Growing ESG requirements

Guidance for (Re)insurers on Climate Change Risk and the Corporate Sustainability Reporting Directive

Introduction

As the demand for sustainable financing and investments grows, regulatory requirements on financial service providers are rapidly evolving. The complexity of the regulatory sustainability framework requires financial undertakings, including (re)insurers, to apply a holistic approach to streamline processes and ensure compliance.

Two significant pieces that require the attention of (re)insurers in Ireland are the Corporate Sustainability Reporting Directive (CSRD) and the Guidance for (Re)insurance Undertaking on Climate Change Risk (Guidance) introduced by the Central Bank of Ireland (CBI). While the CSRD applies in a phased approach and covers sustainability matters across environment, social and governance topics, the Guidance is an immediate ask focusing only on climate risks. The Guidance is a key priority and central requirement of the CBI while we await further updates of the Solvency II Directive with a specific scope on climate change.

Nevertheless, a number of key themes, requirements and tests in Guidance fit into the framework of the CSRD - creating a great opportunity for (re)insurers to look at these processes simultaneously and, as the saying goes, 'kill two birds with one stone.'

Understanding their individual requirements as well as the key interlinkages between them is a first step to build a robust framework that will stand up to internal audit and regulatory scrutiny.

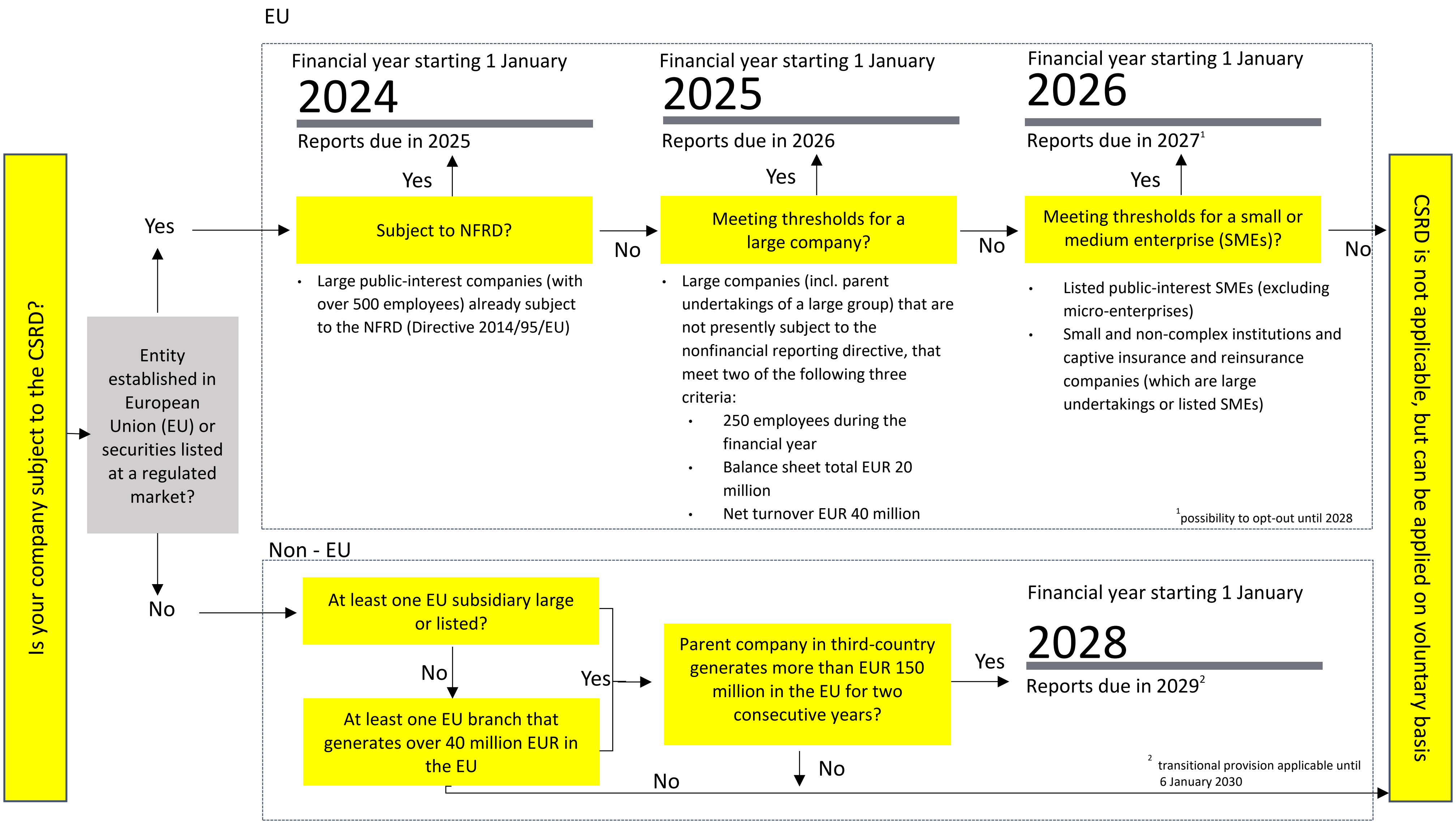
The Corporate Sustainability Reporting Directive (CSRD) is a game changer

As part of a wider European sustainable finance package, the CSRD aims to increase transparency and channel private investments towards a climate-neutral and inclusive economy.

The CSRD amends the existing Non-Financial Reporting Directive (NFRD), with many insurance companies coming into scope in 2025 (reporting 2026) as part of the 50,000 companies expected to be brought under the directive as illustrated below.

The key aspects introduced by the CSRD are:

Extended scope of the existing NFRD and a phased implementation timeline



A new equal playing field by introducing mandatory reporting standards

- All material information regarding impacts, risks and opportunities in relation to ESG matters will have to be disclosed in line with mandatory European Sustainability Reporting Standards (ESRS).
- In scope (re)insurers will be subject to sector-agnostic disclosure requirements (draft ESRS have already been published) and potentially upcoming sector-specific requirements. Information will have to be disclosed across four reporting areas: governance; strategy and business model; impact, risk and opportunity management; metrics and targets.
- The ESRS build on international reporting standards and incorporate requirements stemming from EU legislation, including for example the Sustainable Finance Disclosure Regulation (SFDR) and Taxonomy Regulation. Understanding the interlinkages creates an opportunity to leverage existing information.

A double-materiality lens across the value chain and different time horizons

- All material matters will have to be assessed from an inside-out and outside-in perspective - a concept known as double-materiality. In scope (re)insurers will have to disclose material information on the impact that their activities have on sustainability matters (impact materiality), as well as on the risks and opportunities that sustainability matters pose on their value creation process (financial materiality). The materiality process will have to be well documented.
- Material information will have to cover the (re)insurer's value chain, including its own operations, and direct and indirect business relationships. A transitional three-year period applies.
- In scope (re)insurers will have to disclose retrospective and forward-looking information across short-, medium- and long-term time horizons

Increased transparency through limited assurance and improved internal controls

- Reported sustainability information will be subject to independent, third-party limited assurance.
- In scope (re)insurers will have to include a specific section in their annual management reports on sustainability information. Reports will be submitted in the European Single Electronic Format.
- Audit committees will have additional roles and responsibilities. They will have to inform supervisory bodies of the audited entity on the outcome of the corporate sustainability reporting and its contribution to the integrity of financial reporting.

Meeting the expectations of the CBI through the Guidance on Climate Change Risk

The CBI acknowledges that there is a willingness of (re)insurers to appropriately consider and address climate change risk but also a great uncertainty over how.

The Guidance seeks to clarify the expectations of the CBI in implementing the Solvency II Directive and support (re)insurers in developing their governance and risk management frameworks. It does not introduce new requirements on (re)insurers on climate change risks.

The key aspects introduced by the Guidance are:

Evolved nature of climate risks and the importance of effective governance frameworks

- Climate change risks will have to be managed similarly to other key risks within the risk management framework of (re)insurers. They are expected to adapt and improve the scope, depth and sophistication of methods to integrate and manage climate risks over time.
- The guidance acknowledges the ultimate responsibility of boards, committees and senior management to appropriately consider risks that climate changes poses to (re)insurers, including long-term risks and opportunities.
- (Re)insurers are expected to have appropriate governance frameworks in place to manage climate change risks effectively, with clearly identified and documented roles and responsibilities.

A double-materiality lens across time horizons

- (Re)insurers will have to consider both the 'outside-in' and 'inside-out' perspective when it comes to climate change risks and impact, an approach similar to the CSRD. Risks will have to be assessed over the short, medium and long term.
- Through scenario analysis, (re)insurers will have to take a forward-looking perspective of how they will identify, manage, mitigate and respond to material climate change risks. Such perspective will have to be integrated into their business model and strategy

Scenario analysis of financial impacts to then be reflected into strategy, business model and decision-making processes

- Financial impacts will have to be quantified through stress and scenario analysis, the input of which will feed into the Own Risks and Solvency Assessment (ORSA).
- Based on the outcome of scenario analysis, (re)insurers are expected to adapt their strategy and business model. They must align their Risk Appetite Statement (RAS) to the overall strategy and establish quantitative and qualitative metrics in relation to climate change risks.

Appropriate adaptation of group policies and day-to-day operations

- (Re)insurers are expected to identify, measure, monitor, manage and report on climate change risks through their existing risk management framework.

- Those who leverage group policies and activities are expected to ensure that this input is appropriately adapted for the local entity. This also includes appropriateness of a group ‘Own Risks and Solvency Assessment’.
- Appropriately consider climate change risks in day-to-day operations, including measurement of technical provisions and capital, underwriting and pricing activities.

The interaction between the CSRD and the CBI’s Guidance

While the Guidance is an immediate ask, the CSRD will apply depending on the size of the (re)insurer. Regardless of the latter, many of our clients are using this as an opportunity to address the expectations of the CBI, while assessing their CSRD readiness.

- Both consider climate change a key risk. While the Guidance requires (re)insurers to integrate climate change in their risk management framework, the CSRD requires them to disclose on it irrespective of the materiality outcome.
- Both apply a double-materiality lens, requiring in scope (re)insurers to assess and disclose information across short-, medium- and long-term horizons, with a forward-looking perspective.
- Both place the focus on business models and strategy, and their interaction with climate change.
- Both acknowledge the key role of audit committees and boards by putting additional responsibilities to ensure effective processes and controls.
- Both require internal documented processes that will have to stand to regulatory scrutiny of CBI and limited assurance under the CSRD.

How can we help you?

At EY, we are working with our insurance clients to meet these new requirements, advising them to adopt a unified approach in preparation for these complex exercises.

This includes mapping, gap identification and framework design to strengthen the disclosure architecture, whilst being flexible to incorporate future requirements. All of which is built to meet the regulatory expectations and new assurance standards.

If you would like more information on how EY's team of experts can help, please get in touch.

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