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Creating a climate of change digest

The International Association of Insurance Supervisors (IAIS) issues part one of its public consultation on climate risk supervisory guidance

Leading off

The IAIS rolled out the first part of its public supervisory guidance on climate risk in mid-March.[1] The public consultation paper underscored how climate risk is a source of financial risk that affects insurers (from both the underwriter and investor standpoints) and operations. It also affects the resilience of financial institutions in general and policyholders' property and assets throughout the world. The IAIS wants to promote a globally consistent response to climate change from the sector and is reviewing existing IAIS standards to see if further guidance is necessary.

The consultation paper serves as part one of three segments of ongoing consultations with the insurance sector, with the first consultation proposing climate risk-related text in its insurance core principles (ICP) as part of a globally accepted framework for insurance supervision.[2] For example, the consultation will publicly consult on proposed changes to the ICP introduction and guidance on ICPs 7 and 8, which relate to governance, risk management, and internal controls.

The consultation process follows a 2022 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 supervisory guidance.

In its consultation paper, the IAIS also seeks to compare how the IAIS approaches on climate risk governance and risk management are aligned with related principles set forth by the Basel Committee on Banking Supervision (BCBS). It also requests suggestions on issues or themes to explore in the next consultations and provides analysis on how climate changes impact the global insurance sector.[3]

Additionally, the consultation includes questions seeking stakeholder feedback on their climate-related work regarding supervisory guidance. For example, the paper asks whether the IAIS's work and upcoming consultations on climate risk should cover considerations related to transition planning by insurers. It also wants to know from stakeholders whether there is anything missing from the current IAIS workplan on climate risk, known as the Roadmap.[4] The IAIS 2023–24 Roadmap includes the launch of the three consultations over the next 18 months. It also calls on supervisors to explore introducing additional indicators to capture climate-related risks.

What's next?

- Later this year, the IAIS plans to release an application paper that describes supervisory considerations and good practices on climate scenario analysis building on previous work. In this effort, the IAIS is also working closely with colleagues at the Network for Greening the Financial System (NGFS) and the Financial Stability Board (FSB). In its public consultation paper, the IAIS stated that despite significant advances in the area of climate scenario analysis, it wants to improve ways to share leading practices and to develop alignment among such practices.
- Stakeholder feedback on the first public consultation is being sought through May 16, 2023.
- The public consultation for part two, which will be "quite heavy" on the climate scenario analysis material, is planned to begin in the fourth quarter of 2023 with a new published consultation paper, followed by part three in the first quarter of 2024, according to the IAIS webcast.[5] These consultations will consider changes to ICPs 19 and 21 (related to ICPs 16 and 24) in part two and ICPs 9, 14, 15, 16, 20, 24, and 25 in part three. For example, ICP 15 deals with investments and ICP 16 deals with enterprise risk management for solvency purposes.

Watch now:

- The IAIS held a publicly available virtual background webcast on March 29, 2023, focusing on the consultation paper, which is available for replay.[6]

Oregon considers wildfire map laws

Oregon is considering the enactment of a law that would prevent insurers from cancelling or nonrenewing a homeowner's insurance policy, or increasing premiums based upon the use of a statewide map of wildfire risk.[7]

The bill, SB 82, includes amendments that homeowner's rates "shall not be excessive, inadequate or unfairly discriminatory" but states that no homeowners' premium rate shall be deemed inadequate unless this rate is "unreasonably low for the insurance provided" to the point where its "use or continued use endangers the solvency of the insurer."[8]

The legislation would also give a policyholder the time to repair, rebuild, or replace damaged or lost property.

Specifically, the bill would allow the insured at least a year after the date of the insurer's initial payment toward the cash value of the property that was damaged or lost, or at least two years if the damage or loss happened in a location that was subject to a declaration of a state of emergency or other official proclamation. Companies must also provide additional living expenses to an insured, subject to the policy limits for additional living expenses, for two years after the date of the damage or loss to the insured's primary dwelling if: (1) the damage or loss "occurred in a location that was subject to a declaration of a state of emergency" under existing state law and (2) the "damage or loss is directly related to the emergency that was the subject of the declaration."[9]

At the time of writing, the bill had passed the state Senate and was scheduled for a review in the Oregon House Committee On Climate, Energy, and Environment.[10]

Additionally, the Oregon Senate is considering legislation that would establish hazard zones.

Under the provision, the Oregon State Forestry Department would oversee the development and maintenance of a comprehensive statewide wildfire hazard map that displays the hazard zones. The department would have to provide notice and information to a property owner whose property is assigned to an extreme or high hazard zone, the effects of the categorization, and how the property owner can appeal the assignment of the property owner's property to the extreme or high (wildfire risk class) hazard zone.[11]

A wildfire risk map that was released last summer was withdrawn due to controversy over how it would affect homeowners' insurance rates.[12]

The International Organization of Securities Commissions (IOSCO) publishes a report on international work to develop a global assurance framework for sustainability-related corporate reporting.[13]

IOSCO released its March 2023 report highlighting the growing demand for high-quality assurance over sustainability-related information among investors. While the current regulatory landscape for assurance over sustainability-related information relies mainly on voluntary use of assurance, investors have stressed the importance of globally consistent and comparable assurance and ethics standards.

The report emphasizes IOSCO's support for the ongoing work done by standard setters like the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA) to develop unbiased assurance and ethics standards over sustainability-related information. The IAASB and the IESBA are in the process of developing draft standards for issuance in September and December 2023, respectively, with the intent that the standards will be finalized by year-end 2024.

The report highlights the importance of enhancing capabilities and promoting transparency to support effective assurance. What follows are seven key considerations IOSCO specifically encourages or suggests as actions for issuers, assurance providers, and standard setters:[14]

Profession-agnostic standards

- Issuers – Present "sustainability-related disclosures for independent assurance."
- Standard setters – "Work towards profession-agnostic assurance and ethics (including independence) standards that build on the requirements and principles of existing standards, and that can apply across all reporting frameworks."

Timely progress

- Issuers and assurance providers – "Early engagement with the standard setters' initiatives across the sustainability reporting ecosystem to support readiness to apply the final assurance and ethics (including independence) standards soon after they have been finalised in late 2024, including on a voluntary basis."
- Standard setters – "Continue work to develop high-quality standards in a timely manner and in accordance with robust due process, engaging with stakeholders to help develop standards that are fit for purpose and meet the public interest."

Engagement

- Issuers and assurance providers – "Engage with, and provide feedback to, the standard setters, throughout the development of the standards."
- Standard setters – "Continue engaging with stakeholder groups across the ecosystem, including in emerging markets" and set forth "arrangements to support coordination between the IAASB, the IESBA, and providers of other relevant frameworks and standards within the parameters of existing governance, due process, and public interest mechanisms."

Addressing challenging issues

- Issuers – Ongoing discussions about "the type of high-quality sustainability-related information and analysis that is most helpful to assurance providers' ability to complete their work" especially with audit committee members.
- Assurance providers – "Consultation with other stakeholder groups across the ecosystem to share information and experience on practices and approaches that can effectively address challenging reporting issues."
- Standard setters – "Address challenging issues in developing their standards, leveraging existing frameworks where possible" and "consider input from investors, regulators and other stakeholder groups identified in this report, including those in emerging markets, developing additional guidance as necessary as practice develops."

Connectivity

- Issuers – Engage audit committees "to assess how well sustainability-related reporting and the financial report work together to describe the issuer's material risks, strategies and prospects."
- Assurance providers – "Consider the connectivity between sustainability-related information in the narrative sections of companies' reporting and the financial statements."
- Standard setters – "Continue to engage with the International Sustainability Standards Board (ISSB) and the International Accounting Standards Board (IASB) to ensure the reporting standards have regard to the assurability of sustainability-related information."

Transparency

- Issuers – Engage audit committee assistance "to support assurance providers in meeting their responsibilities, which may include reporting deficiencies, uncertainties and key assumptions."
- Assurance providers – "Support investors' understanding of the scope and nature of the assurance carried out, including by specifying the elements assured and the standards applied, and applying consistently relevant transparency requirements in the assurance and ethics (including independence) standards."
- Standard setters
  - IAASB – "Set clear reporting requirements that promote transparency around the assurance engagement, including disclosure of the standards and requirements applied."
  - IESBA – "Establish clear transparency requirements to enable audit committees and other stakeholders to assess the independence of assurance providers."

Capacity building

- Issuers – "Audit committee members and other directors [should] support the building and maintaining of appropriate knowledge of sustainability-related reporting and assurance, and related skills, tools, and analytical capabilities."
- Assurance providers – "Continue to build capabilities and upskill in this area."

- Standard setters – “Continue outreach work, including with key stakeholder groups, accounting and other relevant bodies, and providers of education, … development of guidance, as needed,” and “consideration of the needs of emerging markets and other stakeholders that may be less familiar with assurance over sustainability-related information.”

The International Accounting Standards Board (IASB) explores climate-related risks in financial statements.[15]

The IASB is assessing how companies' financial statements can provide better information about climate-related risks, as required by International Financial Reporting Standards (IFRS®) accounting standards. The IASB is starting a project on this topic after its Third Agenda Consultation, which revealed that:[16]

- Climate-related risks are frequently perceived as isolated, long-term risks that are not appropriately accounted for in financial statements.
- Better qualitative and quantitative information about the impact of climate-related risks on the carrying values of assets and liabilities reported in financial statements is required for investors.

Through the project, the IASB intends to study the causes of stakeholder concerns about the financial reporting of climate-related risks, such as:[17]

- Unclear or insufficient requirements in IASB Standards,
- Companies' lack of compliance with current requirements, and
- Investor information needs that go beyond the objective of financial statements by focusing on minor revision to IASB Standards, new application guidance, and illustrative examples.

It will not seek to broaden the scope of financial statements or develop an IASB Standard on climate-related risks or develop accounting requirements for pollutant pricing mechanisms. The project team will leverage the ISSB's work to consider sustainability-related opportunities and risks, how scenario analyses could inform asset and liability measurement in financial statements, and how the connectivity mechanisms in the first two ISSB Standards could be replicated in IASB Standards.

The BCBS discusses its work on climate-related financial risks.[18]

BCBS has progressively worked on the inclusion of climate risks in the broader collection of bank supervisory frameworks. The BCBS released its “Principles for the effective management and supervision of climate-related financial risks”[19] in June 2022; and in December 2022, it published responses to frequently asked questions to clarify how climate-related financial risks may be captured in existing Pillar 1 standards.[20]

The Committee is now advancing its work on the development of a Pillar 3 disclosure framework for climate-related financial risks, which upon completion would serve as a consistent disclosure standard for climate-related financial risks at banks with international operations.[21] It is expected that the framework would augment, and be compatible with, similar disclosure initiatives underway by the ISSB and other authorities.[22]

The BCBS anticipates issuing a consultation paper on the proposed Pillar 3 disclosure framework for climate-related financial risks by the end of this year.[23]

Commodity Futures Trading Commission (CFTC) Commissioner Christy Goldsmith Romero gave the keynote address at the ISDA ESG Forum 2023.[24]

During the forum Commissioner Goldsmith Romero emphasized her intent to encourage market resilience from a climate risk perspective through five new proposals that would also address certain recommendations set forth by the Financial Stability Oversight Council (FSOC).

According to the commissioner, climate change has significantly affected both the economy and more specifically commodity and derivatives markets. In addition, climate change has the potential to pose broader risks to financial stability. She explained how climate-related financial risk is being managed using financial markets, specifically the derivatives markets, and pointed to ISDA's 2021 research paper *Overview of ESG-related derivatives products and transactions* to reiterate that “derivatives markets can play an essential role in facilitating the transition into a sustainable economy.[25]

Commissioner Goldsmith Romero's remarks outlined five proposals:

1. Introducing a new category to identify environmental/climate-related products traded in derivatives markets to enhance the commission's understanding of managing climate-related financial risks.
2. Using a comparable approach of oversight for climate-related products as the one used for digital assets, noting “there is no reason to re-invent the wheel.”
3. Conducting consumer education of climate-related products. Additionally, the CFTC should increase its supervisory role for environmental/climate-related products.
4. Establishing a “Heightened Review” framework for self-certified climate-related products, particularly in derivatives related to voluntary carbon credit markets. This framework would include steps to prevent manipulation as well as requirement for increasing confidence in carbon credit's reliability.
5. Enhancing market intelligence to monitor and surveil markets to promote integrity and resilience to climate risk. Increased market intelligence could also help ensure appropriate price discovery and address concerns related to lack of transparency, data, and data standardization in ESG products, all of which could have an impact on pricing.

Finally, the commissioner advocated for a government-wide strategy to better leverage experience, expertise, and resources because climate-related financial risk presents a unique set of risk management challenges.

Contacts

Kristen Sullivan
Audit & Assurance partner | Sustainability and ESG Services leader
Deloitte & Touche LLP
ksullivan@deloitte.com

Ricardo Martinez
Principal | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
rimartinez@deloitte.com

David Sherwood
Managing director | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
dsherwood@deloitte.com

Additional contributors

Trupthi Gorur
Senior solution advisor | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
tgorur@deloitte.com

Nikhilesh Parashar
Lead solution advisor | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
niparashar@deloitte.com

Shruthi Kundar
Advisory lead solution advisor | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
skundar@deloitte.com

Deloitte Center for Regulatory Strategy

Irena Gecas-McCarthy
FSI director, Deloitte Center for Regulatory Strategy, Americas
Principal | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
igecasmccarthy@deloitte.com

Michele Jones
Senior manager | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
michelejones@deloitte.com

Meghan Burns
Manager | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
megburns@deloitte.com

Kyle Cooke
Senior regulatory analyst | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP
kycooke@deloitte.com

Liz Festa
Senior Research Specialist | Deloitte Services LP
lfesta@deloitte.com

Additional Deloitte US perspective on climate risks

For additional insights, please see our ongoing series on how climate risks are shaping US financial regulatory initiatives and the impact these developments may have on the financial services industry and the broader economy:

- Deloitte 2022 CxO Sustainability Report
- 2023 financial services industry outlooks
- Ingraining sustainability in the next era of ESG investing
- The CIO's call to action: Driving an environmentally sustainable tech agenda to accelerate organizational change

Endnotes

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