligned as much as possible with asset-level disclosures from corporates and public entities.

Paragraph 80:

- Insurance Europe acknowledges the relevance of voluntary disclosures based on the TCFD recommendations under ICP 20 when climate risk is material. However, supervisors should take into account the business-sensitivity of some KPIs contained in the TCFD guidance, such as the aggregated risk exposure to weather-related catastrophes of property business (ie annual aggregated expected losses from weather-related catastrophes). Insurance Europe suggests adding the following sentence to clarify this point:

  "Supervisors should carefully assess the business-sensitivity of some Key Performance Indicators contained in the TCFD guidance in order to avoid undermining the competitive position of an insurer."

Section 7.2 Company profile

Paragraph 86:

- As the IAIS mentions this "inside-out" approach at this stage, Insurance Europe believes that it would be useful to already introduce it in the introduction of the paper (see comments on paragraph 7).
- Promoting the convergence of non-financial reporting standards will be even more important to facilitate the transitioning of all sectors, while also accounting for global linkages of financial markets and avoiding competitive disadvantages for globally operating companies. Sustainability disclosures should be strengthened for all sectors as well as for public entities and they should be publicly available. In addition, policy actions to increase the consistency between financial and non-financial reporting should be encouraged to ensure that both follow a similar rationale, especially as non-financial aspects become increasingly relevant from a financial viewpoint.