DLA Piper

SUBMISSION IN RESPONSE TO

GUIDANCE FOR (RE)INSURANCE UNDERTAKINGS ON CLIMATE CHANGE RISK (CP-151)

DLA PIPER

About DLA Piper

DLA Piper launched its Dublin office in 2019 in response to demand for globally benchmarked legal and tax advice from domestic and multinational companies operating in, expanding to or exporting from Ireland.

We have grown our full service team across all of our seven practice groups and sectors, servicing clients in more than 30 countries across the world. Our diverse teams drive better client results by delivering seamless client service through our globally integrated platform. We provide innovative solutions enabled by technology and first-class sector knowledge with global depth.

We are confident of our position as the leading global law firm in Ireland. We are optimistic for Ireland as a location for global business and in the opportunities available to DLA Piper and our clients.

We represent clients who will be directly affected by the implementation of the proposals that are set out in the Consultation Paper No 151 – Guidance for (Re)Insurance Undertakings on Climate Change Risk ("**Consultation Paper**").

Introduction

DLA Piper in Ireland welcomes the opportunity to provide observations on some of the matters that are addressed in the Consultation Paper.

The draft Guidance for (Re)Insurers on Climate Change Risk ("**Guidance**") that has been devised by the Central Bank of Ireland ("**CBI**") serves as a helpful addition to the range of existing frameworks that (re)insurers can use to identify, assess and seek to manage climate change risk as well as other ESG factors.

In view of the role that it plays in society, the insurance sector is uniquely placed to support the world's transition to a sustainable, low-carbon economy. In fact, many of the world's leading insurers have already taken steps to integrate sustainability considerations into the underwriting of risk and their investment activities.

Climate change risk presents unique challenges for the insurance sector. (Re)Insurers are faced with direct exposure to the physical impacts of climate change, which manifest in various ways including through claims arising from damage to property as a result of severe weather events as well as through health and life insurance.

Where the right approach towards climate change risk is not achieved within a firm or more widely within the industry, this raises the prospect of jeopardising insurers' very ability to do what they do best – namely, to assume responsibility for risks and hazards that are faced by society.

Therefore, it is in our collective interests that the insurance industry is well-positioned to adopt the right approach to assessing, monitoring, and mitigating climate change risks.

If (re)insurers are to be in the optimum position to fulfil the requirements of Solvency II in the area of climate change risk, consistency in understanding what is required of the sector, from a supervisory perspective, is really critical. That is why the proposed CBI Guidance is to be particularly welcomed.

In the event that the CBI wishes to discuss any aspect of this Submission, please contact:

Brian Hunt
Legal Director
Dublin
brian.hunt@dlapiper.com

Diarmaid Harnett
Associate
Dublin
diarmaid.harnett@dlapiper.com

Rhea Ingram-Smith
Associate
Edinburgh
rhea.ingramsmith@dlapiper.com

Kirsten Shoraka
Knowledge Development Lawyer
London
kirsten.shoraka@dlapiper.com

Erin Sculthorpe
Associate
Edinburgh
erin.sculthorpe@dlapiper.com

Our Submission

Approach adopted in this Submission

Our Submission seeks to address the three questions that have been posed on page 7 of the Consultation Paper.

1. ARE THERE ANY ELEMENTS OF THE MATERIALITY ASSESSMENT, OR SCENARIO ANALYSIS THAT STAKEHOLDERS WOULD LIKE FURTHER CLARITY ON AND IF SO PLEASE SPECIFY WHICH ELEMENTS?

Materiality assessment

In respect of the conduct of a materiality assessment, the CBI refer to the EIOPA Opinion[1] which states that "*Risks are considered to be material in the context of Solvency II where ignoring the risk could influence the decision-making or the judgement of the users of the information*".

Whilst this is a broad and general definition of "materiality", the EIOPA Opinion also sets out supervisory expectations on the integration of the use of climate change scenarios by insurance undertakings in their Own Risk and Solvency Assessment ("**ORSA**").

We know that many underwriters are concerned over the current availability and quality of data which is essential for defining and creating their own risk assessments, particularly when combined with the uncertainty of climate change and the unpredictability of events.

Both, the EIOPA Opinion[2] and the CBI in its draft Guidance permits a high degree of flexibility for stakeholders. One such example is how the draft Guidance addresses the question of how baseline scenarios should be devised. Whilst it is understandable that flexibility is required in this context, due to the constant evolution and changes in the perceived risks, it is on the other hand very difficult for (re)insurers to assess a risk properly, without a clear framework that determines what requirements should be met from a supervisory perspective.

1 Opinion on the supervision of the use of climate change risk scenarios in ORSA. Accessible at: https://www.eiopa.europa.eu/media/news/eiopa-issues-opinion-supervision-of-use-of-climate-change-risk-scenarios-orsa_en

2 Ibid.

Different lines of insurance will have entirely different exposures to climate change. Presumably, there is far more clarity for (re)insurers that write, for example, parametric or property insurance that specifically insures against the risk of natural disasters – those (re)insurers will have actuaries using methodologies that can measure the effect of global warming, drought, flood risks and so on and will know how to assess climate risks in the context of its impact on their Solvency II obligations. On the other hand, (re)insurers of professional liability risk for service providers (be it financial institutions, construction businesses, law firms, medical negligence and so on), or any other (re)insurers that do not specifically consider natural disasters, will be faced with challenges in determining and assessing how climate change could be a material risk for their lines of business.

There are different guides to climate scenario analysis available, and the CBI's draft Guidance refers, for example, to the "Network for Greening the Financial System Technical Document on Climate scenarios for Central Banks and Supervisors"[3] and the "TCFD Technical Document for the Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities"[4] both of which are likely to be of limited use to (re)insurers in different sectors.

The draft Guidance suggests that when performing a materiality assessment, (re)insurers should consider the items set out in the EIOPA Opinion, and also the EIOPA "Application Guidance on running climate change materiality assessment and using climate change scenarios in the ORSA"[5] ("**EIOPA Application Guidance**"). The EIOPA Application Guidance states that balance sheet, underwriting portfolio and risk profile, as well as the country exposures by peril have to be assessed for materiality. The Application Guidance also puts forward a 3-step approach that can be used in order to conduct a materiality assessment:

i. Defining the business context,

ii. Researching impacts of climate change on the business,

iii. Assessing relevance to the business.

Whilst this is a logical, but very general approach, in their current form, the draft Guidance falls short of clarifying for (re)insurers what methodologies to use and what data to input when undertaking these assessments.

As mentioned above, different business lines will have different exposures, and we consider that in the long run, it may be necessary to have clear frameworks for each market. This would not only provide a clear roadmap, but also certainty for (re)insurers as to what needs to be done in order to achieve compliance with their Solvency II duties in this context. A greater degree of clarity would also serve to ensure that potential breaches of these duties can then be more easily identified.

Although we believe it would be helpful if the proposed Guidance were to be made clearer, in the manner described above, we agree with the inclusion of the reference at paragraph 57 of the proposed Guidance to the EIOPA Application Guidance, which includes worked examples of climate scenarios for dummy life and non-life undertakings.

The finalised CBI Guidance could be an opportunity for the CBI to publish similar dummy (re)insurer examples, particularly for the purpose of focusing on any risks that are very prevalent in or specific to the Irish market. This could also serve as a helpful signpost to (re)insurers to take account or pay more attention to specific risks that they may have paid less attention to or may have otherwise overlooked.

The EIOPA Application Guidance seeks to contribute to lowering the implementation costs for SME (re)insurers, and aids the reporting of comparable information. We believe that the inclusion of Irish market specific examples in the CBI's finalised Guidance could also have this effect, as many of the largest (re)insurers will likely have more resources to dedicate to this cause without a need to rely so heavily on the CBI's finalised Guidance. However, where Irish specific examples could help larger (re)insurers is in reporting comparable information and encouraging larger (re)insurers to focus on areas of concern raised by the CBI itself (albeit through Guidance that does not seek to introduce new requirements on (re)insurers in relation to climate change risks).

3 https://www.ngfs.net/sites/default/files/medias/documents/ngfs_climate_scenarios_for_central_banks_and_supervisors_.pdf.pdf

4 https://www.fsb-tcfd.org/publications/final-technical-supplement/

5 Application guidance on running climate change materiality assessment and using climate change scenarios in the ORSA (europa.eu)

2. ARE THERE ANY OTHER ELEMENTS OF THE GUIDANCE, OR TERMS USED, THAT STAKEHOLDERS WOULD LIKE FURTHER CLARITY ON, INCLUDING THE PROPOSED INFOGRAPHIC?

Subjectivity and climate change risk

Much of the language used in the proposed Guidance is very general and principles based. The use of terms such as “material” and “appropriate” suggest that the CBI is allowing firms the scope to determine in a subjective way which is best in the context of their respective firms. While welcoming that, it would be helpful if CBI could indicate what kind of evidence/ documentation will firms be expected to present when asked to justify the approach that it has taken to arrive at a conclusion that certain matters are material or appropriate in the context of their respective firm.

Climate change risk and risk appetite statement

All types of businesses are exposed to risks – risks which manifest themselves in different ways and which have varying degrees of impact on the business. Being successful in business invariably requires the acceptance of a certain degree of risk in order to achieve the strategic objectives of the business.

For (re)insurers, risks are not just a factor which they encounter in pursuit of their strategy, risk and the assumption of responsibility and exposure to risks faced by others is at the heart of their business. It is this risk transfer which enables the world of business and wider society to continue advancing, safe in the knowledge that when and if a certain adverse risk event occurs, the consequences will to a great degree be borne by their (re)insurers.

Putting in-place a Risk Appetite Statement, as one part of a risk appetite framework, enables (re)insurers to articulate the extent of its tolerance for certain types of risks. A well-defined risk appetite statement provides the members of the Board, key executives and staff with a valuable reference point which enable them to take the business forward in pursuance of its strategy, while being discerning about the type of risk which it is willing to tolerate.

The centrality of climate exchange risks to (re)insurers means that very many firms and their respective Boards will already have climate change risk fixed firmly in their minds, and will have given deep consideration to the near, medium and long-term impacts which this particular risk poses to the business. However, firms are likely to have adopted widely varying approaches to the treatment of climate change risk in their risk appetite framework, and in particular in the risk appetite statement. In this context, the CBI’s draft Guidance is to be particularly welcomed as it spells out the CBI’s expectations as regards the treatment of this risk in the context of a firm’s Risk Appetite Statement.

Avoidance of Supervisory Pressure to Adopt Uniform Approach

In our view, the CBI needs to guard against the risk of supervision or inspection teams providing undue challenge to a firm in respect of its perspective around the treatment of climate change risk which is grounded in the firm’s well-considered and documented reflection on the risks posed. A very high thresholds should be set for the CBI’s intrusion into specific aspects of a firm’s perspective on climate change risk.

Acceptability of Defining Climate Change Risk in Qualitative Terms

While the CBI’s stated preference is that firms should define their climate change risk appetite in quantitative terms, the CBI recognises that some firms may opt to define their climate change risk in purely qualitative terms. It would be helpful if the draft Guidance were to articulate the circumstances in which CBI would find that a firm’s reliance on a qualitative approach is not acceptable. Providing clarity on this point will help to guide firms and also supervisors.

Proposed infographic

In respect of the Infographic, the following question is posed: “Is the exposure material?”

Posed in this way, the question seems to suggest that the answer can only be “yes” or “no”. However, when considering materiality a sliding scale approach seems more fitting as there will likely be different levels of materiality. Therefore, this question is arguably too black and white when the most appropriate answer may need to be more nuanced. If this question is to be retained, it would be helpful to refer to guidance which explains the materiality threshold for the purposes of this infographic.

3. ARE THERE ANY ITEMS NOT MENTIONED IN THE GUIDANCE THAT STAKEHOLDERS THINK SHOULD BE INCLUDED, AND IF SO PLEASE SPECIFY?

Role of transition plans

While the proposed CBI Guidance states at paragraphs 58 to 63 that (re)insurers should integrate climate change risk into their strategy and consider the impact their own activities may have in contributing to, or mitigating climate risk, we note that no reference is made to the role that climate transition plans can play in that context.

A climate transition plan can be used by organisations to clearly articulate how they can credibly and adequately plan to adapt as society collectively moves towards a decarbonised economy. Such plans can plan an important role within the insurance industry.

Many voluntary and mandatory initiatives already exist to help firms develop, promote, and create templates for transition plans, these include:

- Task Force on Climate-Related Financial Disclosures (TCFD) published *Guidance on Metrics, Targets, and Transition Plans (2021)*. The Guidance describes recent developments around climate-related metrics and users' increasing focus on information describing organisations' plans for transitioning to a low-carbon economy. The work of the Taskforce on Nature-related Financial Disclosures is also of note as it builds upon the work of the TCFD.
- International Sustainability Standards Board's (ISSB) Exposure Draft on *Climate-Related Disclosures* – This paper contains proposed disclosures of an entity's transition plan (paragraph 13). This does not contain detailed guidance for what should be included in a transition plan but instead provides high level standards of the type of information that should be included. It is expected that the ISSB standards will be widely adopted throughout Europe in 2023.
- Corporate Sustainability Reporting Directive (CSRD) – This Directive imposes an obligation on organisations to disclose a transition plan that is aligned with limiting global temperature increases to 1.5 degrees (i.e. stricter than the Paris Agreement targets).
- Earlier this year, the UK's Transition Plan Taskforce (TPT) closed a consultation process on the development of a gold standard for transition plans. It is intended that the resulting framework will inform UK regulations for certain financial sector firms and listed companies to publish a climate transition plan.
- The intention of the External Reporting Board (XRB) in New Zealand is that, rather than it prescribing a uniform approach, is to allow market participants to develop a transition plan that applies to their particular context. The underlying rationale is that by having entities develop their own transition plans and dedicating resources to the development of those plans, most market participants will inevitably end up setting targets.

Therefore, we suggest within the finalised Guidance consideration be given to the role which climate transition plans can play in helping firms achieve their strategic goals around climate change risk.

Embedding climate change risk

With respect to the objective that climate change risk forms part of a firm's overall culture, is embedded into the business model, strategy and overall organisational structure, we question whether the CBI needs to go further in providing guidance on the approach that needs to be adopted in order to achieve this.

While the proposed Infographic is helpful in providing a visual overview of the approach to the assessment and ongoing management of a (re)insurer's exposure to climate change risk, consideration should be given to providing additional detail on the approach that CBI expects firms to take.

Need for consistency

It is expected that the CBI will be ensuring that the finalised version of the Guidance will be wholly consistent with the EIOPA guidelines on conducting climate change materiality assessments which were published the day before the CBI's draft Guidance[6].

The clearer and more consistent the Guidance is for the industry, the lesser the compliance burden, and the faster changes can be made to help (re)insurers manage climate change risks.

Proportionate and iterative approach

We welcome the fact that the CBI has indicated that in supervising firms' compliance with the proposed Guidance it will take a proportionate and iterative approach, and we also welcome the CBI's recognition that in the initial period of implementation some (re)insurers may use simplified and/or qualitative approaches.

6 Application guidance on running climate change materiality assessment and using climate change scenarios in the ORSA (europa.eu)