Insurance Council of Australia

30 July 2021

General Manager, Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority
Level 12, 1 Martin Place
Sydney NSW 2000

By email: PolicyDevelopment@apra.gov.au

Dear Sir or Madam

Prudential Practice Guide Draft CPG 229 Climate Change Financial Risks

The Insurance Council of Australia **(Insurance Council**) welcomes the opportunity to comment on *Prudential Practice Guide Draft CPG 229 Climate Change Financial Risks* (**CPG 229**). The Insurance Council is the representative body of the general insurance industry in Australia and represents approximately 95 percent of private sector general insurers. As a foundational component of the Australian economy the general insurance industry employs approximately 60,000 people, generates gross written premium of $53.9 billion per annum and on average pays out $166.2 million in claims each working day ($41.5 billion per year).

The Role of Insurance

General insurers play a vital role in the Australian economy. They help individuals, households, businesses and communities protect their financial well-being by providing an accessible mechanism to transfer, diversify and pool risk. General insurance not only provides peace of mind it also facilitates economic activity. Access to general insurance enables people and businesses to engage in business initiatives which would otherwise not occur because they are too fraught with risk. A robust insurance industry is the hallmark of a modern society and economy.

Insurance Industry Action on Climate Change

The Insurance Council has been implementing a Climate Action strategy since early 2019. The strategy is based on the United Nations Principles for Sustainable Insurance, to which the Insurance Council is a founding signatory. Our strategy has seen us working proactively with governments and other key stakeholders to reduce climate related risks for the sustainability of our industry. We commend the Commonwealth Government's initiative to establish the Australian Climate Services and National Recovery and Resilience Agency as a means to increase risk reduction activity in Australia, and we look forward to continuing our collaboration.

The importance of international alignment

Historically Australia's economic development has relied upon, and continues to rely on, access to international capital. As this structural feature of the Australian economy applies to the general insurance industry, access and continued access to global reinsurance markets is fundamental to the industry's capacity to continue to pool and diversify risk, thereby helping Australian consumers and businesses manage the risks they face. Australian general insurers also need to meet the expectations of domestic and global investors in order to attract capital with which to fund the operation of their businesses.

The Insurance Council therefore considers it a matter of fundamental importance that APRA's views as to how general insurers should manage the financial risks of climate change aligns with international best practice and that APRA's views should neither lag nor go beyond that best practice. The Insurance Council welcomes, and agrees with, APRA's approach of aligning its guidance with the Financial Stability Board's *Task Force on Climate-related Financial Disclosures* (**TCFD**). Compliance with TCFDs is becoming an expectation of global reinsurers and investors.

The Insurance Council also agrees with APRA's view that Climate Change Financial Risks is but one of a number of material risks, albeit an extremely important one, which regulated entities have to manage and that the appropriate framework within which to manage these risks is that established by Prudential Standards *CPS 220 Risk Management*, *SPS 220 Risk Management*, *CPS 510 Governance* and *SPS 510 Governance*. We are in agreement with APRA's view that a separate risk framework is not needed to manage Climate Change Financial Risks.

Considerations to improve CPG 229

Areas where the Insurance Council considers that CPG 229 can be improved relate to APRA's expectations as to:

1. **Should insurers be responsible for commercial customer behaviour?** The extent to which APRA expects that general insurers should encourage commercial customers to change their business practices and models as a part of managing their exposure to Climate Change Financial Risks is potentially a matter of concern.

   General insurers compete to provide insurance products their customers wish to purchase. Inherent to an insurance contract is the transfer of risk. The price or premium at which general insurers are willing to enter a contract of insurance reflects the risk they assume when entering that contract. Accordingly, the amount of a premium also serves as a price signal to customers as to the amount of risk related to their activities, including likely over time in relation to the financial risks of climate change. Insurance cover and price will reflect the extent to which climate change financial risks are taken into account by the business.

   Certainly, general insurers can, and do, point out practical steps customers can take to reduce their level of risk and hence the premium payable to transfer that risk, subject to Corporations Law limitations on providing personal advice. The Insurance Council is also working with Australian Climate Services to help improve the National Risk intelligence, and ultimately we hope to inform tools that the government, or an appropriate authority, can use to better inform customers to manage physical risks to their property and assets.

   However, we believe the wording in the CPG may be interpreted as encouraging institutions to overstep their current role of providing customers with insurance products and services to dictating the behaviours and business activities undertaken by those customers. We would therefore encourage APRA to revisit the framing of this aspect of the CPG.

2. **Scenario Testing.** We welcome and agree with APRA's comments in relation to the importance of scenario testing. However, we are cognisant of, value and appreciate that the general insurance industry is populated by a range of insurers of different sizes and specialist expertise. This diversity of organisations, business models and expertise is a sign of a healthy industry.

   The Insurance Council supports the need for robust scenario analysis whilst ensuring that the analysis be proportionate to the institution's size, business mix and complexity. The Insurance

Insurance Council of Australia

Council is of the view that APRA should clearly define the level of expectation for guidance provided for scenario analysis and a better approach would be for APRA either on its own, or collaboratively with industry, to establish some agreed baseline climate scenarios which all general insurers could use to conduct scenario testing. These can then be varied according to the specific circumstances of each insurer.

We note that the Climate Measurement Standards Initiative (**CMSI**), in partnership with a set of ICA's larger members, has already developed a set of standards for physical risk and is currently exploring transition risk. Engagement in the CMSI has contributed to a relatively sophisticated understanding of scenario development, and our industry will benefit from this as we progress.

The benefits of a collaborative approach is that it will help limit the imposition of unnecessary regulatory cost into the general insurance market, while still providing sufficient flexibility for those businesses with the relevant resources and expertise to develop bespoke climate scenarios which more closely match their particular business model, complexity etc.

We also note that APRA is presently conducting Climate Vulnerability Assessments (**CVAs**) with the major Australian banks and intends to conduct similar CVAs with selected insurers. The Insurance Council considers that the performance of this work presents APRA with a good opportunity to spread the benefit of learnings arising across the entirety of the general insurance industry through their incorporation into a set of baseline climate scenarios.

3. **The role the *Internal Capital Adequacy Assessment Process* (ICAAP)** should play in a general insurers' risk identification process of Climate Change Financial Risks.

   We agree with APRA's consideration that the ICAAP is a suitable framework for considering the impacts of climate risk on capital adequacy. However, the paragraph noting this (para 25) is placed within the 'Risk Identification' section. The paragraph itself is clear that APRA is not suggesting the ICAAP is a tool for risk identification. However, potential confusion could be reduced by moving this, or relabelling, as a new section focussing on the assessment of capital impacts of climate risk exposures.

   We also think it would be helpful if APRA could provide further guidance as to its expectations as to how the ICAAP should apply to this risk in practice. For example, the ICAAP typically applies to a period aligned to the business planning cycle, whereas climate risks emerge over an extended time horizon.

We trust that our observations are of assistance. If you have any questions or comments in relation to our submission please contact [redacted], the Insurance Council's General Manager, Policy – Regulatory Affairs, on telephone: [redacted] or email: [redacted].

Yours sincerely

[redacted]

[redacted]
Executive Director and CEO