

February 23, 2024

Mr. Shigeru Ariizumi
Chair, Executive Committee
Mr. Jonathan Dixon
Secretary General
International Association of Insurance Supervisors (IAIS)
Centralbahnplatz 2
4051 Basel, Switzerland



Re: Draft Application Paper on climate risk market conduct issues in the insurance sector

Dear Messrs. Ariizumi and Dixon:

The Institute of International Finance (IIF) and its insurance members, which broadly represent the global insurance¹ industry, appreciate the opportunity to provide comments on the IAIS's Draft Application Paper on climate risk market conduct issues in the insurance sector (Draft Application Paper).

Overarching Comments

The IAIS should go back to first principles in drafting an Application Paper. As noted in the preface to the Draft Application Paper, Application Papers provide supporting material related to specific supervisory material in the ICPs or ComFrame by providing further advice, information, recommendations, or examples of good practice. Application Papers are subject to the principle of proportionality and should not include new requirements that go beyond the scope of the existing ICPs. However, in practice, Application Papers are often interpreted by supervisors as prescriptive requirements from the IAIS that should be reflected in new local requirements and, this by extension, can raise the implication among supervisors that failure to implement these apparent requirements could give rise to negative assessments. We encourage the IAIS to reiterate and clarify the purposes and intent of an Application Paper for the benefit of its members and stakeholders and to draft Application Papers in a much less prescriptive tone (e.g. the use of the words 'could' or 'may' instead of 'should').

Prior to the issuance of a final Application Paper, the IAIS should consult with the industry and other key stakeholders and, ideally, this exchange should inform the consultation draft. We appreciate that the IAIS recently has held a number of stakeholder engagement sessions on topics that may become the subject of an Application Paper. We encourage the IAIS to engage in this outreach with the industry and other stakeholders on the subject of climate risk market conduct before progressing to a final Application Paper, especially when considering a paper of the depth and breadth of the current Draft Application Paper.

The IAIS is advised to more clearly define the scope of application of any final Application Paper and clearly link any recommendations to its mandate. The IAIS should more clearly define the scope of the Draft Application Paper. The Draft Application Paper addresses two very different topics

¹ References to insurers include reinsurers unless specifically noted.

– greenwashing more broadly, and considerations related to insurance products that provide coverage for natural catastrophes. We encourage the IAIS to consider these issues separately and to align its work on greenwashing with the recent work conducted by the International Organization of Securities Commissions (IOSCO). With respect to greenwashing that is specific to insurance, such activity would likely only manifest itself in insurance products with an investment component.

We also encourage the IAIS to consider how overly prescriptive and burdensome recommendations could hamper the urgent need for insurers to engage in, and for insurers to help their customers engage in, the transition to net zero. A more principles-based approach to any potential market conduct issues can facilitate this transition by giving supervisors more leeway to address these issues in their respective jurisdictions, and, by extension, giving companies the flexibility to consider how they can best support the transition, given their activities, business models and customer profile and needs.

With respect to the sections relating to market conduct, we encourage the IAIS to clearly and directly tie its recommendations on climate risk market conduct issues to its mandate to protect policyholders and to promote fair, safe and stable insurance markets. Specifically, the IAIS should clarify where and how it thinks idiosyncratic market conduct issues or shortcomings related to climate risk may manifest. Many jurisdictions have robust market conduct regimes where the laws and regulations would apply broadly in many contexts including those related to climate risks. We believe that there are few, if any, idiosyncratic climate risk-related market conduct issues related to insurance products that would not otherwise be addressed by these frameworks. Moreover, the extent to which the Draft Application Paper applies to commercial insurance or reinsurance is unclear and, to the extent that particular sections of the Paper or recommendations are directed to the supervision of commercial insurance or reinsurance undertakings, this should be clearly specified, with an explanation of how the products provided by these undertakings could give rise to market conduct issues. Finally, as explained below, there are certain discussion topics within the Draft Application Paper that are not typically considered to be market conduct issues and these topics are more appropriately considered in other contexts.

The IAIS should adopt a principles-based approach to potential market conduct issues related to climate-related risks. The suggestions and recommendations throughout the Draft Application Paper reflect a prescriptive tone, including through the frequent use of ‘should’ in the recommendations contained in Sections 2 and 3 of the Draft Application Paper. We encourage the IAIS to use the term ‘may’ or ‘could.’ A less prescriptive and more proportionate and principles-based approach to any climate risk market conduct issues would better align with the purposes and intent of an Application Paper and would reduce the legal risks associated with the currently fragmented approach to the supervision of climate risk and greenwashing in particular.

A more principles-based approach would also help to address the regulatory fragmentation that subjects insurance groups to significant legal and reputational risks. The IAIS can play an important role in urging insurance supervisors to adopt a principles-based approach that should increase the ‘interoperability’ of various supervisory frameworks and increase the ability of an insurer to meet requirements across jurisdictions.

Supervisors should be careful in defining inappropriate market conduct and provide clear evidence of any such finding. A wide range of actuarial, risk, legal, market and strategic

considerations can form the basis for an insurer's decision to exit a particular market or to change the terms on which it will offer a particular product. Supervisors should be careful not to inadvertently imply that an insurer's decision to exit a market or to cease offering a particular product, or to change the pricing, terms, conditions and/or exclusions related to a product offering, constitutes or is based upon inappropriate market conduct, absent clear evidence of unfair, discriminatory or deceptive practices under the laws and regulations of the jurisdiction.

Moreover, supervisors should avoid any inherent assumption that new or revised data or changes in market conditions can translate easily or quickly into revised pricing or into a decision to enter or exit a market. Even the most reliable data is subject to considerable uncertainty and may be based on assumptions and dependencies that can shift rapidly. The proper analysis of new data and its incorporation into decision-making and management actions can take considerable time and involve input from multiple parties.

Insurers' ability to support the transition to a lower carbon economy can be facilitated or constrained by government and real economy (in)action and does not necessarily represent a conduct issue. We appreciate the IAIS's attention to the role of insurers in supporting the transition of economies towards a more sustainable path by, among other things, offering sustainable insurance products, integrating sustainability practices in their operations and increasing their sustainable investment practices. We encourage the IAIS to consider the role of insurers in the broader context of how the governments and the real economy respond to the pressing need to address climate risk challenges and associated social issues, including protection gaps. Insights from the IAIS's November 2023 paper, *A call to action: the role of insurance supervisors in addressing natural catastrophe protection gaps*, emphasize the fact that addressing protection gaps presents a broad societal challenge that requires a coordinated response from a range of parties. Supervisors have an important role to play in multi-stakeholder approaches aimed at addressing protection gaps, including advising governments on the design and implementation of public-private partnerships, in improving financial literacy and risk awareness among customers, and in creating a regulatory environment that supports the development of innovative products and services. To the extent that the final Application Paper includes references to protection gap issues, we encourage the IAIS to refer the reader to the IAIS's insights from the November 2023 paper.

Specific Comments

Section 2 – Greenwashing considerations

The IAIS proposes to define greenwashing as all misleading sustainability representations (see Paragraph 10). This definition is overbroad, open to different interpretations, and differs from the definition offered by IOSCO, which describes greenwashing as the practice of misrepresenting sustainability-related practices or the sustainability-related features of investment products.² We encourage the IAIS to adopt the IOSCO definition, as it is more precise. Adoption of the IOSCO definition would also advance the important goal of avoiding regulatory fragmentation.

Paragraph 2 of the Draft Application Paper states in broad terms the IAIS's concerns about greenwashing and the attendant reputational and legal risks. The IAIS should better delineate its

² <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD750.pdf>

members' specific concerns as they relate to different insurance lines of business. Supervisory discussions around potential greenwashing risks so far have focused on retail products with an investment component. The IAIS should avoid any inference that insurance products more broadly may give rise to greenwashing concerns, absent clear evidence that supports a broader scope of application. For example, Paragraph 9 should reference the *investment-related* component of *retail* insurance products.

As the IAIS acknowledges in Paragraph 15, greenwashing is not a new risk category and jurisdictions should consider whether existing requirements are sufficient to tackle greenwashing in their markets. The prescriptive tone of the Draft Application Paper does, however, limit jurisdictional flexibility to do so. In particular, conduct concerns regarding accuracy and clarity in describing the investment component of an insurance product are already addressed by robust rules regarding the avoidance of deceptive and misleading advertising or practices and by penalties for violation of those rules.

We have some concern about how a benchmark for measuring the level of environmental or social benefit of an insurance product could be developed, as discussed in Paragraph 27, especially in the absence of a common set of definitions or a globally recognized set of sustainability standards, as acknowledged in Paragraph 46. We suggest the deletion of the second sentence of Paragraph 27. Any sustainability benchmark would be inherently subjective, and the characterization of environmental or social benefits could vary significantly across jurisdictions given different target market sustainability preferences and objectives.

The setting of supervisory benchmarks and targets would likely increase the resources required to be devoted to product development, with a negative impact on product affordability. At a minimum, any benchmark or target would need to be flexible in order to meet local jurisdictional needs. A similar observation applies to Paragraph 43, which suggests that supervisors could provide clear targets for key terms such as 'ethical' and 'sustainable,' and we would encourage the deletion of the second sentence of that paragraph.

Section 2.2 of the Draft Application Paper notes the need for clear and robust sustainability-related definitions and criteria. Supervisory alignment of definitions across jurisdictions and the alignment of definitions with those developed by industry experts would help to avoid the considerable litigation and reputational risks that arise as a result of insurance groups being subject to greenwashing accusations under different sustainability- and climate-related definitions.

Section 2.3 of the Draft Application Paper notes that greenwashing can occur in the design, delivery, or performance monitoring of a product. Consistent with our comments above, we would limit the scope of this statement to products with a retail investment component, in alignment with the IOSCO definition of greenwashing. Moreover, it is important for supervisors to note and take into account that the ability of an insurer to monitor its products at a granular level and on an on-going basis after launch may be constrained by the current state of the art in performance measurement processes and controls and limited by the availability of credible and reliable data and metrics.

Adding substantially to those challenges is the admonition in Paragraph 37 that product assessments should also ensure that the product's investment risk is aligned with the target market's needs, objectives, and characteristics. Assessing a diverse target market's investment needs,

objectives, and characteristics, as well as its sustainability preferences and objectives, and balancing the two in the design, delivery, and performance monitoring of a wide range of retail investment products with an investment component would be, at best, a daunting task that may be further complicated by conflicts between the two goals of strong financial performance and sustainability. Paragraph 37 also assumes that all customers value sustainable products, which may not necessarily be the case.

We would propose the following language in lieu of the current Paragraph 37, which would limit the scope of this paragraph to *sustainability-related* market conduct:

Insurers should determine whether the investment component of a given retail product with an investment component is likely to meet its identified sustainability-related objectives over time, in order to identify opportunities for product revision.

Section 3 – Natural catastrophe considerations

The IAIS advances an overbroad discussion of how market conduct issues, including greenwashing, may arise from the provision of natural catastrophe cover. Moreover, some of the natural catastrophe considerations raised by the IAIS in the Draft Application Paper, including insurance affordability, the lack of awareness of natural catastrophe risks, and the role of governments in covering natural catastrophe losses, are not market conduct issues.

While there can be market conduct issues associated with the marketing, distribution, pricing and claims handling practices of any insurance cover, including natural catastrophe cover, these are not new issues that are idiosyncratic to natural catastrophe cover and that require a differentiated supervisory treatment. Any such issues are already covered by existing supervisory frameworks. To the extent that the IAIS believes that an issue is not already covered by existing supervisory frameworks, the IAIS should more clearly articulate the specific, idiosyncratic and verifiable insurance market conduct issues that could arise in relation to natural catastrophe insurance products that are not already addressed under existing supervisory frameworks. The IAIS should also delete any sections or paragraphs of the Draft Application Paper that reflect factors that are outside of the control or responsibility of insurers.

The importance of preserving insurers' ability to design and price products based on risk should be reflected in any final Application Paper, consistent with the IAIS mandate to maintain fair, safe, and stable insurance markets. Insurers have invested considerable resources in actuarial and risk specialists in order to develop, refine and price their offerings based on the risk appetite and profile of the organization, the environment(s) (e.g., government policy and legal) in which an insurer operates, the communities and markets in which an insurer operates, and the insurer's access to granular risk information regarding specific products and markets. A wide range of factors influence insurers' commercial decisions regarding the design and marketing of products and the pricing of those products in various markets. Moreover, pricing increases are also substantially affected by macroeconomic drivers such as inflation and interest rates and cannot solely be attributable to climate variables.

Insurers need to retain the ability to tailor their product offerings and pricing to account for new information and market signals and to provide market signals to their customers and the broader

market and real economy. This tailoring exercise is increasingly complex and necessarily dependent on the lines of business, activities, strategic goals and plans, and risk appetite of a particular insurer. Decisions regarding product offerings and pricing directly impact the financial position and solvency of insurers and should remain business decisions. Supervisors should not interfere in the business decisions of insurers unless necessary to prevent or address verified instances of consumer harm that are caused by unfair, discriminatory, or deceptive practices under the legal and regulatory framework in place in their jurisdiction. As noted in the IAIS's November 2023 paper, *A call to action: the role of insurance supervisors in addressing natural catastrophe protection gaps*, restricting price through regulatory actions (if intended to increase insurance affordability, e.g., price ceilings), could lead insurers to exit the market on grounds of reduced profitability, further reducing insurance supply. Such restrictions could also potentially undermine important price signals by obscuring the true cost of the risk and limit product innovation, which is needed to help reduce protection gaps.

Insurance affordability, and low awareness among the general public of natural catastrophe risks, while important social issues, are not market conduct risks and should not be a basis for interfering in an insurer's ability to price according to risk. Rather, governments should address these issues as part of the effort to preserve accessible private insurance markets. Extending the responsibility for societal issues to insurers could have the effect of increasing costs and, thus, insurance premiums, which would frustrate the intent of the IAIS and the insurance industry to reduce protection gaps.

With respect to the concern that policyholders may believe erroneously that governments will intervene to absorb the costs of a natural catastrophe event, we agree that this may be a common perception in certain markets. Insurers do provide comprehensive information to policyholders, which contributes to elevating risk awareness and, as well, it is in the interests of (re)insurers that purchasers of insurance cover are aware of these risks. There may be a further role for insurance supervisors to work collaboratively with governments in order to advance more accurate messaging about the role and likely responses of governments (and taxpayers) in absorbing the costs of natural catastrophe losses and the limits of that role. We agree with the recommendation in Paragraph 96 that supervisors could liaise with insurers and other relevant authorities to provide enhanced consumer information on the risks that they are facing in order to facilitate more informed consumer decisions. Again, the IAIS's November 2023 paper is instructive in this regard.

To promote a collaborative approach to this shared responsibility, we propose the deletion of Paragraph 58 and further propose that Paragraph 60 include the following lead-in phrase:

Supervisors, insurers and intermediaries, and governments or civil authorities should work collaboratively to address:

The primary responsibility for financial literacy and insurance protection gaps is shared with governments and civil authorities, supervisors, industry, and the general public. National, regional, and local governments should play a lead role in understanding the exposures of their communities to climate risk, integrating that understanding into climate resilience plans and educating their communities about the importance of avoiding and mitigating climate risks, supported by the insurance industry and the supervisory community. In any discussion of these issues, we encourage the IAIS to refer readers to the findings of its November 2023 report.

We agree with the recommendation in Paragraph 85 that, where appropriate and within their remit, supervisors promote the adoption of practices by consumers to put in place sufficient risk mitigation measures. We agree that supervisors have a role in monitoring any schemes that allow policyholders to receive rebates or rate reductions for implementing risk mitigation measures, as noted in Paragraphs 85 and 86. However, any decision to reflect mitigation in pricing is a business and risk-based decision for an insurer. Provided that these decisions and the amount of any rebate or rate reduction are properly communicated and advertised, supervisors should not substitute their judgment for that of insurers in determining whether and how mitigation is considered in pricing decisions. Pricing adjustments for mitigation cannot and should not be expected to cover the costs of policyholder risk mitigation.

The IAIS should also acknowledge that the actions of insurers and reinsurers in offering and pricing natural catastrophe cover is affected not only by the actions of individual policyholders, but also by the actions or inactions of others in the community and the (in)actions and decisions of government officials. For example, an individual homeowner policyholder residing in a locality that is prone to wildfire risk may take extensive actions to reduce the risk of wildfire damage by creating safety zones, upgrading roofing and siding materials and installing spark arrestors around his or her home. However, if the policyholder's neighbors and the larger community do not take similar mitigation measures, the effectiveness of these individual mitigation measures is greatly diminished. The presence or absence of community action is an appropriate consideration when deciding whether to offer or how to price a policy.

We appreciate the opportunity to provide input on the important issues raised in the Draft Application Paper. Please address any questions or comments on this response to Mary Frances Monroe (mmonroe@iif.com) or Melanie Idler (midler@iif.com).

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Mary Frances Monroe', with a long horizontal flourish extending to the right.

Mary Frances Monroe

Director, Insurance Regulation and Policy