Climate Change: an introduction to implications for insurers

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Agenda

1. What are the implications of climate change for insurers

2. Increasing regulatory focus

3. Key areas of focus for insurers

Climate Change and its impacts

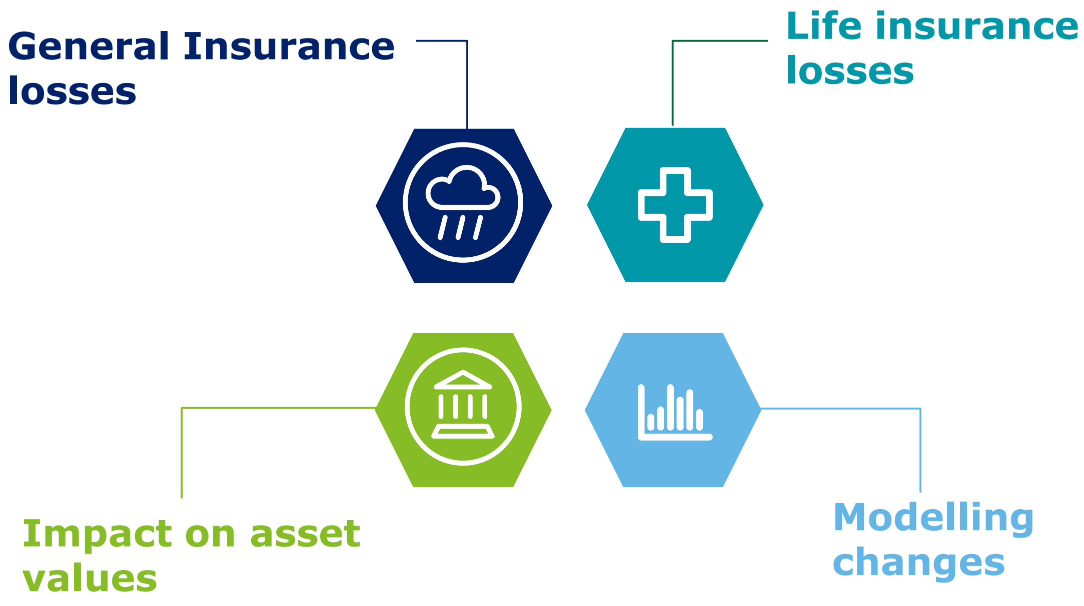
What is it and how does it relate to insurers?

Climate change risk factors

There are two principal risk factors through which climate change has an impact

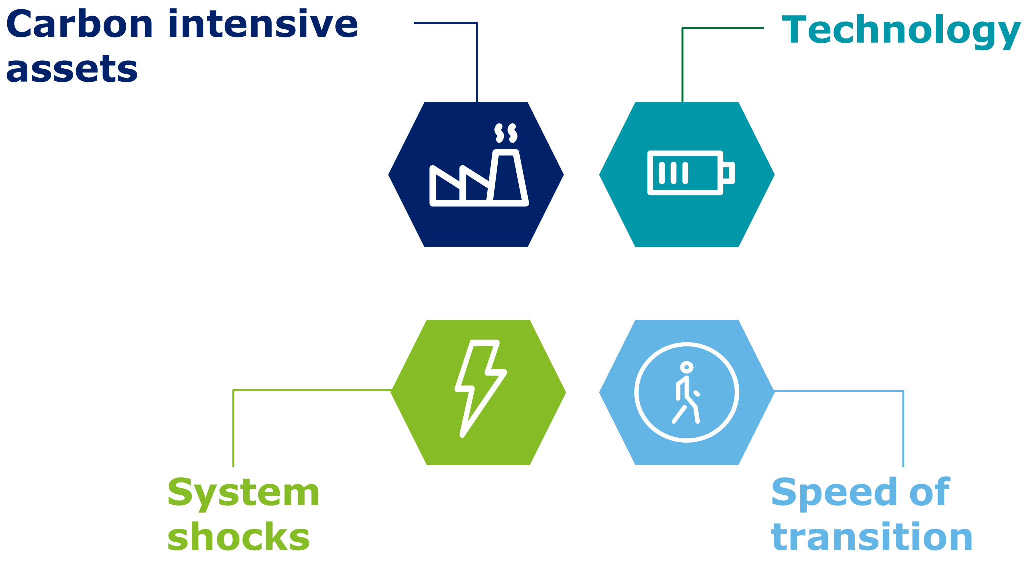
Physical risks

An increase in the frequency and severity of specific weather-related events arising from climate change



Transition risks

The process of the economy adjusting towards a low carbon world



Arguably – a third risk factor: Liability risk

Company's contribution / state responsibility

- Saul v. RWE
- Urgenda v. the Netherlands

Failure to adequately manage the risk

- Conservation Law Foundation v. ExxonMobil
- Illinois Farmers Insurance Co. v. Metropolitan Water Reclamation District of Chicago

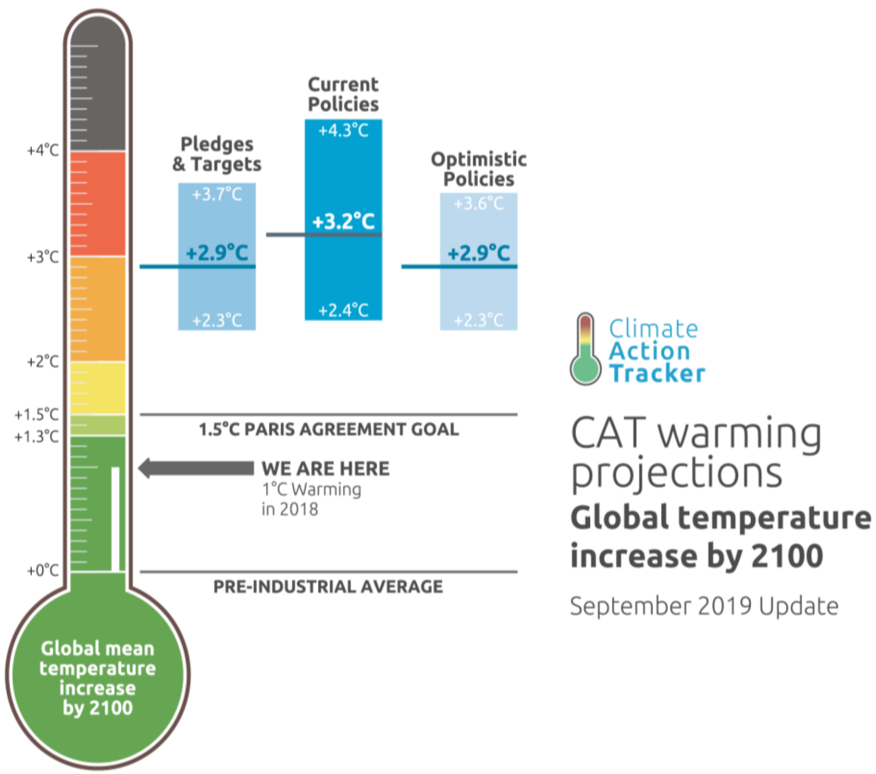
Inaccurate reporting

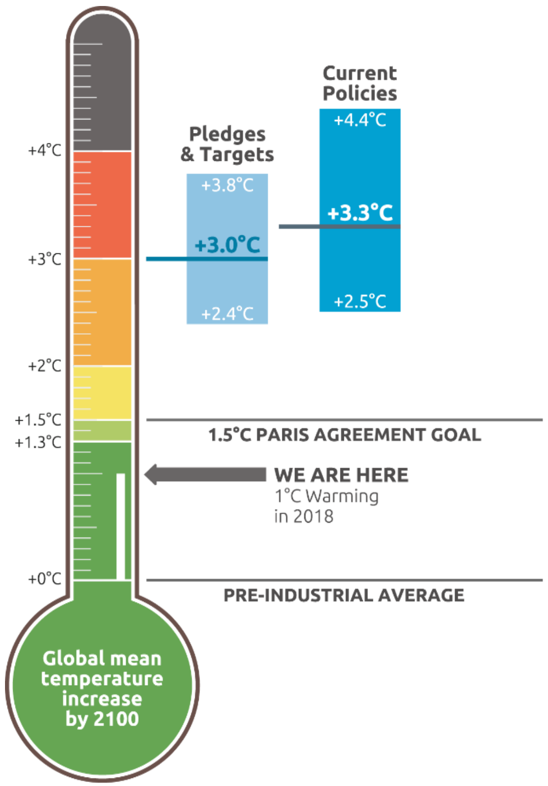
- Abrahams v. Commonwealth Bank of Australia
- ClientEarth regulatory complaints to the FCA
- New York v. Exxon Mobil Corp.

Liability risks are a consequence of physical and transition risks.

Climate Change - current status and modelling uncertainty

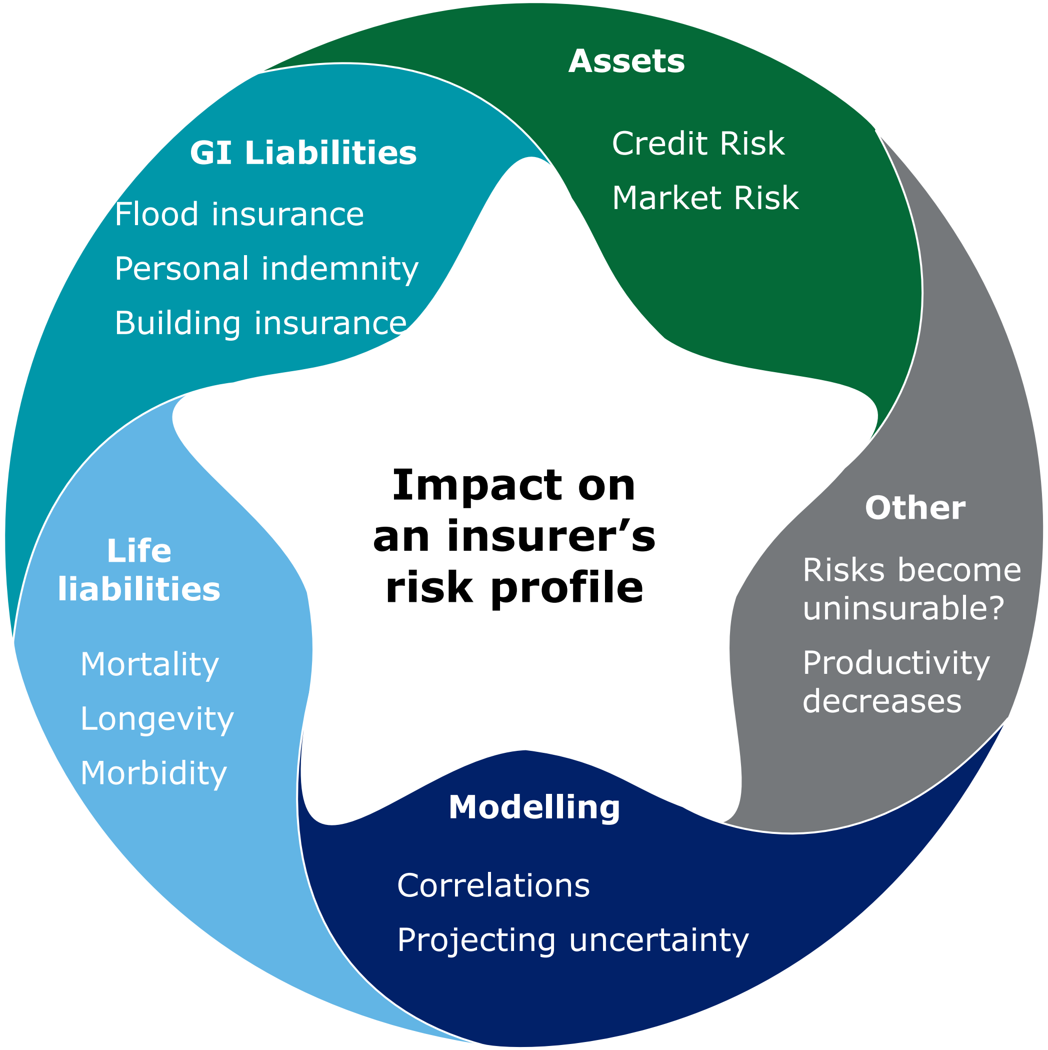
Projections based on climate model widely used across academia and the IPCC





December 2018 Update

Climate Change – the impact on insurers



Implications:

- **Risk mitigation**
- **Strategy**
- **Customer**
- **Operations**
- **Modelling**
- **Capital**

What can insurers do?

Actions throughout the value chain

Governance

- Appoint senior leader (SMF)
- Train board
- Train key staff; risk leaders, finance leaders, corporate social responsibility, marketing, strategy

Management

- Where do the risks lie?
- Size of the risks and sensitivity to the risk drivers
- Are messages aligned: asset management, group, public statements?
- Is it picked up in Pillar 2 reporting and analysis?
- Is climate-related risk treated separately, or allowed for in existing risk categories?

Scenario Analysis

- IST 2019 scenarios as a minimum standard
- Prepare for Biennial Exploratory Scenario in 2020/21?
- Consider what management actions can be taken?
- What are the triggers for action?

Disclosure and MI

- Private: What does SMF need to know? Can they explain (and defend) to PRA? What does board need to know?
- Public: What to disclose? Is it consistent with TCFD, which will be compulsory for UK listed companies by 2022?

Climate risk
Increasing regulatory focus

Climate Change – an increasing regulatory focus

"Climate change has the potential to create significant financial risks for the firms the PRA regulates."
- Sam Woods, Chief Executive Officer of the Prudential Regulation Authority

"The PRA expects insurers to take a strategic approach to addressing the risks from climate change"
- David Rule, Executive Director of Insurance Supervision, Prudential Regulation Authority

"Climate change and the transition to a carbon-neutral economy will transform financial services markets and shape consumer priorities and needs."
- Andrew Bailey, Chief Executive Officer of the Financial Conduct Authority

"The effect of climate change on society and business is one of the defining issues of our time. As well as reporting on their impact on the environment, public companies and their Boards should address the impact of climate change on their business."
- Sir Win Bischoff, Chair of the Financial Reporting Council

"Once climate change becomes a clear and present danger to financial stability it could already be too late to stabilise the atmosphere at two degrees. General insurers and reinsurers are on the front line of managing the physical risks from climate change."
- Mark Carney, Governor of the Bank of England

"The risk climate change poses to businesses and financial markets is real and already present."
– Michael R Bloomberg, Chair of the Task Force on Climate-related Financial Disclosures

"Climate change is no longer simply a social responsibility issue. It is a core financial risk impacting broadly across business, the economy and markets."
- Charles Counsell, Chief Executive of The Pensions Regulator

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SS3/19 – basic requirements

In April 2019, the PRA released PS11/19 and SS3/19.

Key themes

- Climate change presents financial risks which are relevant to the **PRA's objectives.**
- The **key channels** through which climate change risks could materialise.
- The PRA views the risks as **far-reaching, foreseeable, and requiring immediate action.**
- The PRA does **not** believe that the financial risks from climate change are being **sufficiently considered** by insurers.
- The PRA's **expectations apply to all regulated firms**.
- The PRA expects specific **individual accountability** for the risks to be prescribed to an appropriate Senior Manager through the Senior Managers and Certification Regime **(SM&CR)**.
- Insurers across **different sectors will be impacted differently** by the financial risks from climate change.

As of Tuesday 15 October 2019, the PRA expected regulated firms to have an initial plan in place, detailing how they will address the PRA's expectations in this area.

Biennial Exploratory Scenario 2021
Joint bank and insurer stress test

Three scenarios
- Smooth transition to 2°
- Late and abrupt action to 2°
- Business as usual

Individual counterparty analysis
- BoE will provide macroscopic values for each scenario
- Participants to model impacts on individual counterparties: cashflows, collateral values, mitigation, risks, opportunities

Management actions
- Not allowed for in quantitative part of exercise
- Part 2 allows for qualitative description of management actions, e.g. selling brown assets, reducing exposure
- BoE may be able to aggregate exposures across the sector, to understand if there is systemic risk (e.g. insurance availability, fire sale of assets etc.)

Thirty year horizon
- Performed at five-year snapshots on a static H1 2020 balance sheet
- Physical risks accelerated forward from 2080 to 2050

Indicative estimates
- Best Estimate Liabilities
- Risk Margin
- Transitional Measure on Technical Provisions
- Market value of assets
- Surplus
- Own funds impact on Matching Adjustment Portfolio and With-Profits Fund

SS3/19 – basic requirements

Governance

"Understand, assess, address and oversee financial risks from climate change [taking a] sufficiently long-term view, beyond standard business horizons". Allocate responsibility to Senior Management Function.

Disclosure

Disclosures as part of Pillar 3 (CRR and SII). Firms should look to evolve their disclosures to make these as insightful as possible. PRA expects firms to engage with wider initiatives, e.g. TCFD.

Risk Management

Quantitative and qualitative tools to monitor exposure with an expectation that tools will evolve over time.

Scenario analysis

Understand impact on solvency, liquidity and ability to pay policyholders.

a) Short-term assessment aligned to business planning horizon

b) Long-term assessment of exposure

Climate risk

Key areas of focus for insurers

Impacts of climate change on insurers

Potential future regulatory developments

1. The PRA expects a "firm's approach to managing the financial risks from climate change to mature over time"
2. Insurers likely to be included in climate stress tests in 2021 Biennial Exploratory Scenario (BES). Scenarios to be published early H2 2020.
3. Government recently announced it expects all listed companies and large asset owners to be disclosing in line with the TCFD recommendations by 2022
4. Joint taskforce of regulators (FRC, FCA, PRA, Pensions Regulator) will examine the most effective way to approach disclosure, including exploring the appropriateness of making reporting mandatory
5. Publicly-funded financial bodies and UK listed firms will report against TCFD

Embedding climate-related consideration into BAU

Possible evolution over three years.

	2019	2020	2021
Expertise	Appoint Lead Deliver training	Identify areas for external help	Strategic relationships with external partners
Assess and review	French firms Working parties Consultancies	2019 statements Emerging best practice	2020 statements. Best practice.
Areas of focus	Initial understanding & modelling	Improved modelling Tailored scenario analysis	Full balance sheet model.
Strategy and board involvement	Develop governance Develop strategy	Embed governance Implement strategy	Evolve strategy and enhance ORSA analysis.

Any questions