Next steps on climate-related financial disclosure

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Head of ESG Risk
QBE Insurance Group
Abstract

Increasingly insurers are committing to disclose their climate risks and opportunities following the recommendations of the Financial Stability Board’s Task force on climate-related financial disclosures (TCFD), and many have already begun such disclosure.

A key requirement is for insurers to undertake scenario analysis, and to disclose both the financial impact of different scenarios, and their strategic responses to these scenarios.

Needless to say this is easier said than done, especially given the current uncertainties in the behaviour of perils at a local level, and the resulting potential for insurers to adopt very different assumptions.

In this presentation we will discuss attempts to develop standards on the measurement of climate physical risks to assist insurers and other stakeholders in building confidence in our disclosures.
## Taskforce on climate-related financial disclosure

<table>
<thead>
<tr>
<th>Governance</th>
<th>Strategy</th>
<th>Risk Management</th>
<th>Metrics &amp; Targets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disclose the organization’s governance around climate-related risks and opportunities.</td>
<td>Disclose the actual and potential impacts of climate-related risks and opportunities on the organization’s businesses, strategy, and financial planning where such information is material.</td>
<td>Disclose how the organization identifies, assesses, and manages climate-related risks.</td>
<td>Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.</td>
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<td>a) Describe the <strong>board’s oversight</strong> of climate-related risks and opportunities.</td>
<td>a) Describe the climate-related risks and opportunities the organization has <strong>identified</strong> over the short, medium, and long term.</td>
<td>a) Describe the organization’s processes for <strong>identifying and assessing</strong> climate-related risks.</td>
<td>a) Disclose the <strong>metrics</strong> used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.</td>
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<td>b) Describe <strong>management’s role</strong> in assessing and managing climate-related risks and opportunities.</td>
<td>b) Describe the impact of climate-related risks and opportunities on the organization’s <strong>businesses, strategy, and financial planning.</strong></td>
<td>b) Describe the organization’s processes for <strong>managing</strong> climate-related risks.</td>
<td>b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 <strong>greenhouse gas emissions</strong>, and the related risks.</td>
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<td>c) Describe the resilience of the organization’s strategy, taking into consideration different <strong>climate-related scenarios</strong>, including a 2°C or lower scenario.</td>
<td>c) Describe how processes for identifying, assessing, and managing climate-related risks are <strong>integrated</strong> into the organization’s overall risk management.</td>
<td>c) Describe the <strong>targets</strong> used by the organization to manage climate-related risks and opportunities and performance against targets.</td>
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QBE Approach

- Committed to full implementation of TCFD by 2021
QBE Climate Change Action Plan

- QBE has made a public commitment to the recommendations of the Task Force on Climate-related Financial Disclosures.
- Climate Change Action Plan sets out how we will achieve this.
- We have completed:
  - Implemented governance
  - Established an ESG Risk team
  - Established Climate Change Working Groups
  - Performed a high-level impact assessment
  - Assessed the alignment of our investment portfolio to Paris Agreement
  - Integrated climate risk within our ERM
- We are in the process of:
  - Deep dive analysis of underwriting portfolios for liability and transition risk
  - Undertaking physical risk scenario analysis
  - Identifying opportunities from transition risk
- Next year we will:
  - Complete scenario analysis including strategic responses
  - Develop metrics to monitor our performance and set targets

<table>
<thead>
<tr>
<th>DESCRIPTION</th>
<th>ACTION</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
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<tbody>
<tr>
<td>Governance</td>
<td>Disclose the organisation’s governance around climate-related risks and opportunities</td>
<td>Board:</td>
<td>• Strengthen Group Board and Committee oversight of climate related issues</td>
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<tr>
<td>Management</td>
<td>Management:</td>
<td>• Establish a New cross-functional, cross-divisional Climate Change Working Group to support the Board and management in identifying and managing climate-related risks and opportunities</td>
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<td>Strategy</td>
<td>Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation’s businesses, strategy and financial planning where such information is material</td>
<td>• Complete high-level impact assessment of physical transition and liability risks and opportunities across the business over the short, medium and long term</td>
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<td></td>
<td>Strategy:</td>
<td>• Review investment strategy to ensure it appropriately reflects consideration of climate-related risks and opportunities</td>
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<tr>
<td></td>
<td>Strategy:</td>
<td>• Complete further detailed analysis of climate-related risks and opportunities in portfolio and underwriting portfolios</td>
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<td></td>
<td>Strategy:</td>
<td>• Review underwriting strategy in line with detailed analysis of climate-related risks and opportunities</td>
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<td></td>
<td>Strategy:</td>
<td>• Participate in the UNEP FI Insurance industry TCFD pilot group on scenario analysis</td>
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<td></td>
<td>Strategy:</td>
<td>• Integrate additional climate-related scenario analysis into strategic planning across the business</td>
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<td>Risk Management</td>
<td>Disclose how the organisation identifies, assesses and manages climate-related risks</td>
<td>• Establish ESG Risk team to coordinate ongoing engagement of climate-related risks and opportunities across the business</td>
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<td></td>
<td>Risk Management:</td>
<td>• Review Enterprise Risk Management Strategy and Framework to ensure they appropriately reflect climate change considerations</td>
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<td>Risk Management:</td>
<td>• Review risk classes, risk appetite and risk management standards and processes to ensure that climate change risks are properly reflected</td>
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<td>Risk Management:</td>
<td>• Integrate multi-year scenario analysis into risk management strategy</td>
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<td>Metrics &amp; Targets</td>
<td>Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material</td>
<td>Disclosure scope, 1, 2, and 3 operational greenhouse gas emissions</td>
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<td>Metrics &amp; Targets:</td>
<td>Evaluate metrics and targets for assessing climate-related risks and opportunities that are in line with strategy and risk management processes</td>
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<td>Metrics &amp; Targets:</td>
<td>Disclose metrics and performance against targets for assessing climate-related risks and opportunities</td>
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KEY:  
- (a) Commencement date  
- (b) Continued in progress  
- (c) Target completion date  
- (d) Action completed
## TCFD Compliance

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<td>c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.</td>
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Tough questions for working groups: use our internal experts – underwriters, claims etc.

- What does the world look like as we transition to a low carbon economy?
- How will our customers change?
- How will the risks our customers face change?
- What products and services do we need to offer?
- What markets should we be in?

- How will liability business be affected?
- Are we exposed to losses from people taking legal action on climate change?
- How else might we be exposed, and how should we manage that?

- How will natural disasters change?
- What will that mean for our property insurance claims, premiums and strategy?
- How do we adjust our cat models?
- What about marine, aviation, motor…?

- How will climate change affect crops?
- How will farmers respond?
- What can we do to support our customers?

- How will climate change affect people’s ability to pay back home loans?
- How might property prices be affected?
- What might be the credit risk impact?
Challenges for the industry

**Climate Data Deficit**

Insurers, for example, are experts in assessing and pricing risk, but doing this accurately requires access to reliable data, such as such historical records, models and scientific analysis. If past experience is no longer a reliable guide as to what will happen in future, insurers’ ability to underwrite their policies and calculate premiums that keep the business competitive and profitable inevitably suffers.

Geoff Summerhayes – APRA Executive Board Member
Two key challenges

TCFD is incomplete
- Low barriers to entry
- A lot of interpretation required
- An inconsistent approach could result in a lack of confidence in our disclosures

TCFD breaks new ground
- Insurers have never disclosed cat model results
- Long-term risk in a short-term business
- Challenging questions
TCFD is incomplete (I)

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Question</th>
<th>Options</th>
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<tr>
<td>Disclose short, medium and long term, considering:</td>
<td>• What are these in relation to one-year general insurance contracts?</td>
<td>• Lifetime of underlying asset being insured</td>
</tr>
<tr>
<td>- Life of assets</td>
<td></td>
<td>• Insurance contract term, allowing for renewal probabilities?</td>
</tr>
<tr>
<td>- Profile of climate-related risks</td>
<td></td>
<td></td>
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<tr>
<td>- Sectors &amp; geographies</td>
<td></td>
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<tr>
<td>• Current or future exposure or vulnerability?</td>
<td>• Current exposure most logical and not subject to overly optimistic assumptions (cf. energy industry)</td>
<td></td>
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<tr>
<td>• Exposure in particular is very significant, and for physical risk need specific assets, not general growth assumptions</td>
<td>• Management action to be considered in addition to no action</td>
<td></td>
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<tr>
<td>• Peril or geographical splits?</td>
<td>• Likely to be useful to demonstrate robustness of analysis</td>
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<td></td>
<td>• Ensure that no components are missing</td>
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</table>
TCFD is incomplete (II)

<table>
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<th>Requirement</th>
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</table>
| Insurers to disclose impact on revenues, expenses, assets and liabilities. | • What line items should be disclosed?  
• Gross or net of reinsurance?  
• Taxation impacts?  
• What inflation/discounting assumptions to capitalise cash flows? | • IFRS 17 or consistency with current accounting standards?  
• Annual or other periods? |
|  | • Should this be at the mean/expected level, or also at a probability of adequacy level?  
• What about capital impacts? | • Capital is a crucial question – expect costs of capital to increase because of increased volatility in claims  
• Cost of capital is a critical question in how we price and underwrite business  
• Current regulatory capital regime is one-year horizon |
| Describe the resilience of the organization’s strategy | • What does “resilience” mean in this context? | • Is financial impact that does not result in solvency OK?  
• Real risk is not higher claims, but unaffordability leading to a loss of market |
### TCFD is incomplete (III)

<table>
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<th>Options</th>
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<tbody>
<tr>
<td>Description of the critical input parameters,</td>
<td>• Seriously??? For Cat Modelling???</td>
<td>• What is sufficient enough to demonstrate robust thinking, but not</td>
</tr>
<tr>
<td>assumptions and considerations, and analytical</td>
<td>• What are the critical parameters, assumptions and choices?</td>
<td>overly complicated</td>
</tr>
<tr>
<td>choices</td>
<td></td>
<td>• Importance of sensitivity analysis before scenario analysis</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Identify which parameters, assumptions and choices result in the</td>
</tr>
<tr>
<td></td>
<td></td>
<td>greatest change in financial impact</td>
</tr>
<tr>
<td>Uncertainty</td>
<td>• How should insurers disclose the uncertainty in their estimates of</td>
<td>• Scenario Analysis takes care of political uncertainty…</td>
</tr>
<tr>
<td></td>
<td>financial impact?</td>
<td>• But within each scenario there are significant uncertainties</td>
</tr>
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</table>
TCFD breaks new ground

**Cats**
- Never disclosed details of our cat modelling before
- Not interested in forecasts – we want scenarios
- Lower level of accuracy needed – we will never actually price contracts on these scenarios
- Is the board ready to sign off on this disclosure?

**Long-term risk**
- The real risk from climate change is a loss of market as products become unaffordable or uninsurable
- It's not the claims it's the premiums
- How do we explain or disclose this?

**New questions**
- Physical risk – integrating climate into our cat models
- Liability risk – How policies respond will be determined in court. Are we opening ourselves up if we disclose under the assumption they respond?
- Transition risk – it’s not just the change in the size of economic sectors, but the change in the **risks** of those sectors.
Meeting the challenges

*Climate Measurement Standards Initiative*

- An industry-lead collaboration between insurers, banks, scientists, regulators, reporting standard professionals, service providers and supporting parties to develop open-source technical business and scientific standards for climate physical risk projections of future repair & replacement costs of residential and commercial buildings and infrastructure in Australia.
Reduce the risks and costs of disclosure for companies

• Confidence through standards rather than more disclosure
• Confidence through comparability between insurers
• Confidence through appeal to authority
• Guide for developers and model vendors
• Enable widespread adoption
• Focus research & development on what we actually need
• Meaningful and practical regulation
Integrate the science and the models
CMSI – How?

Six month Sprint

Publish Draft for Consultation

Iterate

Steering Group

- Scope & members of committees
- Funding ~$10,000 each

Financial Disclosure Committee
- What should we be disclosing under the TCFD?

Scientific Committee
- How can we do that today?
- How can we do that in the future?
- What’s the R&D Roadmap?

Applications Committee
- Fully specify three scenarios for modelling
CMSI – Who?

**Steering Group**
- QBE, Suncorp, Munich Re, Westpac +
- Climate-KIC, IGCC

**Financial Disclosure Committee**
- CFOs and Sustainability Reporters
- Big 4 accounting firms
- Actuaries Institute, CAANZ
- IGCC Members
- ESG analysts

**Scientific Committee**
- CSIRO, BoM, UNSW (balance of votes)
- Hazard scientists
- Catastrophe modellers

**Applications Committee**
- Model vendors
- Consultants

**Observers**
- APRA, ASIC, RBA
- Rating Agencies

Australian Sustainable Finance Initiative
Questions