Public consultation on draft application paper on climate risk market conduct issues in the insurance sector

Survey response 1

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

General comments on draft application paper

General comments on draft application paper on climate risk market conduct issues in the insurance sector:
The paper brings several very positive and needed issues and recommendations with regards to insurance products availability and transparency concerning climate risks. We can say, in short, that we could not be more supportive of each of them. We would only add, however, that a recommendation regarding innovative insurance of natural assets, that are key not only to mitigate climate change, but also for adaptation and resilience, could be included. We can refer to a couple of pilot products, case studies and policy briefs that have been published recently on the topic: Insurance for mangrove restoration: Reducing Caribbean Risk: oportunities for cost-effective mangrove restoration and insurance (https://www-axa-com.cdn.axa-contento-118412.eu/www-axa-com%2Ff83724d2-fcd0-4a41-bde9-e0330a501d07_tnc_mangrove+insurance_final+hi.pdf) Insurance for coral reef restoration: Designing a new type of insurance to protect coral reefs, economies and the planet (https://www.swissre.com/our-business/public-sector-solutions/thought-leadership/new-type-of-insurance-to-protect-coral-reefs-economies.html) The Nature Conservancy debuts new Hawaii coral reef insurance plan (https://www.greenbiz.com/article/nature-conservancy-debuts-new-hawaii-coral-reef-insurance-plan) Insurance for natural infrastructure: assessing the feasibility of insuring coral reefs in Florida and Hawaii (https://www.nature.org/content/dam/tnc/nature/en/documents/TNC_BOA_ReefInsuranceFeasibility_FLHI_113020.pdf) Webinar: How insurance can support reef resilience (https://reefresilience.org/pt/how-insurance-can-support-reef-resilience-webinar/) Also, we believe that the topic of climate risks and opportunities in the investment portfolio should be addressed as well, regarding a number of transparency issues, due diligence actions for risk assessment and proper mitigatory actions towards the invested companies. We will detail that in further comments.

Section 1 Introduction

General comments on section 1 Introduction
As mentioned initially, we support the proposal in general, so now we include 5 key missing points (all of them related to the investments portfolio): 1. Need of location-specific information of invested companies and, where relevant, their value-chain and disclosure of this information Currently, most insurers/investors do not require location-specific information regarding the operations of the companies they invest in. This prevents completely the assessment of climate physical risks, as well as of other environmental and social risks, such as biodiversity risks (co-related to climate change mitigation and adaptation - see, for example: IPCC and IPBES joint report on Climate Change and Biodiversity: https://files.ipbes.net/ ipbes-web-prod-public-files/2021-06/20210609_workshop_report_embargo_3pm_CEST_10_june_0.pdf and World Conservation Monitoring Center (UNEP/University of Cambridge). Strengthening synergies: how action to achieve post-2020 global biodiversity conservation targets can contribute to mitigate climate change; water risks (co-related to climate change adaptation); risks and impacts to local communities (also co-related to climate risks, once tribal people are forest guardians, as many UNEP studies show (See, for example: https://www.unep.org/news-and-stories/story/indigenous-peoples-and-nature-they-protect, 2020, and https://www.unep.org/news-and-stories/story/unsung-heroes-conservation-indigenous-people-fight-forests, 2023), and forests provide climate change mitigation). This also prevents climate change mitigation related to natural assets, once this is also based on location. It is crucial to acknowledge that, for some industries, climate risks are actually originated in the value-chain: it is the case of food/agriculture, for example, with GHG emissions arising from deforestation, use of chemical fertilizers, animal manure management, entherical fermentation of livestock and so on. In such cases, it is important to recognize the value-chain location as well. 2. Need of consideration of compliance with environmental/climate regulations and of industry specific key-performance indicators Another potential issue is if compliance with regulations is verified or if only best practices (or climate/ESG performance according to KPIs) are considered – and to which extent. It is quite common in the financial sector to check only GHG emissions, when actually what matters is the GHG balance in the atmosphere. Hence, it is essential to comply with environmental regulations, because several natural ecosystems (forests, mangroves, wetlands, oceans) sequester carbon from the atmosphere, affecting the final balance. If we do not preserve and even restore them properly, the speed and intensity of climate change will certainly be affected. However, it is also essential to recognize that the risk level is far different for each industry and that is the reason why IFRS S2 standards, for example, included sector-specific recommendations. Ideally, KPIs should be assigned a different weight for each industry, according to their materiality level. For example, for sectors that are intensive in the use of electricity or fuels, energy consumption and mix should be assigned a high weight. For sectors that are intensive in the use of water, water sources and efficiency should receive a high weight (water scarcity is the most relevant climate physical chronic risk globally). For sectors with high deforestation risks (even in the value-chain), this topic should receive a high weight. Then, according to the company performance on each KPI (their strategies for mitigate the risks, for example), they should receive a final rating by insurers that have their bonds or equities in their portfolios (or are considering to purchase them). 3. Need of disclosure of portfolio companies and their climate/ESG risk level (and criteria for assessment) Also, insurance companies should be required to disclose their climate/ESG criteria for risk assessment regarding investments. And the result of the assessments (at least aggregated information) should be disclosed as well: percentage of high risk, medium risk and low risk companies, for example. This information is useful for insurers clients, investors (who have bonds or securities of insurance companies in their portfolios), insurers regulators/supervisors and other stakeholders. If the companies that integrate the portfolio are also disclosed, stakeholders can also contribute with the insurer/investor adding relevant information if a channel to receive them is created. 4. Need of regulatory definition of minimum level of due diligence Considering the low-level of maturity on climate risks due diligence in the financial sector in general, regulators/supervisors should define the minimum sources of information and diligences to be developed: official sources of data for compliance information and the definition of industries who require specific KPIs, for example, must be considered. Ideally, even the list of sector-specific KPIs, based in already existing recognized standards, could be included in the regulatory guidance. 5. Investments for climate change mitigation and adaptation: need of disclosure In their investment activities, insurers can also choose to invest in positive impact projects . The percentage of investments with these characteristics could be disclosed as well, once risk management is not enough to address the climate emergency: we also need investments in the transition. Of course, in such cases, the insurer must refer either to an official taxonomy or publish its own framework to define climate positive impact investments, with qualitative and quantitative indicators that are used and the process to verify and monitor them for each company or project invested.

6. Need of disclosure of voting and engagement policies with invested companies and their results

Another essential topic regarding insurers investment activities is their risk mitigation efforts, which basically encompass their engagement policies and actions towards invested companies and projects. As investors, insurers must monitor climate risks with a frequency and depth appropriate to the intensity of the climate risk level of each company. Based on this monitoring, engagement actions must take place, either regarding participation in general-assemblies (voting and propositions on climate issues) or also routine interaction with the companies' superior management or technical departments in charge of climate-related topics. These actions are expected to produce relevant outcomes, such as feasible and appropriate transition plans of companies, with corresponding targets and timelines. An appropriate transition plan should consider the company baseline, based in the location of its operations (and/or value-chains, where appropriate), its current performance regarding industry KPIs and technological development in the industry, as well as its financial situation. It must be at the same time ambitious and feasible.

Final remarks

It is important to clarify that we do not consider that these suggestions are complete enough for the challenge that lies ahead. Other aspects could be added and further detailed.
But we are sure that they are useful and able to bring a relevant impact in the insurance industry contribution and resilience to the climate crisis that was generated by the traditional way our economies use(d) to work: low transparency, low consideration of environmental and social impacts. We need a paradigm shift.

Comments on section 1.1 Context and objective
No further comments

Comments on section 1.2 Related work by the IAIS
No further comments

Comments on section 1.3 Proportionality
No further comments

Comments on section 1.4 Scope
No further comments

Section 2 Greenwashing considerations

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Comments on section 2.1 Introduction on greenwashing
We can add that the most serious type of greenwashing is the one that hides harmful consequences of the invested/financed/insured activity. And the best way for regulators to address that is to define sustainability risks and impacts of each industry clearly, which means, defining sustainability KPIs for each industry, assigning a weight to each of them and requiring that financial institutions (including insurers) get information from each company on these KPIs. Also, location information (including value-chain, when relevant, according to KPIs) should be required.

Comments on section 2.2 Clear and robust sustainability-related definitions and criteria
Very good. No further comments.

Comments on section 2.3 Offering products with sustainable features that meet certain policyholder requirements
We agree with everything that is there, but add that, for item 41, that insurers must disclose the framework they use (which indicators, with which weigh) and the source of data/information used to classify the product as sustainable.

Comments on section 2.4 Insurers promoting their own sustainability profile to attract clients
Very good. No further comments.

Comments on section 2.5 Substantiation of sustainability representations presented to policyholders
We agree with everything, specially item 47, and that is why we propose that regulators/ supervisors should define the minimum sources of information and diligences to be developed: official sources of data for compliance information and the definition of industries who require specific KPIs, for example, must be considered. Ideally, even the list of sector-specific KPIs, based in already existing recognized standards, could be included in the regulatory guidance.

Section 3 Natural catastrophes considerations

Comments on section 3 Natural catastrophes considerations
Very good! No further comments.

Comments on section 3.1 Introduction on NatCat considerations
Very good! No further comments.

Comments on section 3.2 Provide easy to understand products, using plain language
Very good! No further comments.

Comments on section 3.3 Test the understanding of exclusions and promote transparent advice
Very good! No further comments.

Comments on section 3.4 Affordability
Very good! No further comments.

Comments on section 3.5 Access
Very good! No further comments.

Comments on section 3.6 Timely and fair claims handling
Very good! No further comments.

Section 6 Additional questions

Does the draft application paper provide sufficient detail to be a useful tool for supervisors and insurers?
We believe further detail is needed, specially regarding climate/sustainability integration into investment decisions, as proposed on the first section (Introduction). We also think that recommendations on the integration of climate/sustainability factors in the compensation schemes of superior management of insurers would be useful

Is there any additional work the IAIS should be undertaking in the area of climate risk market conduct issues in the insurance sector?
Research on innovative insurance products that provide climate resilience. Research on the correlation between climate/sustainability performance (considering industry specific KPIs) and financial performance in the short, middle and long-term would be very useful to guide insurers investments.