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New risk on the block

By Pamela Hellig

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The wheels of the insurance industry turn slowly – but turn they do. And while it may take another few years to see how finely they grind the issue of climate change, South African life insurers are starting to engage with this new(ish) risk on the block.

Source: Supplied. Pamela Hellig, the consulting actuary at Insight Life Solutions.

The progress in climate risk management we have seen to date, which is likely to accelerate in 2024, is driven by several forces, not least of which is impending regulation.

Climate change has been described as a “wicked problem” because it avoids straightforward articulation and is impossible to solve in a way that is simple or final. What makes it especially wicked for life (as opposed to short-term) insurers, is that it compounds the risk already inherent in their uncertain, long-term and complex businesses.

It affects everything from the assets in which they invest policyholder funds to the valuation of liabilities in a rapidly changing environment. And that’s just one half of the double materiality whammy – insurers will need to report both on how their business is affected by sustainability issues (“outside in”) and how their activities impact society and the environment (“inside out”).

Hurdles and delays

The decision-makers at life insurers are also not immune to the biases, cognitive dissonance and mental blocks that affect all of us when thinking about climate change: it’s unknown, overwhelming, and difficult to know where to start.

To date, South African life insurers have lagged their counterparts in more developed markets on the climate-reporting front. There are many reasons for this, including their capacity being absorbed by other industry phenomena like Covid and IFRS 17, a lack of local guidance and, perhaps, the analysis paralysis caused by the tornado-sized funnel of doubt created by climate-related risks.

Where there has been discussion, it has been focused on short-term insurance, where the impacts of acute extreme weather events are more obviously seen and felt – think of the property damage caused by recent floods, wildfires, and spring tides.

For life insurers, the risk has been perceived as less immediate, less obvious and less urgent. It has been argued that any impacts on mortality or health will be immaterial and will only crystallise decades in the future; a problem for the next generation of actuaries to worry about.

Regulatory push for change

The proverbial tide is starting to turn and it is being driven by local legislative and regulatory developments. The Climate Change Bill, the first piece of legislation in South Africa specifically aimed at mitigating and addressing the effects of climate change, was passed by the National Assembly in October 2023.

Since the second half of 2022, the South African Reserve Bank's Prudential Authority (PA), the regulator for insurers in South Africa, has been sending consistent signals that it takes this risk very seriously by publishing the following communications:

- **Prudential Communication 10 of 2022:** Climate-related risks, which provided initial views of the PA on climate-related risks and their potential impact on financial institutions.

- **Prudential Communication 1 of 2023:** Flavour-of-the-year topic communication to insurers, which conveyed the message that climate-related risks are of such significance that additional focus from a supervisory perspective is required.

- **Proposed Guidance Notices:** Proposed guidance on climate-related disclosures for insurers and proposed guidance on climate-related risk practices for insurers. The proposed guidance will likely evolve into final guidance and then a best-practice report in 2024.

In 2023, the Financial Sector Conduct Authority (FSCA), which is the market conduct regulator of financial institutions in South Africa, published its *Statement on Sustainable Finance and Programme of Work*, which sets out how its aims to build a sustainable finance sector supported by five pillars (taxonomy; disclosure, reporting and assurance; market development; active ownership and consumer education).

Given the increasing urgency and myriad emerging developments related to climate change, the FSCA has stated that work may initially emphasise climate matters.

The three certainties in the world of a life insurer are death, taxes, and regulation. Given the growing regulatory momentum, insurers, whether they believe that climate change will have a material impact on their business, that climate change is caused by human activity, or even that climate change is real, will need to start thinking about how they measure and disclose climate-related risk over the next year.

Starting the climate-risk management journey

Despite the lack of formal regulation at this stage, there is plenty of guidance on where to start. As far as disclosure requirements go, the PA has said that looking at the recommendations of the Taskforce for Climate-related Financial Disclosures (TCFD) and the International Sustainability Standards Board (ISSB) is a good place to start. There are many publicly available examples of insurers abroad already having implemented these recommendations that can serve as a guide.

In terms of risk management, insurers can apply the same frameworks and controls to climate-related risks that they would apply to any other risk: identify, assess, manage, monitor, and report.

For some insurers, the expected impacts may, indeed, turn out to be immaterial, but they will only know that after systematic analysis. The initial scenarios and models may be simplistic to start with, but there will be ample opportunity to refine strategies over time.

The urgency to act

The keyword is “start”. The PA has advised that the management and reporting of climate risk is a journey and each insurer’s response will be unique and reflective of its nature, scale, and complexity.

2024 will be a year in which insurers can no longer put off their climate-risk management; not only because of regulatory developments, but also because the risks of ignoring it are just too big to ignore.

Fortunately, this wicked problem is one that can be solved one bite at a time. And while insurers may be intimidated by the size of the beast, they should be advised that they can start small, start simple, as long as they just start somewhere.

ABOUT PAMELA HELLIG

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