

# Supervisory and Regulatory Approaches to Climate-related Risks

Geneva Association cover letter

30 June 2022

Financial Stability Board (FSB)  
Mr Klaas Knot  
Mr Dietrich Domanski

Zurich, 30 June 2022

Dear Mr Knot,  
Dear Mr Domanski,

The Geneva Association appreciates the opportunity to respond to the FSB's interim report on *Supervisory and Regulatory Approaches to Climate-Related Risks* (interim paper).

The Geneva Association is a global think tank of the re/insurance industry whose members are Chief Executive Officers of insurance and reinsurance companies. Core activities of The Geneva Association include identifying and investigating key trends and conducting strategic research on issues that are likely to shape or impact the re/insurance industry. More information about our work is available on [www.genevaassociation.org](http://www.genevaassociation.org).

This letter provides a perspective of the global re/insurance industry on supervisory and regulatory approaches pertaining to climate change. Rather than responding to each question as raised in the interim report, we would like to highlight a number of issues.

In January 2020, The Geneva Association (GA) launched the Task Force on Climate Change Risk Assessment (GA Task Force). This task force has been working to advance and accelerate the development of holistic methodologies and tools for conducting forward-looking climate change risk assessment and scenario analysis that would produce decision-useful information for the re/insurer and enhanced reporting to relevant stakeholders. In its first two reports (published in 2021),<sup>1</sup> the task force called for the need for a more holistic approach anchored in decision-making processes, using a combination of qualitative and quantitative analysis, taking into consideration both sides of the balance sheet.

As such, the Geneva Association appreciates the intent of the FSB to assist supervisory and regulatory authorities in developing their approaches to monitor, manage and mitigate risks arising from climate change. While promoting consistency across sectors and jurisdictions can be helpful, it is important that supervisory approaches with regard to climate change risk (as with any risk) consider sector-

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<sup>1</sup> The Geneva Association. 2021a. *Climate Change Risk Assessment for the Insurance Industry – A holistic Framing of Decisions and Other Key Considerations for Both Sides of the Balance Sheet*. Authors: Maryam Golnaraghi and The GA Task Force on Climate Change Risk Assessment. (February). [https://www.genevaassociation.org/sites/default/files/research-topics-document-type/pdf\\_public/climate\\_risk\\_web\\_final\\_250221.pdf](https://www.genevaassociation.org/sites/default/files/research-topics-document-type/pdf_public/climate_risk_web_final_250221.pdf)  
The Geneva Association. 2021b *Insurance Industry Perspectives on Regulatory Approaches to Climate Change Risk Assessment*. Authors: Maryam Golnaraghi and The GA Task Force on Climate Change Risk Assessment - (June). [https://www.genevaassociation.org/sites/default/files/research-topics-document-type/pdf\\_public/climate\\_regulation\\_web2.pdf](https://www.genevaassociation.org/sites/default/files/research-topics-document-type/pdf_public/climate_regulation_web2.pdf)

specific business models and particularities. From a re/insurance industry perspective, climate change is not a new risk class in the risk assessment practices of re/insurers. It is an important risk factor, amongst others, affecting both the liability and investment sides of the balance sheet. Although models are continually evolving to appropriately capture climate change risk, the re/insurance industry has decades of experience in modelling and pricing climate risks, such as through the use of catastrophe modelling for climate risk analysis. As we anticipate the impacts of climate change,<sup>2</sup> the focus of the third and final report of the GA task force offers guidance and key considerations for P&C and life re/insurers' on how to assess the resilience of their business models to climate change risks and build internal capacities that would produce decision-relevant climate change risk information through exploratory, iterative and adaptive processes.

Climate change risk is high on the agenda of the International Association of Insurance Supervisors (IAIS). We highly recommend the FSB to consider the important work under way at the IAIS prior to coming up with insurance-specific systemic risk mandates in order to avoid duplication and to leverage the meaningful and tailored construct for systemic risk assessment implemented by the IAIS in 2019. The Geneva Association has been closely involved in the IAIS' climate-related work to date and in the development of IAIS' Holistic Framework for the assessment and mitigation of systemic risk in the insurance sector (Holistic Framework), which is designed to assess and respond to arising systemic risks across the insurance industry. As part of the Holistic Framework, the IAIS conducts a Global Monitoring Exercise (GME) aimed at monitoring risks and trends in the global insurance sector, including those that may lead to systemic risk, and publishes the outcomes in the Global Insurance Market Report (GIMAR). Last year the IAIS issued a special edition of the GIMAR dedicated to the potential financial stability impact of climate change on the insurance sector.<sup>3</sup> The conclusion of the analysis done as part of this report was that the insurance industry was well capitalised, even under adverse climate scenarios. Beyond the IAIS, the IFRS International Sustainability Standards Board (ISSB) is developing disclosure standards for sustainability- and climate-related risks with the aim of providing a global baseline.

### *Systemic risk*

Before recommending an extension of the data-collection exercises, disclosure and climate assessment already in development, regulators need to better understand the manner in which climate change represents a systemic risk for the insurance sector. While climate change undeniably comes with risks to societies globally, to date, the link between climate change and insurance-sector systemic risk remains unclear. Insurance regulators should assess the potential impact of climate change risk on financial stability by applying the IAIS Holistic Framework, which delineates a coherent process and mechanism for identifying vulnerabilities, corresponding transmission mechanisms, and mitigating factors. It is unclear how the impact of climate risk on asset values might create a fire sale risk such as we saw in other parts of the financial industry during the 2008 financial crisis. Climate risk will likely follow a different path. The macro prudential tools proposed by the FSB such as additional capital, systemic risk buffers, and exposure limits are therefore highly premature and potentially misaligned with the level/type(s) of risk. These measures would also limit re/insurers'

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<sup>2</sup> We distinguish the terms 'climate risk' and 'climate change risk' and do not use them interchangeably. Specifically, **climate risk** refers to the (extreme) weather-related risks that P&C re/insurers underwrite at any given time. **Climate change risk** includes physical, transition and litigation risks with a view to the future.

<sup>3</sup> See the following link for the 2021 GIMAR special edition: <https://www.iaisweb.org/uploads/2022/01/210930-GIMAR-special-topic-edition-climate-change.pdf>

role in providing long-term transition finance and therefore limit the industry's ability to support the green transition.

Further research is required to first understand the potential for climate risks to become systemic in nature for the financial industry and then consider what system-wide actions may be necessary to mitigate such risks, if any. We urge the FSB to work with the international community to continue to assess potential systemic interlinkages by building upon the work that is currently underway, before recommending additional data collection and climate scenario assessment from individual firms.

#### *Reporting, data collection and reliability*

We support the efforts by policymakers and standard-setters to develop a well-harmonized and evidence-based approach to assessing potential climate change risk across the insurance and financial services industry but note the nascent and ever-evolving state of climate-related, science-based data and analysis. We caution against initiating overly granular data-gathering exercises on an accelerated basis. Beyond the operational burden, which could distract from other, higher-priority industry initiatives to assess and address climate risk change, it will also become increasingly difficult for regulators and other stakeholders to discern 'signal' from 'noise'. We therefore encourage the jurisdictional regulators, with the assistance of global regulatory standard-setting bodies such as the IFRS/ISSB or IAIS, to coordinate on the design and execution of surveys, data and other information requests and consider how such requests support or align with regulatory monitoring objectives. Table 1 in the FSB report is a good manifestation of the breadth and scope of information collected by jurisdictional supervisors.

For the purpose and merits of data collection to be clear, a distinction between microprudential and macroprudential supervision is needed, but these concepts seem currently blurred in the paper. Some of the data the paper suggests collecting is already collected for microprudential purposes, hence it seems something additional would need to be collected for macroprudential purposes. Importantly, if supervisors and firms manage micro-prudential, firm-specific risks well, potential system-wide implications are reduced.

We want to caution against the view that strong(er) governance, processes and controls by the re/insurance company will ensure the reliability of climate-related data for internal and external reporting purposes. For example, highly granular data (for example, on a local, geographical basis) might not be sufficiently reliable as it is heavily dependent upon data provided by non-financial corporates such as our insureds and investees. Similarly, such granular data may not be readily comparable across a broad range of re/insurance and financial services companies. A good example are investment-associated scope 3 emissions. We are not against reporting scope 3 emissions. However, since measurement methodologies for certain asset classes are still in development and investees need to build their reporting infrastructure, we consider a phased approach appropriate.

#### *Supervisory tools and practices*

Considering the proliferation of different scenario analysis exercises across jurisdictions, we strongly support FSB's coordination efforts. However, we caution against drawing firm conclusions from these exercises and using results to guide supervisory actions, particularly over longer time horizons. The interim paper recommends expanding the use of climate scenario analysis and stress testing from micro-prudential to macro-prudential purposes but does not explore whether these tools provide

information that is useful for risk management and decision-making. At this stage, the answer seems to be unclear.

The interim paper discusses the merits of dynamic and static balance sheet approaches for forward-looking assessments with longer time horizons. Both static and dynamic approaches are of limited use for macroprudential purposes, mainly because of the inherent complexities and hence uncertainties it creates, which limits the usefulness of the results derived from it. These approaches furthermore include many economic and zero-management action assumptions that are likely not to hold true. Insurers should therefore be able to decide on the approach that best fits their assessment and chosen time horizons.

The FSB report recommends the Own Risk and Solvency Assessment (ORSA) as a tool to be reinforced though the inclusion of climate-related risks as part of material financial risks. We support the notion of including climate risks in the ORSA process for micro-prudential purposes, if deemed material by the re/insurer, as ORSAs reflect re/insurer's view on its own risk. The ORSA is not a tool that can be extended to assess system wide risks. In addition, it is important to note that there are inherent uncertainties when assessing climate change risks requiring a combination of qualitative and quantitative approaches for assessing climate change risks over various time horizons depending upon availability and reliability of input data.

#### *Conclusion*

Climate change risk analysis in the insurance sector continues to evolve and more work is needed to determine if and through what transmission channels climate change can pose a systemic risk. The IAIS *Holistic Framework* and the Global Monitoring Exercise (GME) are well able to take account of possible systemic risk to the insurance sector emanating from climate change. Regulators and supervisors should align priorities and work with firms to continue to focus on micro-prudential risks from climate change. If firms properly monitor, manage and mitigate firm-specific climate-related risks to their businesses, there will be less systemic risk. It is therefore premature to recommend financial supervisors to consider macro-prudential policies and tools, such as additional capital or systemic risk buffers, not least because solvency regimes in place in many jurisdictions already have provisions for unquantified risks.

Yours sincerely,

Dennis Noordhoek  
*The Geneva Association*