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GFIA Response to Draft IAIS Issues Paper on Climate Change Risks to the Insurance Sector

General comments

GFIA appreciates the opportunity to comment on this paper and shares with supervisors the importance of the issues.

As emerging from the paper, there are increasing workstreams set by regulators and/or supervisors across jurisdictions to investigate climate change risks and the implications that these may have on the insurance sector. GFIA members are engaging in these jurisdictional developments, and this paper is aimed at highlighting a number of views shared by the GFIA members on these issues.

As a general comment, GFIA members strongly believe that any regulatory/supervisory initiatives aimed at addressing climate change concerns should:

- Assess and investigate the extent to which the industry is already pro-actively and on own initiative taking steps in line with political objectives. Such an assessment is key for helping regulators assess the sense of need/urgency for new regulatory actions.
- Recognise that regulation is not the only, and often not the most appropriate response to the issue of climate change. Governments and public authorities play a crucial role in enhancing resilience and adaptation measures.
- Assess new regulatory/prudential proposals against already existing jurisdictional measures that already meet climate risk policy objectives.
- Assess potential unintended consequences of proposals on insurers' product offering and investment.
- Be designed in a way that mitigates potential negative impacts on the wider financial system.
- Duly considered proportionality.

GFIA views the paper broadly as a summary of developments across a number of jurisdictions and reflecting formative thinking by the IAIS. It is noteworthy that in its conclusions reference is made to differing views existing among supervisors and regulators to priorities and also to a systemic global response to the implications of climate change. While very much understanding that this is a draft issues paper GFIA would suggest that the report could benefit from/by:

- More consistency across different sections and clarity on some definitions and interpretations of key themes and topics.
- Better distinguishing between primary insurers and reinsurers. Different materiality, risk, knowledge and insurer risk management activities should be reflected in regulatory approaches.
- Laying out the consequences for different regulatory approaches in more detail. The paper only includes a short section in the conclusions and in some examples of individual countries in chapter eight.

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GFIA members acknowledge the IAIS' desire to gain a better understanding of the risks posed by climate change or extreme weather events. However, GFIA notes that:

- While climate change is a cause for more extreme weather events, the timing and impact of these events remain uncertain at a global level as well as at local level.
- To enable an affordable transfer of risk to the insurance sector a more holistic approach to adaptation involving national, regional and local government is necessary in reducing climate change risk.
- A number of issues related to climate change may require a jurisdictional response and measure (as opposed to global initiatives).
- More emphasis should be put on already existing / pro-active responses by the insurance industry to climate change issues, in key areas such as investment, underwriting and (transition risk) management.

Climate science research has and will continue to identify specific risk factors of interest to supervisors, insurers and insurance underwriting. Although climate change will create a universal impact on society, climate change will impact geographic regions and perils differently. Supervisors and insurers will need to adjust accordingly. GFIA encourages additional research that will provide consumers and underwriters with clarity on specific risk threats and their applicability to specific geographic areas.

The insurance sector has long-standing experience in providing protection against natural catastrophes and is therefore well placed to provide advice to public authorities on climate change adaptation projects. Because such adaptation projects may have a material effect on potential climate risk impacts, potential regulatory responses should also be adjustable to positive, as well as negative, changes.

In addition, insurers are updating their underwriting policies by using predictive methods and modelling. Nevertheless, the fact that the future is unpredictable and not uniform is why GFIA believes that universal, prescriptive responses are inappropriate

Below are some more detailed comments on specific areas of the paper.

Questions from the paper

Q20: Comment on Paragraph 14

Physical Risks – The use of the terms "shocks" to refer to natural disasters is somewhat inappropriate. The occurrence of low probability events is not new or surprising to insurers.

Also, GFIA questions the implied importance of uninsured losses in a paper that is focused on the impact of climate risks to the insurance sector.

A more detailed discussion of the link between climate change and physical risk (extreme weather events) would be beneficial as uncertainty in climate change impact on physical risk is quite often quite high and variable, with diverse impacts on different geographic locations and their associated perils. .

Transition Risks – In addition to the risks specified in this section, the negative side-effects of overly restrictive insurance regulatory actions should be considered for inclusion in this section.

With respect to investment risk, while GFIA appreciates that policy objectives related to climate change already have/could over the years have an impact on the valuation and risk nature of assets, it notes that such concerns are, in many cases, already addressed by risk-based regulatory regimes, where qualitative and quantitative measures are aimed at precisely identifying and addressing (material) risks that insurers are exposed to. For example, in many cases prudential rules consider credit ratings as an input in the assessment of risks – this in itself is a good example of showing how measures implicitly react to assessment of climate risk by rating agencies (see section 3.1.2).

GFIA highlights that policy initiatives aimed at addressing climate risks embedded in insurers' investments should both take into account existing measures and assess any new rules against potential macro-economic effects on the financial system. For example, any regulatory demands/incentives for mass divestment in particular sectors may cause significant turbulence on financial markets and can ultimately have impact on financial stability.
Comment Box

Q23: Comment on Paragraph 15

Regarding the statement *"[w]hile certain climate factors are long-term in nature, many are already proving to be material for firms[...]"* GFIA notes that:

- As underwriters of natural catastrophe risk, the insurance sector is especially aware of and sensitive to the risks posed by climate change.
- In a number of cases, existing risk-based insurance regulations are already requiring insurers to identify and measure material risks.

To address the risks (from underwriting to strategic risk, operational to reputational risks) alluded to in this section, it is vital that authorities enhance public resilience and place focus on the implementation of adaptation measures through effective prevention planning. Thinking in insurance terms fosters a sound attitude to risk management.

Also, GFIA suggests eliminating references to "prominent" social movements under "Reputational Risks". In addition to the opinion-based use of the word "prominent", GFIA suggests the IAIS should analyse NGO pressures carefully. For example, requirements for the cessation of underwriting coal-fired power infrastructure may constitute an illegal restraint of commerce in one or more jurisdictions.

GFIA believes the statement that "insurers' capacity to pay future claims may be significantly affected if climate related risks significantly disrupt capital markets," should be tempered. In lieu GFIA suggests, "Climate related risks may impact capital markets. Such impacts may reduce the value of insurer investments and their claims paying capabilities." Just as climate risks will impact different geographies in non-uniform ways, the impacts on insurers and their investments will also differ. While excessive investment risk concentration is a regulatory concern, GFIA anticipates that most insurers have a well-diversified investment portfolio. As regulators evaluate individual insurers and the relative materiality of its potential investment losses, relevant considerations should include, without limiatation: insurer risk management practices, investment diversification, investment duration and correlation to the insurer's liability duration, and the marketability of respective assets. In terms of risk management, it is important to note that, as it emerges from the paper, in a number of jurisdictions both regulators/supervisors and the industry are already looking into assessing likely impact scenarios, including potential systemic risk ones, and whether existing/new tools can address concerns.

Q33: General comment on Section 3.1.2

GFIA appreciates that climate change is becoming a key area of discussion in a number of jurisdictions across the world. As these discussions develop and clear ambitions are set by policymakers, it is likely that regulatory measures across sectors would be put in place to meet ambitions. Such measures could in turn have impacts on financial markets and physical assets, and thus a significant impact on the insurance sector which has such a key role in the economy.

It should be however recognised that: 1) in many cases, regulations are already designed to ensure new risks are identified and measures and 2) new regulations will be phased in over years, and financial stability should and will likely remain a key priority of decision makers. For example, in the absence of a smooth transition and adequate sustainable investment supply, companies pressured to dispose of their holdings might drive up the availability of securities for sale and bring down their value, with potential systemic effects.

Unfortunately, the IAIS paper seems to suggest that new risks, with serious implications on the insurance business, would arise "suddenly" and create massive impacts – this is simply not correct. GFIA therefore believes that the IAIS should aim to more clearly highlight the medium/long-term likelihood of these risks emerging.

In response to the observations made in this section, GFIA notes that:

- **In a number of cases, climate related risks are already embedded, today, in the investment positions and risk assessments of insurers.** For example:
  - As the paper notes, some credit rating agencies already reflect such risks in their assessments.
  - In a number of regulations credit ratings are a key parameter in insurers' asset allocation decisions and/or risk measurement. As credit ratings value climate risks, these will be implicitly reflected on insurers' regulatory measures – so no further policy actions may be needed.
  - Similarly, some regulations already require insurers to identify and measure all material risks – and a number of companies have already identified climate to be a material risks and have addressed it accordingly.
- **Policymakers should recognize that the supply of "green"/"sustainable" assets remains extremely limited.**
  - While indeed, it may be the case that a number of insurers' assets are not immune to climate change, regulatory actions that cause "sudden exits" from such assets or massive capital requirements that would have a similar effect should be avoided. Any such measures would affect financial stability.
  - The supply of assets immune to climate change risks is very limited. So even if insurers wanted to invest more in "green" assets, the supply is not there. So governments should focus on

  creating the right assets, suitable for insurers to invest in, instead of requiring diverstiture of assets that are exposed to climate risk.
  - Until adequate and sufficient supplies of non-carbon energy sources are available globally, some carbon energy will be needed to satisfy user demand.
  - Further, most major energy sector issuers of securities have already undertaken sustainable and green initiatives. Some sovereigns have done this as well. Regulators should not take unilateral action to encourage disinvestment or reduce financial statement credit for such investments.
  - Sustainability "regulation" and engaging or encouraging actions that can be viewed by others as manipulating investment values, unrelated to the pure investment risk as recognized by the market, has the potential to be very disruptive to the global economy
- Regarding the link between climate change risks and prudential requirements, the insurance industry supports rules that measure and capture real risks. If there is evidence that green and/or brown assets are less/more risky than other investments, prudential regulation has to recognise this on the basis of the actual risks, not on the basis of artificial incentives/disincentives.

Q34: Comment on Paragraph 22

GFIA believes the risk to investment activities is overstated because it does not consider these risks are already being assessed throughout the investment process and monitored from an investment risk management perspective. Further, it does not consider that insurer investment portfolios are high credit quality, diversified across sectors and sub-sectors. Investment durations and asset liquidity are also relevant considerations. While the potential accumulated reduction in global fossil fuel industry revenues through 2040 is startling, the impact on a particular insurer's investment portfolio will depend upon its current and future investment decisions. GFIA does not expect that insurers will hold a material portion of their investment portfolios in assets that do not have a reasonable possibility of achieving an acceptable rate of return over time.

GFIA notes that there are further jurisdictional considerations to take into account. For example, Investment values will likely vary by jurisdiction. For example, the financial strength of utility sector stocks has been affirmed by rating agencies and regulatory bodies in some jurisdictions. Additionally, many concerns about investments in high-carbon sectors are being mitigated within those sectors – e.g., while the number of coal-based power generating facilities has dropped dramatically, electric utilities now account for almost all investment in a major jurisdiction's wind power and more than 60% of investment in solar energy.[1]

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1 Edison Electric Institute, Letter to California Insurance Commissioner Dave Jones, May 2, 2016, http://www.eei.org/issuesandpolicy/testimony-filings-briefs/Documents/Ltr_Commissioner_Dave_JonesMAY2si.pdf

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Moreover, closed power plants in that jurisdiction are not "stranded assets", as the costs of decommissioning these plants typically are recovered in the electricity rate structure.[2]

Q35: Comment on Paragraph 23
In response to the observations made in this section, GFIA notes that:

- Sovereign Debt: As previously mentioned in our comments, the physical impact of climate risks will not be uniform and different perils will impact perils in diverse geographies differently. The materiality of an insurer's exposure to climate impacts on sovereign debt is typically managed through investment diversification, other risk management practices, and the size of likely climate impacts in relation to the economy of the particular sovereign. While GFIA agrees that extreme weather may have outsized impacts on the value of certain sovereign debt, GFIA does not anticipate that such climate impacts will have a significant, general impact on insurer solvency or claims paying capability.
- Municipal Debt: The greatest impact is to issuers in the municipal sector which are less resilient, have small and undiversified economies and as a result would also be lower rated. This also does not take into consideration risk management activities which manage the clash risk associated with exposures which have the potential to be exposed on the asset and the liability side.
- Real Estate: The report's suggestion that policy measures and regulatory requirements for the energy efficiency of building stock affect the value of Real Estate portfolios is very specific to the Dutch property market and is not necessarily representative of the property holdings of all global insurers which may hold a diversified property portfolio.

Q36: Comment on Paragraph 24
GFIA recommends the removal of the reference to the AODP Global Climate Index 2016 survey of institutional investors for the following reasons:

- The 2016 survey ratings are "based on a mixture of publicly available information and asset owner disclosures", especially considering the voluntary base of participation. For example, the report notes that: *"The top 500 asset owners (by AUM) that decline the invitation to participate were researched by our team of analysts and assessed using publicly available information or information provided to us by their members or stakeholders." – this* simplification may have created significant biases in the conclusions and cannot be used as solid proof by the IAIS.
- The situation illustrated by the 2016 survey is outdated and the situation has already greatly improved as confirmed by the 2017 survey by the very AODP Global Climate Index 2017 (see full report here).

2 Ibid.

The 2016 survey already recognizes that *"a growing number of insurers have publicly committed to investment in this [low carbon economy] sector (P. 19)".* Indeed, some leading insurance companies have, in recent times, decided to stop underwriting some or all coal companies (see examples of public statements by AXA (2017), SCOR (2017), Zurich (2017), Lloyd's, Generali (2018). These are just a few examples, which prove how developments in this area are progressing at a fast pace, and which also prove the pro-active approach of the insurance sector on climate change related issues.

Q38: Comment on Paragraph 25

It is unclear what is meant by "at a higher level, coordination across the insurance value chain." Also, GFIA argues that the wording for the 5th bullet point in paragraph 25 could be clearer. It could say "Mainstreaming climate risks across business functions and compliance systems."

The issues associated with climate change risks are complex and need to be tackled in an integrated fashion by various parties including governments, regulators, financial sector players, other sectors, and more generally by the society as a whole.

- While most of the supervisory recommendations relating to future risks and conditions were considered from a risk assessment point of view, more focus should be placed on adaptation. Adaptation has the capability to change insurance risks in the future. In that regard, governments, including supervisors, have an important role to play in developing national disaster risk management frameworks and in terms of adaptation planning. Insurance is an integral part of the whole risk-management cycle, from risk identification to risk transfer and recovery. However, insurance products are neither a substitute for other adaptation measures nor an instrument for the funding of adaptation or mitigation measures. It is public authorities to take the leading role in building public resilience.
- Importantly, the paper should more explicitly acknowledge and highlight the inherent difficulties in assessing the physical risks associated with climate change. For example, it is remarkably difficult to discern whether a specific weather catastrophic event is due directly to the impact of climate change or natural weather variability.
- As such, the requirement for insurers' risk management systems to "accurately identify, assess and account for the impacts of climate change" (p.18) may be difficult to achieve.
- Furthermore, data availability and granularity challenges, especially in terms of scenario analysis are difficult problems to overcome. This is another area in which public authorities can play a leading role. In addition and in order to achieve comparability in reporting, which GFIA believes should be a goal, sufficient time must be given for best practices to develop. As a result, GFIA stresss the importance of consulting with the insurance industry on the potential unintended consequences specific to each jurisdiction.

While GFIA welcomes the opportunity to consider the effect of environmental changes to the insurance sector, GFIA believes that the Issues Paper does not give enough weight to recent trends in the industry that suggest that the industry is well-positioned to respond to environmental changes.

In fact, links and correlations between climate change issues and market developments are not straightforward. For example, at the same time as Co2 concentrations were increasing and global temperatures rising, the policyholder surplus of property and casualty insurers in a major jurisdiction was growing and reached an all-time high in 2017 . The global reinsurance industry is healthy and generally well-capitalised. These facts are positive indicators that the P&C insurance industry is aware of, and capable of managing, the risks associated with environmental events. Furthermore, GFIA believes that the paper does not adequately consider the growing use of data analytics and technology that will enhance the resiliency of insurers and many of their policyholders in coming years.

As mentioned above, the risk to insurer investment activities also is overstated. For example, a recent report from Moody's Investor Service found that this risk is relatively small "given P&C (re)insurers' low asset leverage and well diversified investment portfolios."

Related, GFIA believes that the language used to describe the perceived challenges to the industry should be tempered and take account of the industry's strengths. For example, the paper describes the risks to the industry as "significant" and "material" or describes the risks as arising from potential market "disruptions" or "rapid devaluation" of assets. While regulator concerns about the valuation of certain industries may ultimately have some validity, the impact on given insurer investment portfolios is likely to be muted by the insurer's investment diversification. Any regulatory action should be premised upon realistic risk associated with a given insurer's investment portfolio.

Q45: Comment on Paragraph 31

Regarding Table 1, Implications of climate change for the core objectives of insurance supervisors – GFIA strongly disagree with the conflation of "uninsurable" and "redlining" under the second column of the table.

An uninsurable risk is one that cannot be insured practically at any price. It is legitimate – in fact, important – for an insurer to decline to underwrite an uninsurable risk. By contrast, in at least one major jurisdiction, the term "redlining" typically refers to the illegal practice of denying services, either directly or through selectively raising prices, to residents of certain areas based on the racial or ethnic composition of those areas. The reference to redlining in this section should be removed.

GFIA also disagrees with the characterization of macroprudential stability found in this table. Similar to the paper's discussion of investment risk, the potential for systemic risks to the financial system appear to be overrepresented. Furthermore, the paper implies that the transmission of systemic risk lies mainly with uninsured losses. Uninsured losses, as a societal concern, cannot be addressed by insurance supervisors only but would, in the majority of cases, require broader intervention.

Q50: Comment on Paragraph 35

Physical Risks – Considerations regarding how uninsured losses affect banks and investors should be undertaken by banking and securities regulators.

Q51: Comment on Paragraph 36

Transition Risks - The last bullet, "Examining whether the capital allocation choices of insurance firms are well aligned with the future needs of the low-carbon economy…", appears to suggest that a regulator would question or interfere with the legitimate business decisions of management based on political decisions about the "needs" of the economy. GFIA suggests this bullet be removed.

Q53: General comment on Section 6

While GFIA appreciates that supervisors in a number of jurisdictions are initiating work on climate change risks (either based on explicit requests by regulators or on own initiative), it should be noted that jurisdictional developments are at a very early stage. It would therefore be hard to imagine how the IAIS could take the lead on proposals, given that its own members are very little advanced on these issues.

At the same time, it is key that jurisdictional efforts and results are used to inform international discussions. GFIA therefore believes that any work focused on how to review ICPs to reflect climate change risks should be considered only at a later stage, once a significant number of IAIS members have had similar discussions in a jurisdictional context and can thus use jurisdictional experience to inform a global response.

In addition, GFIA notes that:

- The ICPs are intended as a set of high level general framework and standards that are designed to be flexible and responsive to issues across jurisdictions and timely to "provide a globally accepted framework for the supervision of the insurance sector". They define "essential elements that must be present in the supervisory regime in order to promote a financially sound insurance sector and provide an adequate level of policyholder protection."
- Despite the apparent difference in focus, the draft Issues Paper suggests potential use of the ICPs to reflect or integrate political decisions about public policy as to how best to address the risk of climate change, on a global basis. GFIA notes that at this stage global political commitment is still being discussed.
- The ICPs are not intended to be measures that usurp other policy decisions of individual jurisdictions or as mechanisms to intervene in individual entities' risk management.
- Companies will consider natural catastrophe risks in their ERM programs and through underwriting and risk management in general. Regulators will be part of the discussion, but these are and should remain to be management decisions, not regulatory decisions.
- ICPs have always suffered by attempts to make them overly prescriptive. A one size fits all approach would be a regrettable decision, particularly in the context of the treatment and variability of climate risk.
- Where real and specific issues of climate-related risk are identified, they can be most effectively handled on a company-by-company basis in discussions with supervisors, under the existing ICPs and respective local frameworks.

GFIA strongly believes that insurance regulation efforts in response to climate change risks is neither the appropriate nor most effective place for global action. Each geographic area will be affected differently, and they each need to address the probability and impact of natural catastrophes they suffer from differently. In fact, each company needs to address their own investment as well as underwriting risk as they do today. This is not a one-size-fits-all issue.

Q60: Comment on Paragraph 43

Risk Management and Internal Controls – The word "reasonably" should be added as follows: *"…insurers' risk management systems, controls, and functions must be able to **reasonably** accurately identify, assess, and account for the impacts of climate change."*

Q67: Comment on Paragraph 50

GFIA reiterates a concern with the overstated emphasis on investment risk potentially resulting in "significant disruption to financial markets" or a "rapid devaluation of financial assets". Investment risk needs to be evaluated on a per entity basis based upon its investment portfolio composition and diversification.

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About GFIA

Through its 40 member associations, the Global Federation of Insurance Associations (GFIA) represents the interests of insurers and reinsurers in 61 countries. These companies account for around 87% of total insurance premiums worldwide. GFIA is incorporated in Switzerland and its secretariat is based in Brussels.