Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Feedback Statement on Consultation Paper 151

Guidance for (Re)Insurance Undertakings on Climate Change Risk

March 2023

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Introduction

On 3 August 2022, the Central Bank of Ireland (the Central Bank) published Consultation Paper 151 (CP151) on Guidance for (Re)Insurance Undertakings on Climate Change Risk (the Guidance).

The consultation period for CP151 closed on 26 October 2022. The Central Bank received four submissions in response to the consultation - one from a (re)insurance undertaking, one from a law firm, one from a professional body, and another from a representative body.

This paper summarises the submissions received and sets out the Central Bank's feedback in response to the submissions. It should be read in conjunction with CP151 as it refers to terms and numbering used in the consultation paper. You can find a copy of all submissions on the Central Bank's website here and a copy of the consultation paper here.

The Central Bank wishes to thank all parties who responded to CP151 for their submissions.

Financial Risks and Governance Policy Division

Insurance Policy

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Feedback on Submissions

The respondents commented across a range of areas in CP151, which are addressed thematically below.

General Comments

Submission

All respondents welcomed the Guidance, recognising the threat that climate change already poses and the urgency to assess and mitigate climate change risk.

In particular, respondents welcomed the Central Bank's recognition of proportionality and iteration[1], the capacity to leverage work done at Group level, and the infographic - as a very useful tool to support implementation.

Materiality Assessment

Submission

Most of the comments received in the submissions related to the materiality assessment. As the materiality assessment cuts across several themes, the comments have been grouped thematically below.

Baseline Scenario

There were divergent views in the submissions regarding the appropriate level of prescription that should apply to the baseline scenario. While recognising the flexibility the proposed Guidance offers, some respondents were in favour of further prescription with regard to choosing a baseline scenario. Some responses indicated that less experienced or smaller firms favoured prescriptive guidance here.

Some respondents requested that specific examples of climate change scenarios be included.

One respondent questioned the need for a separate baseline scenario for the assessment of the materiality of climate change risk that is different to their baseline business scenario.

[1] Initially (re)insurers may use simplified and/or qualitative approaches and could use means other than as set out in the Guidance to achieve the stated objective.

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Central Bank Feedback

The Central Bank recognises that climate change is a new and evolving area of expertise for (re)insurers and acknowledges that (re)insurers are at different stages of development in relation to the management of climate change risk.

The Central Bank proposes to conduct a workshop on the materiality assessment to assist (re)insurers during the implementation phase of the Guidance.

Due to the breadth and diversity of business written by (re)insurers regulated by the Central Bank (e.g., across products, perils, geographies) it would not be appropriate for the Central Bank to specify the climate change scenarios to be considered in the materiality assessment. (Re)insurers looking for more information on climate change scenarios, may find the "*Application guidance on running climate change materiality assessment and using climate change scenarios in the ORSA*" (EIOPA's Application Guidance)[2] helpful.

For the same reason, it would not be appropriate for the Central Bank to specify the parameters by which firms carry out financial assessments of the potential impact of material climate change risks identified by (re)insurers in their ORSA.

The Central Bank considers the baseline scenario to be the (re)insurer's view of how and at what pace climate change will evolve over the short, medium and long term, rather than a financial projection. We expect that this view informs the business planning projections rather than being considered as a separate scenario. We have taken on board the responses related to this and have clarified this in the Guidance.

Time Horizon

Respondents noted that the time horizons set out in the Guidance were much longer than typical business planning time horizons. They also noted that the level of uncertainty materially increases as the

[2] https://www.eiopa.europa.eu/publications/application-guidance-climate-change-materiality-assessments-and-climate-change-scenarios-orsa_en

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time horizon lengthens with questions raised as to how (re)insurers could make projections over such a long period and the value of any such projections.

There were also some differing views, with one view that the longer term should be considered in strategic thinking whereas another view was that the longer term was too speculative to inform current strategy and should only be included in the Own Risk and Solvency Assessment (ORSA), if appropriate.

Others requested clarification on the rationale for the selection of the time horizons and to amend the shorter term from 5 – 10 years to 0 – 10 years.

Central Bank Feedback

The Central Bank recognises the level of uncertainty over longer-term financial projections.

We clarify that the time horizons included in the Guidance are aligned with the time horizons for climate change in EIOPA's "*Opinion on the supervision of the use of climate change risk scenarios in the ORSA*"[3] (EIOPA's Opinion), Paragraph 3.3.

Further, as noted in the more recent EIOPA's Application Guidance, the short, medium and long time horizons for the emergence of climate change risk (0-10, 10-30, 30-80), are much longer than the short, medium and long term time horizons for business planning purposes. (0-5, 5–10, 10-30). We have updated the Guidance to clarify that the Central Bank expects (re)insurers to consider the longer term climate change time horizons for the purposes of the materiality assessment.

We have also updated the Guidance to clarify that the Central Bank expects that the assessment of the financial impact of and material exposure to climate change and actions identified by (re)insurers to manage any material exposures are considered over the business planning horizons.

The Central Bank accepts that initially, the analysis of longer time horizons may be more exploratory and qualitative in nature but

As noted in the EIOPA Application Guidance, the short, medium and long time horizons for the emergence of climate change risk (0-10, 10-30, 30- 80), are much longer than the short, medium and long term time horizons for business planning purposes (0-5, 5 – 10, 10-30).

[3] https://www.eiopa.europa.eu/publications/opinion-supervision-use-climate-change-risk-scenarios-orsa_en

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that the scope of analysis and methodologies will develop and improve over time. (Re)insurers may consider different approaches, for example, the financial assessment of potential impacts could be undertaken on a "what if" basis rather than on precise parameters.

We expect (re)insurers to reflect on the outcome of this analysis when considering what action(s) they need to take to mitigate any material long-term risk.

We agree with the suggestion that the short term climate change risk time horizons should range from 0–10 years instead of 5-10 years

Materiality and Other Points

A number of respondents requested additional detail on materiality and direction on how to assess materiality.

Several respondents asked for direction on where the materiality assessment should be documented and whether it was appropriate to document it in the ORSA.

Some respondents sought guidance on when a qualitative assessment would be unacceptable.

One respondent sought further clarity on the Central Banks's expectations in relation to the assessment of the feasibility of assumptions underlying management actions.

Central Bank Feedback

The definition of materiality included in the Guidance is that outlined in the EIOPA's Opinion.

The documentation of the materiality assessment is a matter for each (re)insurer, as it is dependent on the specificities of their business. (Re)insurers could consider including this within the business planning process.

The Central Bank expects the feasibility of any material reliance on future management actions and other mitigating factors to be assessed. With regard to the assessment of the feasibility of assumptions used to justify such management actions, we have

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provided some examples of the types of assumptions that might be used in the Guidance.

Double Materiality

Submission

A number of respondents sought further clarity on how (re)insurers can use their influence in their underwriting activities and asked for more clarity on the interaction with the forthcoming Corporate Sustainability Reporting Directive (CSRD). Another respondent, while supporting the concept in principle, suggested that (re)insurers could only consider double materiality in certain circumstances. One respondent expressed the view that net zero expectations should not be established through regulatory guidance.

Central Bank Feedback

The Central Bank recognises the voluntary efforts of the (re)insurance sector in supporting the transition to a carbon neutral world.

We have highlighted the opportunities that (re)insurers have to use their influence in their investment and underwriting activities.

This Guidance paper does not seek to mandate (re)insurers to adopt net zero strategies or to require the development of sustainable products. We have clarified this in the Guidance by including net zero as one example of the type of public commitment that (re)insurers may make in relation to climate change. However, reinsurers should be aware of the potential reputational risk that may arise if they fail to meet any sustainability related public commitments or do not develop sustainable products (e.g. in line with shifting consumer behaviours/stakeholder sentiments).

With regard to the interaction with the CSRD, (re)insurers may take sustainability reports into account when considering their own underwriting and investment strategies.

The Central Bank recognises that the concept of double materiality is an evolving one and is something that it will continue to monitor and engage externally on as appropriate.

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Cost/Benefit Considerations

Submission

A number of respondents noted that while the Guidance does not create additional regulatory requirements, effort and resources would need to be allocated to fulfil the expectations of the Central Bank.

Central Bank Feedback

The Central Bank is introducing the Guidance to clarify its expectations with respect to the appropriate management of change risk under existing Solvency II requirements.

The Guidance was drafted in response to industry requests for more clarity and support in this area.

In considering the level of resources and effort, the Guidance explicitly allows for proportionate approaches taking account of the materiality of the (re)insurer's exposure to climate change risk and the size and complexity of the (re)insurer.

Additionally in terms of efforts and resources needed to fulfil the expectation:

- In some cases, depending on the level of maturity of a (re)insurer's existing approach to climate change risk management, additional effort and resources may be required. However, the Guidance may alleviate potential future costs which may be incurred by (re)insurers through inaction or a delay in taking action to appropriately consider and address the impact of climate change risks on the business.
- In other cases, where (re)insurers consider that they are already appropriately managing this risk and no further action is needed, limited effort should be needed in demonstrating to their supervisor how that is the case.

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Other

Submission

The submissions included a number of additional points, which we have addressed hereunder.

Infographic

The infographic was broadly welcomed in the submissions. One respondent requested that the infographic include references to where the different elements should be documented. Another highlighted a discrepancy between the text and the infographic regarding optionality. One respondent suggested the yes/no response to materiality is too black and white.

Consistency

A number of respondents pointed to specific paragraphs that suggested the expectations went beyond regulatory expectations, for example regarding remuneration. We have taken on board these responses and amended the Guidance as appropriate.

Autonomy

One respondent set out that (re)insurers should be able to decide what risks are key for them without an expectation that climate change be a key risk for all; (re)insurers should be able to decide if climate change risk is not material.

Data and Expertise

Most respondents noted that there are issues with data availability and lack of expertise on climate change risk.

Role of the board

One respondent noted that the expectations set out for the board are too prescriptive and that the involvement of the board should be part of the overall governance.

Supervisory Expectations

A number of respondents noted the importance that the supervisory approach is consistent with guidance and does not impose a uniform approach. One respondent highlighted the importance of regular feedback on emerging good practice.

Further clarity

The submissions included some clarification requests such as level of validation required; level of public disclosure expected when a (re)insurer finds itself with increasing uninsurable risks; embedding climate change; and that there is no mention of transition plans.

Central Bank Feedback

Infographic

The Central Bank notes the feedback on the infographic. The infographic is intended to help (re)insurers to visualise the interlinkages between the different elements of the Guidance. It is not intended to fully replicate all of the optionality in the Guidance.

Consistency

We note the comments on consistency and we have reviewed the Guidance and performed a further consistency check. In particular, we have revised the wording related to the Board responsibilities and remuneration to remove any over-prescription.

Autonomy

While the Central Bank considers that climate change risk is no longer an emerging risk, it is not the intention of the Central Bank to specify that climate change is a key risk for an individual (re)insurer. The Guidance sets an expectation that where an individual (re)insurer concludes that climate change risk is not a material risk for them, this conclusion, together with its justification, are well documented.

Data and expertise

While we recognise that climate data is not perfect, (re)insurers are expected to consider the various sources, which are available, or use proxies and estimations where data is not yet available, to build as clear a picture as possible of how climate change risks may affect their business. (Re)insurers have a responsibility to ensure that they have access to the appropriate level of skills and resources to appropriately manage the risks they face.

Role of the board

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As the board is ultimately responsible for the proper monitoring and oversight of all activities of (re)insurers, we consider the expectations set out in the Guidance to be appropriate.

Supervisory Expectations

The Central Bank agrees with the feedback on consistency of supervisory approach with the Guidance and the importance of regular feedback as good practices emerge.

Further Clarity

Level of validation: the Central Bank expects that the validation referenced in the reserving and capital section satisfies the Solvency II requirements relating to validation.

Level of disclosure required: From a prudential perspective, the Central Bank does not set expectations related to disclosure requirements.

Embedding climate change: The Central Bank considers that the Guidance provides helpful support for (re)insurers to embed climate change within the (re)insurer. We will continue to monitor emerging practices and will use this information to consider whether further guidance is required.

Transition Plan: Although transition plans are not currently required under legislation, they may be a useful tool for (re)insurers to consider their transition to a climate neutral society. However, where (re)insurers have made climate related public commitments, we expect them to have a transition plan, or something similar, that guides their actions aimed at achieving those commitments.

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