

GFIA response to FSB consultation on supervisory and regulatory approaches to climate-related risks

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.

The emerging and evolving nature of climate-related risks requires supervisors' active engagement and cooperation with policymakers to develop an environment that helps all sectors contribute in full to the transition to a more sustainable economy while managing risks to financial stability.

GFIA thus welcomes the intent of the Financial Stability Board's Interim Report, which is to provide guidance to cross-sectoral supervisors in order to avoid duplicative or contradictory standards between jurisdictions and to facilitate the assessment of material climate-related risks, which is still at an early stage of development.

The private sector needs reliable climate-related information as much as policymakers, regulators and supervisors, as the basis for better management of climate-related risks. It is essential that a basis of comprehensive and robust international data is established for both the private sector and financial authorities to allow them to monitor and assess climate-related financial risks. Ultimately, an adequate mitigant of macro-risks is companies' own progress on measuring and addressing climate risk, combined with micro-prudential supervisory tools. Both are increasingly present throughout the insurance industry. It is essential to keep in mind that for any such exercise, the financial industry must have adequate data from the real economy (eg, from the companies in which it invests) for making investment and underwriting decisions, and it also needs sufficiently robust models. Furthermore, it should be recognised that there are limits to the ability to provide granular data due to the limitations of scientific and other data sources which become less certain over the longer term. For these reasons, the FSB should accept more qualitative reporting of the impacts of climate change.

It is critical that any disclosure/reporting mandate respects the principles of confidentiality, proportionality and materiality. Voluntary and compulsory sustainability disclosure is growing exponentially globally, and standardised filings will be implemented in the years to come. To avoid duplicating or competing with the overarching non-financial disclosure standards that are being developed, supervisory data requests should focus on supplementing data captured by existing prudential reporting and public climate-related financial disclosures. This will help streamline information and avoid unnecessary costs for both insurers and supervisors. Sharing best practices and promoting transparency between jurisdictions will avoid duplicative or contradictory standards, while also reducing requests for information. It is vital that any information request by supervisors is carefully considered and proven to be essential for fulfilling their supervisory duties.

GFIA recommends reflecting materiality in the FSB recommendations. While the FSB makes references to a number of jurisdictional developments that do mention materiality, the FSB Interim Report emphasises it insufficiently. Materiality, which is one of the key elements in (micro-)prudential supervision, along with proportionality and confidentiality, should likewise be reflected in any macro-prudential assessment and macro policy tools.

It is also very important that supervisors engage and communicate with financial institutions about how the reported data will be used. In any case, it is important that insurers have flexibility in the disclosures, while respecting consistency and comparability, where relevant and possible. Models for measuring climate-related risks and exposures are being developed, and the materiality of climate-related risks may change over time. For example, it should be avoided that reporting requirements are used as another way to prescribe what insurance companies should do, for example, on the governance of climate-related risks (eg, a dedicated committee on climate-related risks).

More specifically, on the different categories of climate-related data highlighted in the Interim Report (p.12):

<i>FSB</i>	<i>GFIA's comment</i>
Sufficiently granular data on sectors or economic activities that are sensitive, vulnerable or exposed to physical, transition and liability risks arising from climate change	Relevant. Insurers need real economy data to inform investment and underwriting decisions.
Financial institutions' (direct or indirect) exposures to such sectors or economic activities impacted by transition risk	Relevant for direct exposures but clarification is needed of the definition of indirect exposures. Insurers need real economy data to address exposures to transition risk when making investment and underwriting decisions.
Geographical location of financial institutions' exposures	Less relevant with regard to the geographic locations of insurers, but relevant from a real economy perspective to inform insurer investment and underwriting decisions. Proportionality regarding the geographic location of financial institutions' exposures is needed.
Financial institutions' reporting (and their counterparties' reporting) of carbon related metrics, including reporting of Scope 1 and Scope 2 GHG emissions, and progressively expanding to Scope 3 GHG emissions	Relevant but there is a need for proportionality. Progressive reporting to Scope 3 GHG emissions needs to be matched with the development of internationally recognised approaches for calculating Scope 3 for underwriting and financed emissions.
Information on financial institutions' governance, business model and strategies and, where relevant, transitions plans	Materiality of climate risks differs between entities and may change over time. Insurance companies that do not identify significant climate risks in their risk profile should not be forced to establish a dedicated committee. Rigid approaches to the most appropriate governance to manage climate risks should be avoided. Supervisors may want to provide voluntary guidance on climate risk governance but should not prescribe one approach rather than another.
Information on financial institution's significant counterparties	Relevant. Insurers must have access to good quality sustainability-related information at the asset level based on a globally coordinated approach to general company ESG data reporting.
Systemic risks to inform a macroprudential perspective	With real economy data, the insurance business model, ie, investment management and underwriting, has significant flexibility to address climate risk.

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

Supervisors should rely on existing processes to ensure the reliability of supervisory reporting on the one hand and financial and non-financial public filings on the other. GFIA would like to underline that the insurance sector is partly dependent on other sectors' data and data quality, particularly for Scope 3 data.

In addition, GFIA suggests elaborating on the potential characteristics of a third-party verification mechanism. Given the uncertainty surrounding climate-related data, GFIA also suggests carefully considering the appropriateness of a third-party verification mechanism. At the same time, it should be noted that the insurance sector is partly dependent on other sectors' data and data quality.

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

GFIA agrees with the need to promote common definitions and approaches that will facilitate cross-border comparison. The report appropriately identifies the elements of a common high-level definition of climate-related risks.

The definitions of transition risks and physical risks align with the definitions suggested by the Task Force on Climate-Related Financial Disclosures (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 paramount for improving the comparability and availability of data while also reducing compliance costs for companies. GFIA agrees with the goals set by the International Sustainability Standards Board (ISSB) built on the TCFD Recommendations and highlights that ISSB Exposure Drafts are currently submitted to public consultation. GFIA supports the ISSB's willingness to promote the principle of connectivity with financial reporting. While it is important, where possible, to include monetary amounts and other quantitative data related to financial statements in sustainability reporting, it should be limited to some topics only. Any extension of the supervisory reporting should respect the principles of confidentiality, proportionality and materiality.

Additionally, GFIA suggests highlighting that coordination between the ISSB and regional initiatives is vital for promoting the convergence of sustainability reporting standards across the various jurisdictions and achieving global consistency and comparability. A global risk ideally demands a globally coordinated response, not more fragmentation. Again, progressive expansion of reporting to Scope 3 GHG emissions needs to be matched with the development of internationally recognised approaches for calculating Scope 3 for underwriting and financed emissions.

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.

It is very important to note that there is no practical evidence that would justify concluding that insurers are exposed to systemic risks from climate change. Because the effects of climate change materialise over time, insurers are able to adjust policies, underwriting, pricing and decisions on whether or not to cover a risk. This means that the systemic risk is not faced by insurers but rather by society. Therefore, when applying stress tests, supervisors and regulators should not feel the need to have identified a problem for the industry, since the problem is one for society and only indirectly for insurers.

The insurance industry shares the view that the potentially systemic nature of climate-related risks is an important consideration in supervisory and regulatory approaches. It 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 may be necessary to demonstrate how climate-related risks may lead to a systemic event.

Climate-related risks are expected to materialise over a long period which may allow the financial system to adapt. In addition, to the extent the risk is localised in some places or lines of business and can be diversified globally, a climate-related event can have very severe consequences for some financial institutions without being systemic for the financial system. GFIA suggests elaborating on examples provided in the consultation document to illustrate concretely how a physical risk event and/or a transition risk event could threaten the financial system.

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

According to the report, several existing supervisory and regulatory tools and policies could be used to address the unique features of climate-related risks: supervisory review and evaluation processes; risk analytical tools (scenario analysis, stress testing); other supervisory actions (eg, supervisory capital add-ons); and macroprudential tools and policies. It should be noted that, in the case of climate risk, measurement and assessment tools remain under development. Similarly, data on climate-related issues is in itself a key challenge. Against this background, the limitations of existing tools and their application to climate risk should be taken into account.

With regard to capital add-ons, supervisors should continue to support risk-based prudential rules and focus on governance (Pillar 2) and reporting and disclosure (Pillar 3) elements. Allocating capital to risks that may or may not occur in 20 to 30 years' time could cause unintended consequences and more fundamental system-wide risks, eg, making insurance too expensive and leading to underinsurance and an increase in protection gaps, making society less resilient to climate change.

For internationally active insurance groups (IAIGs), the supervisory college provides an opportunity for a coordinated approach that minimises 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*

GFIA cautions against prescription in the Own Risk and Solvency Assessment (ORSA) processes. The ORSA should continue to represent the insurer's own view of its risk profile, and the capital and other means needed to address the risks. The ORSA report must remain relatively short, produced in a reasonable timeframe, with clear conclusions, fit for purpose, well governed and useful for business purposes. The ORSA scenarios should focus on key risks and major trends to drive the discussion with management about the top 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 be able to choose appropriate scenarios and time horizons for material risks. It is therefore vital that insurers have the maximum flexibility in applying the most appropriate tools and assumptions to their own risk management frameworks.

The conclusions of climate change scenario analysis should be included in the ORSA only if the insurer considers climate risks material. It is vital that scenarios remain relevant for each company's risk profile. Undertakings need to have full flexibility to reflect differences in time horizons and company characteristics (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). An ORSA generally reflects a time horizon of a few years, while some climate-related risks may occur over a longer time horizon, such as 20 to 30 years. The main aim of the ORSA is to reflect the company's own risk analysis so that it remains useful for decision-making, so being overly prescriptive goes against its very essence.

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

GFIA recognises that while appropriately designed climate stress tests can provide information to help assess financial industry exposures, the starting point should not be the assumption that insurers are vulnerable to climate-related risks. In addition, stress tests should avoid pulling in false accuracy, over-complication and granularity, and becoming excessively burdensome for insurers. Finally, GFIA supports good practice and agrees that standardisation/harmonisation is needed to a certain extent.

Long-term scenario analysis is not suitable for assessing the solvency of (re)insurers, which has been calibrated over a 12-month horizon. When instantaneous shocks are used, any confusion between the results of the scenario and capital requirements should be cleared up, as this might result in ill-informed market signals, inconsistent with a stable transition to greater financial sustainability. Before mandating specific scenario analysis, supervisors should address the need for standardised climate risk scenarios, eg, the Network of Central Banks and Supervisors for Greening the Financial System (NGFS). Additionally, specific issues related to the insurance sector's understanding of physical risk modelling need to be addressed, such as:

- the need to improve physical risk analysis by linking it to natural catastrophe models/climate models, ie, general circulation models);
- the applicability to real estate/geographic location and asset-backed loans on property, ie, 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 materialise in 20 to 30 years could cause unintended consequences and more systemic risks, eg, adversely affecting the availability of insurance, which could lead to under-insurance and an increase in the insurance gap, making society less resilient to climate change.

Furthermore, stressed scenario analysis relies on a limited set of scenarios whose probability of occurrence is not quantified, and can thus deliver valuable inputs, especially when data is lacking or when triggers are difficult to model (eg, political decisions). However, it is not a prediction of future conditions, and therefore should not be used as a solvency assessment tool, but only to focus on climate risks.

It is critical that only sector-wide information — not individual company information — is published, should there be any public report by the supervisors based on the results. For example, with company information, the public could confuse 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 carefully avoid creating misunderstandings.

GFIA agrees that top-down stress tests are better suited to evaluating the macroeconomic impacts of climate change-related risks through the interconnectedness of financial sectors and the links with the real economy. Bottom-up approaches cannot satisfactorily answer questions on the transmission channels from one financial sector to another and to the real economy as, in practice, every participant will make different assumptions, leading to results that cannot be aggregated.

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?

GFIA appreciates the FSB's review of good practices, challenges and lessons learned on macroprudential tools and policies on climate-related risks.

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) that are broadly part of existing prudential frameworks.

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.

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About GFIA

The Global Federation of Insurance Associations (GFIA), established in October 2012, represents through its 40 member associations and 1 observer associations the interests of insurers and reinsurers in 67 countries. These companies account for 89% of total insurance premiums worldwide, amounting to more than \$4 trillion. GFIA is incorporated in Switzerland and its secretariat is based in Brussels.