# Finance Watch response to the IAIS public consultation on ICP 17 regarding capital adequacy

## Q1. General comments on the ICP17

The revision of the ICPs is a welcome evolution to ensure current developments and associated risks are properly evaluated and addressed from the prudential point of view. We welcome the IAIS' work to guarantee solvency of the insurance undertakings, which should also serve the interests of policyholders.

However, the text of the revised ICP 17 misses the opportunity to address climate-related financial risks. The 2021 Application Paper already recognised that climate-related risks are a material source of financial risk, with possible adverse impact on financial stability. Furthermore, the 2023 public consultation on climate risk supervisory guidance proposed to add reference to climate-related financial risks in the introduction to the ICPs, acknowledging its growing importance. Thus, including it in prudential measures, such as capital requirements, is indispensable to ensure insurers are adequately capitalised to cushion climate-related losses.

We recognise the challenges in quantifying climate-related financial risks, as climate developments are non-linear and forward-looking by nature, which makes it impossible to accurately estimate future risks using historical data. Transition risk, as well, cannot by definition be captured using historical data, as the transition has not yet occurred. Nonetheless, financial supervisors and experts recognise that the utter uncertainty of its development poses a considerable threat to the global financial system, requiring a prudent approach to the challenge.

Please also refer to the Finance Watch submission to the 2023 IAIS consultation on climate-related risks.

## Q20. General comments on Guidance ICP 17.2.3

The revised ICP 17 rightfully recognises that requiring insurers to maintain adequate levels of capital resources to enhance the safety and soundness of the insurance sector should not result in increasing the cost of insurance for policyholders beyond its economic value or inhibit the insurers' ability to compete in the marketplace.

Yet, the wording of this paragraph suggests that capital requirements are only to be seen as a cost to the institution and its competitiveness in the market. We also do not agree with the implicit suggestion that an increase in capital requirements automatically leads to an increased premium for the policyholder. Capital requirements are a risk-based protection measure for the insurers' as well as for the policyholders, therefore the discussion of tradeoff between private profits and financial stability, which is a public good, is not appropriate from the prudential perspective. In fact, the increase of capital has a proven positive effect on the economy. As suggested by research from the BIS, additional capital has resulted in healthier financial institutions.[1] Mindful that the BIS studies have covered the banking sector, we are not aware of any other authoritative research, which would demonstrate negative impacts on the economy from the insurance prudential capital requirements. Covering potential losses materialising through climate-change is an important measure to ensure that insurers' are able to deal with this emerging and complex to manage risk.

Supervisors in different jurisdictions are working to adjust approaches to disclosures and prudential frameworks to better account for climate-related risks. There is a clear risk of diverging approaches and a key role for the IAIS to support harmonisation.

Given that this is an emerging area of risk, there is an opportunity to support a collective understanding of how it can be addressed and supervised. This would both ensure that the risk is properly managed, but also that insurers are not disadvantaged in certain jurisdictions through differing approaches to these risks.

## Q72. General comments on Guidance ICP 17.7.4

There is an opportunity to add climate-related risks to ICP 17.7.4 as a clear example of a risk that is difficult to quantify. Although climate risk will probably manifest via market, liquidity and natural catastrophe risks, the timing and scale of materialisation are unlikely to be measured with any degree of precision. Given the non-linear nature of these risks, there is a strong case for taking a precautionary approach to applying capital requirements to account for climate-related financial risks - starting with exposures which are most certainly subject to high transition risk and contributing to the increasing physical risks in the system.[2] Thus, we consider it essential to mention climate-related financial risks explicitly under the provisions of ICP 17.7.4.

Based on the insights from net-zero climate scenarios and the international climate objectives, we can clearly conclude that certain sectors of the economy such as fossil fuel exploration and production are subject to high transition risk. As such, this risk should be recognised by insurers and supervisors and adequate capital provisions should be made to cushion climate-related losses. Additionally, accounting for climate risk in capital requirements overcomes existing data and modelling challenges aimed at precise measures, which will neither be possible nor timely.

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[1] BIS (2022). *Evaluation of the impact and efficacy of the Basel III reforms*.

[2] Finance Watch (2021). *Insuring the uninsurable: Tackling the link between climate change and financial instability in the insurance sector.*

## Q73. General comments on Guidance ICP 17.7.5

The last sentence of ICP 17.7.5 should further add the importance that insurers not only address material risk in their ORSA, but also draw conclusions about their capital adequacy to cover identified material risk by taking  a precautionary approach to capital requirements.