

## Response to consultation on FSB consultative report on supervisory and regulatory approaches to climate-related risks

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### Key messages

#### Supervisory and regulatory reporting and collection of climate-related data from financial institutions

- The Financial Stability Board (FSB) has highlighted the lack of climate-related data from the real economy for policymakers and supervisors to assess climate-related risks effecting the insurance industry and other financial institutions. This data gap, along with inconsistencies in the data that is available, are deterring them from effectively addressing climate-related financial risks and delivering on the Paris Agreement.
- In the EU, the availability of data should improve significantly thanks to the ESG reporting initiatives that are under way in different jurisdictions: eg the Corporate Sustainability Reporting Directive (CSRD) and European Single Access Point (ESAP) at the EU level. These initiatives will allow European insurers to fully realise their transition plans, to better assess their climate-related risks and exposures, and to conform their reporting as required by the Sustainable Finance Disclosure Regulation (SFDR) and Taxonomy Regulation.
- The FSB, standard-setters and supervisors should take into account the developments in reporting and data availability to avoid repetitions and inconsistencies with existing or upcoming initiatives. A truly global risk like climate change demands a globally coordinated approach.

#### System-wide supervisory and regulatory approaches to assessing climate-related risks

- There is no evidence to justify the conclusion that insurers are particularly vulnerable to system-wide impacts from climate change. Climate change realises over time and insurers can adjust policies, investments, underwriting, pricing and decisions on risk coverage. Systemic risk per se is not faced and transmitted by insurers. It is rather faced by society.
- Appropriately designed climate stress tests can provide information to help assess financial industry exposures. However, the starting point should not be a premature conclusion that insurers are vulnerable to climate-related risks.
- Given the exploratory nature of the stress test, and particularly given the limited data availability and robustness challenges, it is important to recognise that it can only give indications for relevant issues and needs further work before drawing conclusions.
- Stress tests should avoid false accuracy, over-complication and granularity by focusing on materiality to avoid placing excessive burdens on insurers.
- The insurance industry supports good practice and agrees that standardisation/harmonisation is needed, to a certain extent, in relation to modelling and stress testing to allow for (financial) sector-wide comparability.
- In the case of publication, it is critical that only sector-wide information – and not individual company information – is published.

### Early consideration of other potential macroprudential policies and tools to address systemic risks

- In terms of system-wide approaches to assess climate-related risk, there is no indication or evidence of any systemic risk faced by insurers relating to climate risk. It is, therefore, premature to already develop new tools for the insurance sector other than continuing developing monitoring tools, such as the climate stress tests.
- Any development of macroprudential tools in the future, if evidenced, has to be based on a comprehensive cost benefit analysis, including a full assessment of potential downsides and unintended consequences before making proposals for consultation.
- Regulatory/supervisory overshoot and/or macroprudential measures triggered at bad timing would be counterproductive and can undermine financial stability and delay the climate transition.

## Detailed response

### A. Supervisory and regulatory reporting and collection of climate-related data from financial institutions

1. *Does the report highlight the most important climate-related data (qualitative and quantitative) for supervisors' and regulators' identification of exposures and understanding of the impacts of climate-related risks of financial institutions and across financial sectors? Please provide examples of climate-related data deemed most relevant and that should be prioritised.*

Yes — Overall the report covers relevant climate-related data.

The European insurance industry welcomes the intent of the FSB Interim Report to achieve cross-sectoral consistency and to consider interactions between sectors, in line with the FSB roadmap for addressing climate-related financial risks. A truly global risk like climate change demands a globally coordinated approach. As the FSB roadmap notes, policymaking requires, as general pre-conditions in particular, reliable information, appropriate diagnostics, and effective policy instruments. In a similar vein, pre-conditions are required for private institutions to duly take account of climate-related risks in their risk management. Insurance Europe remains convinced that the FSB has a major role to play in helping realise these pre-conditions.

The most effective mitigant of macro-risks is companies' own progress on measuring and addressing climate risk, combined with micro-prudential supervisory tools. The monitoring and assessment of climate-related financial risks, by the private sector and financial authorities, however, crucially rests on comprehensive and robust international climate-related data. While the insurance sector has made good progress on data and climate-related risk practice on its own, gaps in data from the real economy remain significant. These gaps are a major shortcoming when it comes to informed investment and underwriting decisions; and they are an impediment to develop more mature, transparent and robust models. Data consistency and gaps must therefore be areas of concern to the FSB too.

In relation to supervisory reporting, key elements in (micro-)prudential supervision, namely materiality, proportionality, and confidentiality, should be equally reflected in any macroprudential assessment and macroprudential policy tools. It is important that supervisors have a good understanding of the climate risks landscape across financial sectors while also taking note of different business models. While the FSB makes references to a number of jurisdictional developments that do mention materiality, the FSB report insufficiently emphasises the concept. Insurance Europe therefore recommends reflecting materiality in the FSB recommendations. It is also key that any information request by supervisors is carefully considered and proven to be essential for fulfilling their supervisory duties. Multiplication of parallel and similar, but not identical, requests should be avoided. These considerations form essential aspects for the peer review of regulatory and supervisory practices against the FSB guidance foreseen in 2023 in avoiding excessive burden on both supervisors' and insurers' sides.

There is an inherent link between public disclosure and supervisory reporting. Regarding public disclosure, voluntary and compulsory sustainability disclosure is growing exponentially globally, and standardised filings will be implemented in the years to come. To avoid multiplication and, even, contradiction with the overarching non-financial disclosure standards being developed, supervisory data requests need to focus on capturing the climate change related risks which are neither accounted for in the existing prudential reporting nor the emerging sustainability public reporting. This is essential to streamline data / information and avoid unnecessary cost on both the insurers' and supervisors' ends. Data is a valuable resource but can be helpful only when it is carefully aligned with the objectives. Too generic sets of data which include an exaggerated number of irrelevant data points can dilute the valuable outcome that deserves better attention.

Supervisors should engage and communicate to financial institutions how and for what purposes the reported data will be used. Any reporting mandate should respect the principles of confidentiality, proportionality, and materiality. In any case, it is important that insurers have flexibility in their approaches while being mindful of consistency and comparability where relevant and possible. There is no one-size-fits-all approach, and insurers' practices continue to evolve. Models for measuring climate-related risks and exposures are being developed and refined, and materiality of climate-related risks will change over time. For example, reporting requirements must not be used as another way to prescribe what insurance companies should do, for example, on governance of climate related risks (eg via a dedicated committee on climate-related risks).

Given the rapid developments and inherent uncertainty in the risk management of climate-related risks, the supervisory community, including standard-setting bodies, has a duty to actively help create an environment, the pre-conditions and an open culture to discuss the treatment of and exposure to climate-related risks. To do so, would help financial institutions have better insights into risk exposure, and to mitigate the impact from climate-related risks. 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, policyholders and insurers to develop more broadly, a policy and regulatory environment that enables all sectors to contribute in full to the transition to a more sustainable economy, for example:

- A globally coordinated approach.
- Adequate data from the real economy beyond the financial sector.
- Long-term policy and political commitments.

For instance, Insurance Europe appreciates the efforts of the International Sustainability Standards Board (ISSB) in developing baseline global sustainability reporting standards having accounted for the recommendations by the Task Force on Climate-Related Financial Disclosures (TCFD), Sustainability Accounting Standards Board (SASB) etc. However, it still remains unclear how, in practice, such a baseline standard will be adopted in jurisdictions where different accounting standards are prevalent (eg US Generally Accepted Accounting Principles (GAAP)).

*2. Does the report draw attention to the appropriate areas to increase the reliability of climate related data reported by financial institutions?*

The insurance industry highlights the following:

- While data quality is essential, it should be noted that it is not a new topic. Supervisors can rely on processes already in place to ensure the reliability of the supervisory reporting on the one hand, and the financial and non-financial public filings on the other. At the same time, there should be an understanding that the insurance sector is dependent on other sectors' data and data quality and external models.
- On the one hand, increased third party verification would result in higher data quality, but on the other hand it would also lead to higher costs.

3. *Does the report appropriately identify the elements of a common high-level definition of climate-related risks (physical, transition and liability risks)?*

The industry agrees with the need to establish common definitions and approaches that will facilitate cross-border comparison; ideally there would be a single set of definitions. The report appropriately identifies the elements of a common high-level definition of climate-related risks. However, a need exists to understand the important concepts of sustainability risks that are relevant to climate risk: eg double materiality, climate risk as a risk driver, time horizon (long-term / 20-30 years) and reporting (supervisory reporting different from public disclosures).

The insurance industry welcomes that the definitions of transition risks and physical risks concur with/rely on TCFD.

4. *Do the proposed recommendations help accelerate the identification of authorities' climate-related information needs from financial institutions and work towards common regulatory reporting frameworks? Please elaborate on areas where the recommendations could be enhanced, if any.*

Developing international sustainability reporting standards is of paramount importance to improve comparability and availability of data, including from the real economy, while also reducing compliance costs for companies. The industry agrees with the goals set by the ISSB that are built on the TCFD recommendations. However, overlaps between financial and sustainability reporting should be avoided. Any extension of supervisory reporting should respect the principles of confidentiality, proportionality, and materiality. It is important that any data request on top of public disclosure mandates is justified and proven to be essential for fulfilling their supervisory duties.

Additionally, the industry suggests highlighting that coordination between the ISSB and regional initiatives is paramount to promote convergence of sustainability reporting standards across the various jurisdictions and achieve global consistency and comparability. Convergence should be of genuine interest to the FSB too, next to the Network for Greening the Financial System (NGFS) and other bodies, given that a baseline for climate-related data, ground-up, is critical to successfully execute their climate-related risk duties and achieve their objectives.

With respect to the recommendations:

- Recommendation 1: the supervisory objective should always respect the mandate given to supervisors and not go beyond. The increased sense of urgency related to climate related risks should not lead to a competition for being the most 'sustainable' supervisor.
- Recommendation 4: Supervisors could publish good practice documents as more companies report climate-related information as this would be particularly beneficial for smaller undertakings.

## **B. Incorporating systemic risks into supervisory and regulatory approaches**

5. *Does the report identify relevant system-wide aspects that should be considered as part of supervisory and regulatory approaches to incorporate systemic risks arising from climate change? Please elaborate on other aspects that should be considered, if any.*

Yes, it identifies the aspects that could be part of supervisory/regulatory approaches to incorporate any potential impact on insurers that could theoretically arise from climate change and hit all sectors equally at the same time (systemic risks per se according to the interim report's terminology). Regarding the insurance industry, it is very important to note, however, that in practice there is no evidence that would justify concluding that insurers are particularly vulnerable to system-wide impact from climate change. For example, regarding underwriting,

because climate change realises over time, insurers can adjust policies, investments, underwriting, pricing and decisions on risk coverage. This means that systemic risk per se is not faced and transmitted systematically by insurers. It is rather faced by society.

This should be fully taken into account when developing plausible stress scenarios and interpreting the results of stress tests. For example, the recent UK stress test indicated under the worst-case scenario (no additional action, 3.3°C higher relative to pre-industrial levels by the end of the scenario) results would be equivalent to an annual drag on profits of around 10-15% on average.

The industry nonetheless shares the view that the potential systemic nature of climate-related risks is an important consideration in supervisory and regulatory approaches. The industry agrees that system-wide aspects of both, risk transfers between financial sectors and feedback loops between the financial system and the real economy, should be taken into account. However, interlinkages and transmission channels are highly complex, and more research and analysis are needed to demonstrate how climate change-related risks may lead to a systemic event. Furthermore, conclusions drawn today can be different tomorrow, because of the dynamics, eg because of climate adaptation measures.

As opposed to traditional financial risks, which can materialise overnight with near-immediate systemic consequences, climate change-related risks are expected to materialise over a longer period allowing the financial system to adapt to it in an orderly fashion. In the same vein, to the extent the risk is localised in some geographies or lines of business and can be diversified globally, a climate change-related event can have severe consequences for some financial institutions without being systemic for the financial system.

The examples in the consultation document could be elaborated on, to concretely illustrate the channels by which a physical and/or transitional risk could negatively impact the financial system systematically.

Additionally, it is crucial that policymakers are sufficiently aware of potential systemic effects on the financial system that measures intended to mitigate and deal with climate change could have.

6. *Does the report accurately reflect the extent to which current supervisory and regulatory tools and policies address climate-related risks?*

Yes, the industry notes that, indeed, these are traditional tools used for measuring other types of risks, which could be (and in some cases have already been) expanded to climate risk. However, in the case of climate risk,

- Significant data gaps exist; and
- The measurement and assessment tools remain under development.

Against this background, there should be awareness regarding limitations in existing tools and their application to climate risk.

Consequently, supervisors should continue to support risk-based prudential rules and focus on Pillar 2 (risk management, governance) and 3 (reporting) elements. Allocating capital to risks that may or may not occur in 20-30 years' time could cause unintended consequences and more fundamental system-wide risks: for example, by making insurance too expensive leading to under-insurance and increasing the insurance gap, which would make society less resilient to climate change.

In addition, it should be noted that for an Internationally Active Insurance Group (IAIG), the supervisory college as an existing tool provides an opportunity for a coordinated approach to minimise the cost and resources needed to respond to multiple, uncoordinated supervisory / regulatory requests.

7. *Do the proposed recommendations on incorporating systemic risks into supervisory and regulatory approaches, including the expanded use of climate scenario analysis and stress testing for macroprudential purposes, address the appropriate areas? Please elaborate if there are any other features or tools that should be considered.*

- *On supervisory risk management expectations of financial institutions*

Insurers caution against prescription in the own risk and solvency assessment (ORSA) processes. The ORSA should continue to represent the insurer's own risk profile view, and the capital and other means needed to address those risks. The ORSA scenarios should focus on key risks and major trends to drive the discussion with management on high priorities envisioned over the strategic planning horizon. The insurer should decide for itself how to perform this assessment based on the nature, scale and complexity of the risks in its business.

Therefore, each insurer should have the necessary flexibility in applying the most appropriate tools and assumptions — this includes scenarios and time horizons for material risks — to their own risk management frameworks.

The conclusion of climate change scenario analysis should be included in the ORSA only if the insurer considers climate risks material. The ORSA, including any climate scenario analysis where material, should remain limited to assessing firm-specific risks: ie be a micro-prudential tool. Systemic risk is macroprudential and hence does not belong in the ORSA (see existing IAIS work). Moreover, undertakings need to have full flexibility to reflect differences in time horizons and company specificities (the measurement and quantification of these risks is necessary only when these effects are financially material for the insurer, which depends on their company-specific strategy).

In particular regarding the time horizon, an ORSA generally reflects a time horizon of one to three years, while some climate risks may occur over a longer time horizon, such as 20-30 years.

- *On the use of scenario analysis and stress testing*

It is first important to clarify that scenario analysis and stress testing are two different tools for a) firms' specific risk assessment and b) for assessing systemic impacts/potential vulnerabilities, and that in the climate-related risk context, the time horizons are predominantly long-term. Scenario analysis is conducted by firms' subject to materiality. FSB's focus is on macroprudential monitoring and hence it must recognise that such assessments are not for individual firms to conduct but an exercise that should be conducted by supervisors/central banks subject to their respective mandates. Insurance Europe encourages the FSB to clarify the two different perspectives, their purposes as well as the owners of such exercises more clearly.

The insurance industry notes the following on the use of stress testing:

- Insurance Europe recognises that appropriately designed climate stress tests can provide information to help assess financial industry exposures.
- Regarding macroprudential objectives, given the exploratory nature and lack of maturity of climate stress testing, the focus, at this stage, should be on assessing potential sensitivities, vulnerabilities, and the resilience of the financial sector. Unnecessary complication of stress tests with too many other aspects should be avoided.
- Also, given the exploratory nature of the stress test it is important to recognise that it can only give indications for relevant issues and the need for further work before drawing conclusions.
- It is important to make a distinction between identification of insurers' sensitivities to risks and identification of vulnerabilities. These are fundamentally different: insurers will be sensitive to any risk they take on behalf of customers, but this does not mean they are vulnerable. This is, therefore, relevant for climate change stress tests, as well as all other stress tests.

- The longer-term horizons will allow time to assess changes in physical risks which will only materialise over a longer period. However, while the changes projected may have very significant impact on society, it should be recognised that in many or even most cases the impact on insurers' solvency may be very limited due to their ability to take mitigating actions such as changing investments, repricing or redesign of products or no longer accepting the risks.

Furthermore, regarding the use of scenario analysis and stress testing:

- Before mandating specific scenario analysis, supervisors should address the need for standardised climate risk scenarios: for example, NGFS.
- Additionally, specific issues related to the insurance sector's understanding of physical risk modelling, such as:
  - The need to improve physical risk analysis by linking it to natural catastrophe models / climate models (eg general circulation models);
  - The applicability to real estate / geographic location and asset backed loans on property: eg mortgages, from an investment perspective; and
  - The need for open-source data and modelling platforms: eg OASIS.

Using these tools to allocate capital to risks that may or may not materialize in 20-30 years could cause unintended consequences and more fundamental system-wide risks: eg adversely affecting the availability of insurance that could lead to under-insurance and an increase in the insurance gap, making society less resilient to climate change.

- Long-term scenario analysis is not suitable to assess the solvency of (re)insurers. The assumption that all the risk potential of the next 30 years will materialize instantaneously at the end of a calendar year "n" can be made for operational purposes, as it is easier to design, implement and interpret scenarios in this fashion. However, this assumption is an overly simplified reflection of the real world and, therefore, cannot be misguidedly read as a value at risk-type of stress.
- When instantaneous shocks are used, any confusion between the results of the scenario and capital requirements should be cleared as this might result in ill-informed market signals, inconsistent with a stable transition to greater financial sustainability.
- Stressed scenario analysis has its limitations, it is different from probabilistic loss modelling, due to its reliance on a limited set of scenarios with an unquantified probability of occurrence. The plausibility of the stressed scenarios is supported by a narrative. As such, stressed scenario analysis can deliver valuable inputs, for example where data are lacking or triggers are difficult to model (eg political decisions), but it should not be used as a solvency assessment tool.
- As mentioned in the report, in line with some authorities, the industry agrees that top-down stress tests are better suited to evaluate the macroeconomic impacts of climate change-related risks through the interconnectedness of the financial sectors and the links with the real economy. Bottom-up approaches cannot satisfactorily answer questions on the transmission channels across financial sectors and with the real economy as, in practice, every participant will make different assumptions leading to results which cannot be aggregated.
- The industry agrees with the limitations of dynamic balance sheet approaches underlined in the consultation documents.
- It is critical that only sector-wide information — and not individual company information — is published, should there be any public report by the supervisors based on the results. For example, company information risks confusing the public between formal solvency related requirements and information and stress test results, turning the exercise into a capital related one which must be avoided. In addition, communication to the public needs to be balanced and careful to avoid misunderstanding.

### **C. Early considerations on other macroprudential tools and policies**

8. *Are there other areas of work, literature or research being conducted on macroprudential tools and policies on climate-related risks that should be considered in the report?*

The industry appreciates the FSB's review of good practices, challenges and lessons learned on macroprudential tools and policies on climate-related risks. The industry shares the view that work on potential macroprudential tools and policies is at an early stage and subject to important trade-off considerations. In addition, there are considerable conceptual challenges.

Regulatory/supervisory overshoot and/or macroprudential measures triggered at bad timing would be counterproductive and can undermine financial stability and delay the climate transition.

The industry agrees with the reference to the current literature suggesting that the impact of climate-related risks can be captured within traditional financial risk categories, such as credit, market, liquidity, operational and insurance (underwriting) risks that are broadly part of existing prudential frameworks.

### **D. Additional considerations**

9. *Are there any other issues that should be considered in future work of the FSB on supervisory and regulatory approaches to climate-related risks?*

No comments.

*Insurance Europe is the European insurance and reinsurance federation. Through its 36 member bodies — the national insurance associations — it represents all types and sizes of insurance and reinsurance undertakings. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers pay out over €1 000bn annually — or €2.8bn a day — in claims, directly employ more than 920 000 people and invest over €10.6trn in the economy.*