The IAIS Needs to Step Up on Climate

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The International Association of Insurance Supervisors holds its annual meeting in early November, in the midst of escalating crises in the industry related to accelerating climate change. Yet the only climate-related agenda item focuses on data transparency. This is an inadequate response from the global network of insurance regulators. The IAIS needs to step up on climate.

The IAIS must act because the industry is driving climate risk and financial system vulnerabilities

August 2023 marked 50 years since the insurance industry first warned about the increasing risks of climate change.[1] Meanwhile, the climate crisis has become a grim reality for billions of people – most seriously for poor and marginalised communities in parts of the global North as well as throughout the global South that have contributed the least to climate change. July 2023 was the hottest month in recorded history and unprecedented heatwaves, wildfires and floods have ravaged countries around the world.

Since 2017, the insured losses from natural disasters (and mostly human-made climate disasters) averaged $110 billion per year, more than double the average amount in the previous five years.[2] In response, reinsurance and primary insurance rates have increased rapidly, and growing parts of the United States, Australia and other countries risk becoming uninsurable.

“I do believe we’re steadily marching towards an uninsurable future, not only in California, but throughout the United States", California's former insurance commissioner Dave Jones warned recently.[3] Such a future creates serious risks to the insurance industry and to the communities and businesses whose risk the industry is supposed to manage.

Emissions from the energy sector reached a record amount in 2022.[4] In spite of its powerful role as a global risk manager, the insurance industry is not using its influence to accelerate the transition from fossil fuels to clean energy. OctoberInstead, it is adding fuel to the fire by underwriting the continued expansion of oil and gas extraction.

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[1] Muenchener Rueckversicherungs-Gesellschaft, Hochwasser-Überschwemmung, August 1973, p. 7.
[2] Chandan Banerjee et al., “Natural Catastrophes and Inflation in 2022: A Perfect Storm” (Swiss Re, March 22, 2023), https://www.swissre.com/institute/research/sigma-research/sigma-2023-01.html.
[3] “California Tries for a Different Path than Florida on Insurance,” POLITICO, September 10, 2023, https://www.politico.com/news/2023/09/09/california-florida-disaster-insurance-00114859.
[4] Energy Institute, “Energy System Struggles in Face of Geopolitical and Environmental Crises,” Energy Institute, June 26, 2023, https://www.energyinst.org/exploring-energy/resources/news-centre/media-releases/ei-statistical-review-of-world-energy-energy-system-struggles-in-face-of-geopolitical-and-environmental-crises.

UN Secretary General António Guterres, civil society groups[5] and other actors have called on the insurance industry to align underwriting and investments with the goals of the Paris Agreement, but none are yet Paris-aligned. Numerous insurance companies have adopted restrictions on their fossil fuel business, but it is difficult for any one insurer to adopt bold climate action in the interest of the industry and society as a whole under competitive pressure.

The Net Zero Insurance Alliance (NZIA), which was founded in 2021, was supposed to create a level playing field for a science-based transition of the insurance industry and a credible pathway to the 1.5 °C Paris Agreement goal. Yet under pressure from the fossil fuel lobby, under the pretence of anti-competition,[6] 20 of the original 31 NZIA members have left the alliance and the NZIA abolished all material requirements for its members. This poses great risks for an orderly transition in the insurance sector, and requires regulators to urgently clarify scope for collective industry action in the public interest.

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Meanwhile, actuaries – who provide crucial risk assessments for the insurance industry – are sounding the alarm about the extreme inadequacies of current risk modelling and management practices. The Institute and Faculty of Actuaries (the UK's professional association for actuaries) found that:

- The climate-scenario models commonly used in financial services are significantly underestimating climate risk, meaning assessments of likely damages are way off.
- More realistic models show that carbon budgets may be smaller than anticipated and risks may develop more quickly.
- Most current regulatory scenarios (e.g. in the UK) do not reflect experience or fully capture risk, are not realistic, and don't account for tail scenarios.[7]

The Financial Stability Board - the international body that monitors and makes recommendations about the global financial system - and the Network on the Greening of the Financial System have also acknowledged the significant limitations of climate scenario analysis as it currently stands.[8]

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[5] See, e.g.: Finance Watch, "Open Letter: Banks and Insurers Must Account for Climate Risk," July 7, 2022, https://www.finance-watch.org/publication/open-letter-banks-and-insurers-must-account-for-climate-risk/.
[6] Cynthia Hanawalt and Denise Hearn, "Of Pots and Kettles: Big Oil and the Anti-ESG Movement Are Accusing Banks of Running 'Climate Cartels,'" Fortune, August 2, 2023, https://fortune.com/2023/08/02/big-oil-anti-esg-movement-banks-climate-cartels-politics-finance/.
[7] Sandy Trust et al., "The Emperor's New Climate Scenarios" (Institute and Faculty of Actuaries, July 2023), https://actuaries.org.uk/media/qeydewmk/the-emperor-s-new-climate-scenarios.pdf.
[8] Financial Stability Board and Network for the Greening of the Financial System, "Current Climate Scenario Analysis Exercises May Understate Climate Exposures and Vulnerabilities, Warn FSB and NGFS," November 15, 2022, https://www.fsb.org/2022/11/current-climate-scenario-analysis-exercises-may-understate-climate-exposures-and-vulnerabilities-warn-fsb-and-ngfs/.

Current global insurance regulations are patchy at best

The global regulatory environment on insurance and climate-related financial risk is patchy at best. This points to the need for the IAIS to strengthen standards and create a level playing field.

For example:

- The EU's insurance regulatory regime, known as Solvency II, began an update in 2021 to, among other changes, require stronger sustainability risk management by (re)insurers, including climate scenario analyses. However, as mentioned above, climate change scenario analyses are subject to significant limitations so that they cannot be relied upon as prudential measures. Requirements on mandatory transition plans were introduced by the European Parliament,[9] but remain subject to debate between the co-legislators. Further, the proposal does not include capital requirements to address stranded asset risk.[10]
- Although insurance regulation is even patchier in the U.S., where individual states hold most of the insurance regulatory powers, federal policymakers and some state regulators are beginning to sound the alarm about the need for climate-related insurance regulation:
    - The U.S. Treasury Department's Federal Insurance Office (FIO) published a report on supervision and regulation of climate-related risks in June 2023, in which it noted that, though "there are nascent and important efforts to incorporate climate-related risks into state insurance regulation and supervision…efforts are fragmented across states and limited in several critical ways." In that report, FIO outlined the physical, reputational, liquidity, and other climate-related risks insurance companies face. Among its findings on transition risk, the report noted that the U.S. insurance industry's corporate bond and equities investment exposure to high GHG-emitting industries is approximately $439 billion, or 15% of those investments.[11]
    - Treasury Secretary Janet Yellen has warned of a "protection gap" across the insurance industry, estimating that only 60% of $165 billion in damages from climate disasters in 2020 were covered by insurers [12] In addition to inflicting major burdens on households and businesses, this "protection gap" also further raises financial stability concerns because of the possibility that more frequent catastrophic climate events could trigger losses that spread throughout the economy through defaults, delays, underpayments, and so on.

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[9] Finance Watch, "European Parliament's Committee on Economic and Monetary Affairs Agrees Position on Solvency II," July 18, 2023, https://www.finance-watch.org/press-release/european-parliaments-committee-on-economic-and-monetary-affairs-agrees-position-on-solvency-ii/.

[10] Isabella Salkeld and Caroline Metz, "What Is Solvency II and Why Does It Matter?," ShareAction, accessed October 24, 2023, https://shareaction.org/news/what-is-solvency-ii-and-why-does-it-matter.

[11] Federal Insurance Office, "Insurance Supervision and Regulation of Climate-Related Risks" (U.S. Department of the Treasury, June 2023), 59, https://home.treasury.gov/system/files/136/FIO-June-2023-Insurance-Supervision-and-Regulation-of-Climate-Related-Risks.pdf.

[12] Christopher Condon, "Janet Yellen Sees a 'Protection Gap' between Insurance and Climate Change—Just 60% of 2020's $165 Billion in Losses Got Covered," Fortune, July 30, 2023, https://fortune.com/2023/07/30/janet-yellen-protection-gap-insurance-climate-change-disasters-treasury-secretary/.

    - Both Connecticut[13] and New York[14] have issued guidance to insurers on climate-related financial risks. New York's guidance highlights reducing fossil fuel investments and underwriting as a recommended approach to mitigating risks and Connecticut's insurance commissioner is now required to take the state's net-zero goals into account in its regulation of insurers.[15]
- New corporate climate disclosure rules in the EU (CSRD) and California (SB 253) will start requiring, including many insurers, to disclose Scope 3 emissions.
    - The CSRD requires all large companies and all listed companies (except listed micro-enterprises) to disclose information on what they see as the risks and opportunities arising from social and environmental issues, and on the impact of their activities on people and the environment.[16]
    - SB 253 requires companies with greater than $1 billion in annual revenues to file annual reports publicly disclosing their Scope 1, 2 and 3 greenhouse gas (GHG) emissions.[17]

What is the IAIS?

The International Association of Insurance Supervisors (IAIS) is a voluntary membership organisation of insurance supervisors and regulators from over 200 jurisdictions, constituting 97% of the world's insurance premiums.[18] The IAIS plays a key role in insurance supervision globally: IAIS is the global standard-setting body responsible for developing and assisting in the implementation of principles, standards, and guidance as well as supporting material for the supervision of the insurance sector. The IAIS is hosted by the Bank for International Settlements (BIS) in Basel, Switzerland.

The IAIS annual meeting in Tokyo, 9-10 November 2023

The IAIS holds an annual conference, which "provides an excellent platform for insurance supervisors and the insurance industry from around the world to exchange views on issues relevant to the supervision of insurance markets." The conference is timed to feed into the IAIS' annual Roadmap development cycle.[19]

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[13] "GUIDANCE FOR CONNECTICUT DOMESTIC INSURERS ON MANAGING THE FINANCIAL RISKS FOR CLIMATE CHANGE," Bulletin (State of Connecticut Insurance Department, September 15, 2023), https://portal.ct.gov/-/media/CID/1_Bulletins/Bulletin-FS-44.pdf.
[14] Acting Superintendent of Financial Services Adrienne A. Harris, "Acting Superintendent Adrienne A. Harris Announces DFS Issues Final Guidance To New York Domestic Insurers on Managing Financial Risks from Climate Change," Department of Financial Services, November 15, 2021, https://www.dfs.ny.gov/reports_and_publications/press_releases/pr202111151.
[15] Public Citizen, "In Global First, Connecticut Passes Bill Addressing Insurers' Participation in Risky Fossil Fuel Finance," Public Citizen, June 17, 2021, https://www.citizen.org/news/in-global-first-connecticut-passes-bill-addressing-insurers-participation-in-risky-fossil-fuel-finance/.
[16] "Corporate Sustainability Reporting," accessed October 24, 2023, https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en.
[17] Daniel Feldman et al., "California Legislature Passes Landmark Climate Disclosure Laws: Spotlight on SB 253," Inside Energy & Environment, September 18, 2023, https://www.insideenergyandenvironment.com/2023/09/california-legislature-passes-landmark-climate-disclosure-laws-spotlight-on-sb-253/.
[18] IAIS, "IAIS Organization Members," accessed October 24, 2023, https://www.iaisweb.org/uploads/2023/08/iais_organisation_members.pdf.
[19] IAIS, "The IAIS Strategic Plan, 2020-2024," June 2019, 17, https://www.iaisweb.org/uploads/2022/01/190613-2020-2024-Strategic-Plan.pdf.

The IAIS' current position on climate change

The IAIS includes climate risk within its key trends and developments that could reshape the business of insurance. It is grouped alongside technological innovation (including digital), cyber risk, conduct and culture, financial inclusion and sustainable economic development and diversity, equity and inclusion. These areas (excluding diversity, equity and inclusion) are listed as IAIS' strategic themes for 2020-2024.[20]

Actions the IAIS has taken to date:

Disclosures

- The IAIS' Climate Risk Steering Group has set up a disclosures workstream that will study the Climate Related Disclosure Standard closely and take stock of relevant developments in climate risk disclosures.

Data

- Climate data elements were added to the Global Monitoring Exchange (GME) in 2022.[21] These elements have become a regular feature of the IAIS' annual assessment of insurance sector risks and provide a global baseline of climate risk data for the insurance sector.

Financial Stability

- The IAIS published a special topic edition of the Global Insurance Market Report (GIMAR) on the insurance sector' investment exposures to climate-related risks in September 2021.[22] This report provided the first quantitative global study on the impact of climate change on the insurance sector.

Standard Setting

- In 2022, the IAIS performed an internal gap analysis of existing IAIS supervisory material to assess how climate risk is already captured and to identify possible further work in terms of standard-setting and/or providing further guidance on supervisory practices. As a result of the gap analysis, the IAIS is now publicly consulting on changes to guidance related to various of its Insurance Core Principles (ICPs) and to develop supporting material in several consultations during 2023 and early 2024.
- The first consultation, published in March 2023 and closed May 2023, outlines proposed changes to the ICP Introduction, which positions climate risk within the global framework for insurance supervision.[23] The consultation includes questions seeking stakeholder feedback on the overall climate-related work as it relates to

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[20] IAIS, 7.
[21] IAIS, "Global Insurance Market Report (GIMAR)," December 2022, https://www.iaisweb.org/uploads/2022/12/GIMAR-2022.pdf.
[22] IAIS, "Global Insurance Market Report: The Impact of Climate Change on the Financial Stability of the Insurance Sector," GIMAR Special Topic Edition, 2021, https://www.iaisweb.org/uploads/2022/01/210930-GIMAR-special-topic-edition-climate-change.pdf.
[23] IAIS, "Public Consultation on Climate Risk Supervisory Guidance – Part One," March 16, 2023, https://www.iaisweb.org/2023/03/public-consultation-on-climate-risk-supervisory-guidance-part-one/.

supervisory guidance. Two more consultations will open in 2023Q4, and another in 2024Q1.

The IAIS must urgently step up its efforts and standards on climate

A disclosure-focused agenda is an inadequate response from the global network of insurance regulators in the face of the urgency of the climate crisis. The IPCC AR6 Synthesis Report has made clear that the world is approaching irreversible levels of global heating, and that it is now or never to take drastic action to avoid disaster.[24] As the UN Secretary General has said, "2023 is a year of reckoning. It must be a year of game-changing climate action. We need disruption to end the destruction. No more baby steps. No more excuses. No more greenwashing."[25]

Therefore, the IAIS should:

- **Take a precautionary approach to addressing environmental risk:** Environmental risks – including both climate- and nature-related risks – are still a regulatory blindspot. Too much reliance is placed on historical data in addressing the risk, whereas by definition climate change and biodiversity loss are forward-looking, non-linear and irreversible phenomena. The IAIS must provide guidance to supervisors on how to include environmental risk into the supervisory framework, and reflect the risks in capital standards for the internationally-active insurance groups.
- **Set expectations for credible transition plans**: The IAIS should offer best practice guidance to ensure that insurance companies adopt transition plans with short-, medium- and long-term targets and aligned with credible 1.5°C pathways. Supervisors should review transition plans to understand an insurer's levels of transition risk exposure. The guidance should follow the UN HLEG Standards on Net Zero Commitments by Businesses, Financial Institutions, Cities and Regions.
- **Steer the industry away from exacerbating climate risk**: The IAIS should offer best practice guidance for supervisors to ensure that insurers consider climate-related risk implications for their solvency position. The IAIS work on capital standards should be based on a precautionary approach to capital requirements reflecting the one-for-one rule (a dollar of capital held per dollar invested) for any investments in the fossil fuel sector across all asset classes.[26]
- **Don't let contributors to the crisis get public support**: The IAIS should propose rules to ensure that insurance companies that still underwrite or invest in new fossil fuel projects are excluded from managing or participating in any programs supported with public funds to insure climate risks and strengthen climate resilience.
- **Rely on climate science:** The IAIS must ensure supervisors mandate the use of climate science when assessing possible impacts of the climate crisis, as opposed to the flawed prevailing economic models, which by design are not able to capture the

[24] IPCC, "AR6 Synthesis Report: Summary for Policymakers Headline Statements," 2023, https://www.ipcc.ch/report/ar6/syr/resources/spm-headline-statements/.
[25] António Guterres, "Secretary-General's Briefing to the General Assembly on Priorities for 2023," United Nations Secretary-General, February 6, 2023, https://www.un.org/sg/en/content/sg/speeches/2023-02-06/secretary-generals-briefing-the-general-assembly-priorities-for-2023.
[26] Finance Watch, "The One-for-One Rule: A Way for COP26 Ambitions to Manifest in Financial Regulation," October 27, 2021, https://www.finance-watch.org/the-one-for-one-rule-a-way-for-cop26-ambitions-to-manifest-in-policy/.

consequences and non-linear complexity of climate change, and substantially underestimate its economic cost.

Japanese civil society speaks out ahead of Tokyo meeting

“The insurance industry first warned about the climate crisis 50 years ago but to this day - despite extreme weather events already causing hundreds of billions of losses a year - continues to support oil and gas expansion. The insurance sector should act as a firefighter to help and protect us from climate disasters, not add fuel to the fire.

“The IAIS are the international standard-setter for the insurance industry, and have a responsibility to ensure that insurance underwriting aligns with climate science. They must steer the industry on a path that is in line with the 1.5°C temperature rise limit.”

- Marika Kita, campaigner with Japan Center for a Sustainable Environment and Society (JACSES)