KPMG

CP151 Central Bank of Ireland

Guidance for (Re)insurance Undertakings on Climate Change Risk

Consultation Paper 151

During August the Central Bank of Ireland ("Central Bank") released Consultation Paper ("CP") 151 Guidance for (Re) Insurance Undertakings on Climate Change Risk.

This CP is amongst a number of recent publications relating to climate change, including the Central Bank's letter setting out its supervisory expectations in relation to climate and other ESG issues from November 2021, and EIOPA's recent application guidance on climate change materiality assessments and climate change scenarios in the ORSA.

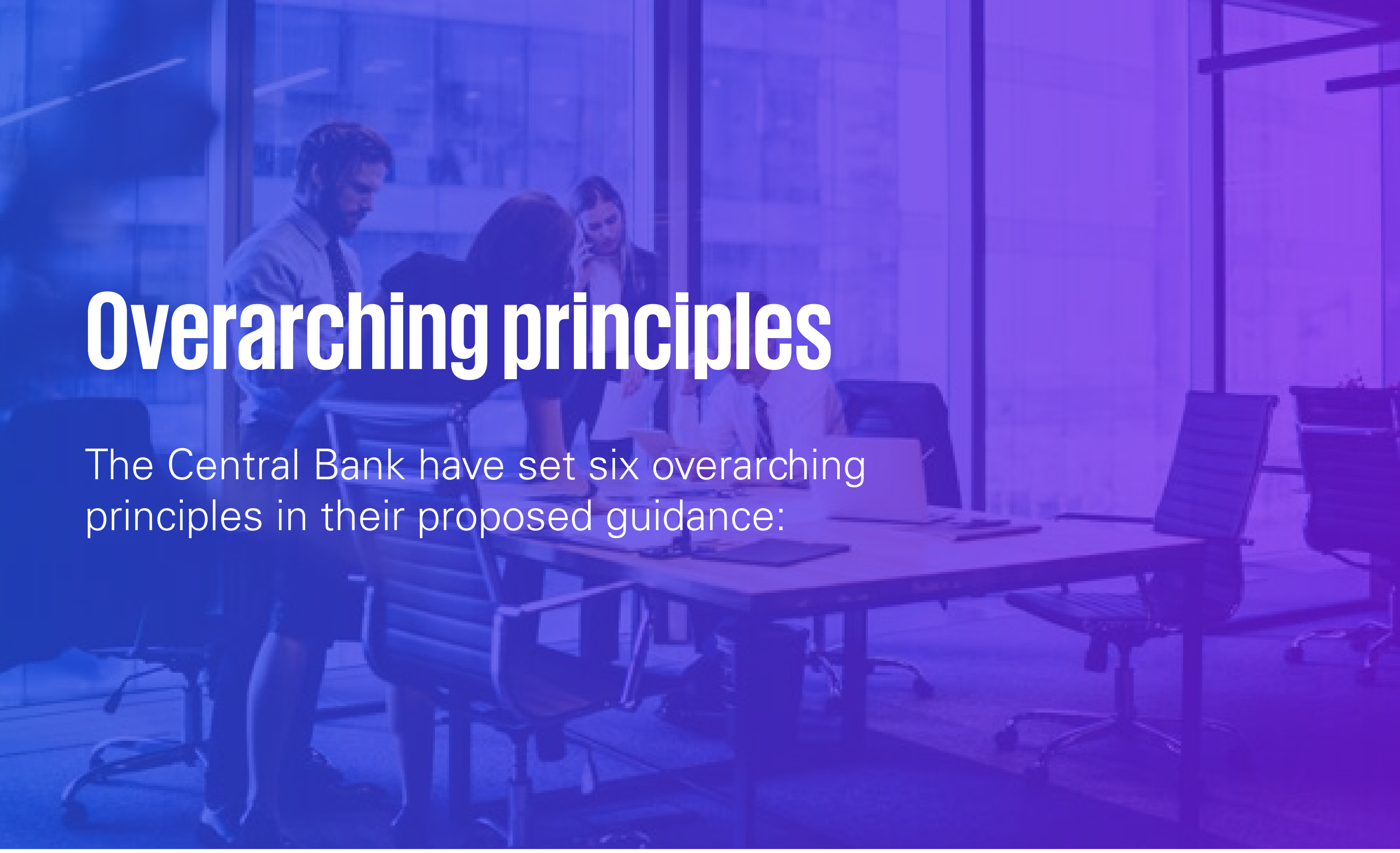
This reflects continued sharpening focus on this area with the CP highlighting the increasing frequency and severity of weather related events already having an impact on the insurance sector globally and reiterating that the time for action is now.

The climate crisis and associated climate risk considerations are complex requiring more dynamic and longer term risk assessments. As a result, standardised approaches, established models or past data are not readily available.

To understand the potential financial implications of climate change it will require close cooperation across several disciplines, use of expert judgement and a patchwork of different models and datasets. Notwithstanding the complexities involved the Central Bank expects to see a step change in how (re)insurers are responding to climate change risks. The guidance is intended to clarify the Central Bank's expectation on how (re)insurers assess climate change risk for their business. The guidance applies to authorised insurers and (re)insurers including captive (re)insurers and third country branches.

The Central Bank's Climate and Emerging Risk Survey from 2021 found that while there is consensus that action is required there is uncertainty on how to go about it. Of the 92 (re)insurers who responded to the survey:

- 20% fully integrate climate change risk in their risk management framework, with fewer than half conducting some form of scenario analysis or stress testing.
- Over half do not have a climate change risk management strategy, plan or policy in place.
- Two-thirds of (re)insurers have not incorporated climate change risk factors into their pricing.
- Whilst some (re)insurers have identified opportunities, only 6% have acted on those opportunities.



Overarching principles

The Central Bank have set six overarching principles in their proposed guidance:

01. Iterative approach

Acknowledging that (re)insurers are at different stages of development, initially simplifications or qualitative approaches may be required, however it is expected that the scope, sophistication and depth of the methods improves over time.

02. Key risk

Climate change is no longer an emerging risk and has transitioned to a key risk. As a result, the Central Bank expects it to be managed as a key risk in its own right within the risk management framework.

03. Double materiality

When performing their materiality assessment firms are expected to consider both the effect that climate change has on the activities of the (re)insurer and the impact that the (re)insurers' own activities have on the climate. The materiality assessment is expected to determine the extent of scenario analysis performed.

04. Role of the ORSA

The ORSA is central to developing an integrated approach to climate change risk. In particular it is central to forming a forward looking view through scenario analysis to understand the impact on strategy, business model, activities across the insurance value chain and ultimately influence how the business is run.

05. Time horizons

Firms should assess climate change risk, including materiality assessment and scenario analysis, over the short (5-10 years), medium (30 years or mid-century) and long term (80 years end century). The Central Bank acknowledges that long-term analysis may be challenging and therefore an iterative approach to enhance methodologies over time is expected, in particular where the risk is material.

06. Group engagement

Where (re)insurers leverage group policies and activities, they should ensure that this input is appropriately adapted for the local entity, including an assessment of the appropriateness of a group ORSA for the local entity. (Re) insurers should ensure consistency of plans or actions with those of the group, including public commitments made by the group.

Guidance

The guidance sets out the Central Bank's expectations across a number of areas including

Governance including:

- the roles of the Board and senior management
- allocation of responsibilities including expectations of key functions
- renumeration policies.

Understanding the potential exposure through performance of materiality assessment including:

- selection of a baseline scenario
- evolution of materiality of the risk exposure over time
- feasibility of the mitigating management actions
- documentation of the assessment including conclusions
- frequency of assessment.

Assessing the potential financial impact through scenario analysis and the ORSA including:

- selection of scenarios to quantify the impact
- communication of the approach and output to the key governance fora including the Board.

Integration of climate risk into strategy, business model and decision making including:

- responses to challenges identified in the scenario analysis including mitigating measures required over the short, medium and long term
- implementation plans and processes to manage implementation.

Robust plans underpinning public communications including:

- alignment of the Risk Appetite Statement with the overall strategy including forward looking exposure limits and thresholds over the short, medium and long term
- embedding within business as usual across the business including risk management, reserving, capital, underwriting, pricing and investments.

What happens next

The Central Bank is inviting feedback on the guidance and the consultation remains open until 26 October 2022.

How we can help

KPMG's Insurance sector experts partner with our Sustainable Futures experts to ensure clients have appropriate frameworks in place to meet regulatory expectations and to ensure that sustainability risks are managed and controlled to avoid exposure to reputational damage and weak market stability due to inappropriate actions and practices.

Introducing our Sustainable Futures practice

KPMG Sustainable Futures is KPMG Ireland's dedicated ESG and climate advisory practice, established to support financial, corporate and public sector clients navigate the complex and fast evolving climate change and sustainability agenda.

The team brings together a wide range of disciplines including sustainability practitioners, economists, engineers, corporate strategists, climate scientists and sustainable finance experts to deliver market leading advice and solutions to our clients.

Examples where our team can assist within each of the regulatory landscape expectations are as follows:

Risk Assessment

- We can conduct a Dynamic Risk Assessment of your operations to understand how all the risks that you are managing interact. This exercise will identify key nodes of your risk matrices to focus your efforts on managing those risks that have the greatest impact on your operations now and in the future.
- We can assist you in completing an assessment of double materiality that will define the material topics for your operations.
- We can support you in identifying key climate change risks and identify their potential impacts on your portfolio.
- We can support you in preparing scenario analyses to identify potential exposures and the best course of action in mitigating climate change risks.

Risk Management Framework

- We can help you in designing, assessing and embedding the potential impact of climate change on your risk profile.
- We can assist you with implementing internal control mechanisms to ensure that decision makers have adequate and bespoke management information ("MI") and risk reporting to inform discussion and decision-making.
- We can assist you in reviewing existing product policies and ensure that the consideration of climate change risks is evidenced at each stage of the product development process.

Disclosure Support

- We can support you in enhancing the completeness and reliability of the data you include in your risk assessment and disclosure activities.
- We can support you by conducting an ESG Readiness Assessment of your investment portfolio, including an evaluation of compliance with regulatory requirements of Article 8 and 9 funds and alignment with the EU Taxonomy.
- We can support you in aligning your reporting activities with the EU's Sustainable Finance Disclosure Regulations ("SFDR"), the Corporate Sustainability Reporting Directive ("CSRD") and the Task Force on Climate-Related Financial Disclosures ("TCFD").

Contact us

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Produced by: KPMG's Creative Services. **Publication Date:** Sept 2022 (8602)