Keynote Speech at the DIFC Insurance Association Webinar

"Insuring" a Sustainable Future is Not Science Fiction

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Introduction

Good afternoon and thank you to the DIFC Insurance Association for inviting me today.[1] I applaud the Association's support for the insurance sector in the Dubai International Financial Centre (DIFC). The Association offers a steady stream of engaging and topical discussion events, training and upskilling opportunities, and constructive dialogue amongst stakeholders.

Were any of you lucky enough to score free tickets to Coldplay's performance at Dubai Expo on Tuesday? I was not, but I caught the performance online – what an electrifying show! It was an amazing initiative to support Expo's "Programme for People and Planet" in alignment with the United Nations' Sustainable Development Goals. How inspiring that a world-renowned band has launched a global tour based on sustainability. The lead singer Chris Martin and the band looked at everything from power usage and materials used to build the stage to the kind of food and beverages served. It was fantastic they decided to start their tour in Dubai – and free of charge! Chris Martin, if you and the band are listening, the Dubai Financial Services Authority invites you to a fireside chat on sustainability and finance.

Today I'll explain why I think "insuring" a sustainable future is not science fiction. But first, let's cover a brief update on the insurance market in the DIFC. I should note that any opinions or musical preferences are my own and may not reflect the official positions of the Dubai Financial Services Authority.

DFSA Market Update

We're beginning the third year of the global pandemic. This crisis has brought relentless challenges, hardships, and losses to so many. It's been a trial unlike any other. I was a supervisor in New York during the Global Financial Crisis in 2008, and in that event, the financial system was viewed as the source of the weaknesses that led to economic hardships around the world. In contrast, during the

[1] The speaker thanks Iman Essop for the research assistance and input she provided for these remarks.

pandemic, the financial system in many parts of the world has been a source of strength for economies. Financial services providers have helped many governments deliver assistance and relief payments to so many and continue to offer credit and insurance products to businesses and consumers.

Here in the DIFC, the financial services market continues to stand resilient and – contrary to expectations – grew substantially over the past two years. Providers have demonstrated ongoing agility in adapting to unceasing changes in the external environment.

The DFSA currently oversees 537 Authorised Firms, up from 509 this time last year. Only two insurance firms withdrew last year – both due to licence rationalisation following a global M&A deal. Eight new firms were authorised. Our insurance team now supervises 77 firms: 18 reinsurers, 26 reinsurance brokers, and 33 reinsurance managers and underwriting agents. The pipeline of new applicants is healthy. In fact, we've had a record number of new enquiries received in the last 12 months.

Based on the unaudited quarterly returns for the year 2021, DIFC firms underwrote an aggregate USD1.8bn in Gross Written Premiums (which is up from USD1.7bn in 2020) and brokered USD1.1bn in GWP (down from USD1.3bn in 2020). The decline in brokerage numbers reflects the booking of some treaty business elsewhere for some international firms.

Activity levels in the DIFC insurance sector are up, and the overall sentiment seems to be positive.

Sustainability

While COVID-19 has forced all of us to learn new ways to live and work, another threat has quickly become top of mind for policy makers, regulators, and the financial sector. Unchecked temperature increases from climate change will give way to a rise in the frequency and severity of natural catastrophes. The losses from these catastrophes may destabilise the financial sector, especially insurers that guarantee against losses on physical assets, property, and human lives.

Climate risk is non-linear with points of no return. This means its effects are likely to be significant and possibly irreversible. The extent of the adverse outcomes depends on what we do in the short term. The message that emerged from COP26 in Glasgow last year is clear: the time for action is now or never.

The good news is that many across the financial services industry have heard this call to action. Investors and the public have financed over USD35 trillion worldwide in sustainable and responsible investments inspired by the United Nations' Sustainable Development Goals or by environmental, social, and governance-related initiatives, also known as ESG initiatives.

Sustainable finance engages every business in the financial sector, and I'll focus today on insurance. So why do I believe that insuring a sustainable future is not science fiction? Let me explain. Among this year's Oscar's nominees is a film in which Jennifer Lawrence and Leonardo DiCaprio portray astronomers who spot a comet speeding towards earth that could result in an extinction-level collision. In most other science fiction movies, an unlikely alliance of scientists, engineers, soldiers, and astronauts would mount a long shot but brilliant plan to defend the planet. In this year's Oscar contender, most people initially ignore the increasingly frantic astronomers. "Don't Look Up" becomes a movement – and the title of this satire of science fiction disaster tropes.

My message for insurers active in the DIFC is the opposite: look up – but do more than look up. Help us to flatten the rising curve of average temperatures. Sustainable is attainable – but only if all of us take significant, deliberate, and lasting steps to rethink the impact of insurance sector on the environment. We can embrace opportunities to encourage new behaviours and promote activities that support a healthier and more resilient world. We must do so now. The United Nations tells us we have only ten years left to act. "I hear the sound of ticking clocks" – as Chris Martin intones in the song "A Whisper."

All of us can do three things to embed sustainability and wider "ESG" considerations into the insurance business.

First, **get your shop in order**: I'll share some thoughts on what firms can do internally around risk management, controls, and governance to put ESG principles at the heart of their businesses.

Second, **open a larger window into your shop**: we can do more to adopt consistent and reliable disclosures. Let's help external stakeholders understand how insurance providers are supporting sustainable activities.

Third, have a shop floor for everyone. I'll share some personal thoughts on how the insurance industry can help protect the world's most vulnerable communities against hardships and losses that climate change may cause.

First, Get Your Shop in Order

As society's "risk managers", insurance industry participants are uniquely qualified to build resilience amidst climate change. You have specialist skillsets to assess, quantify, price, manage and carry risks. Consequently, you are especially well prepared to address the first step, which is to get your shop in order.

Climate risk is a subset of sustainability risks, though I will use the two terms interchangeably. Climate risk encompasses **three risk categories** that dovetail with and should be considered alongside the conventional risks with which insurers and intermediaries traditionally engage. The three categories are **physical**, **transitional,** and **liability** risks.

The international standards-setting body, the International Association of Insurance Supervisors (IAIS), offers a useful definition of **physical risks** in its May 2021 "Application Paper on the Supervision of Climate-related Risks in the Insurance Sector." The IAIS defines physical risks as increased damage and losses arising from physical phenomena associated with climate-related trends and events. In identifying damage that arises from both "trends and events," the IAIS is saying that losses can stem from individual extreme weather events as well as from gradual and cumulative shifts in climate patterns.

Physical risks may not rank highly for organisations based in the UAE or the broader Middle East because the climate tends to be quite predictable in this region. Many international reinsurers choose to do business here because the risk of natural catastrophe is low. Still, we know that the local infrastructure has been built to cope with only predictable weather patterns. The slightest change in climate, for example, experiencing more than expected rainfall, can result in severe flooding in the region.

Transition risks arise from disruptions associated with moving to a low-carbon economy that negatively affect asset values or the cost of doing business. For example, introducing carbon pricing may result in credit downgrades and reduced valuations; technological advances could affect the pricing of existing products; and shifts in public sentiment and preferences will impact certain markets.

Liability risks arise from climate-related claims under liability policies as well as direct actions against insurers for failing to manage climate risk. An example here would be director and officer (D&O) insurance providers experiencing a spike in investors filing claims against a business or its Board alleging that it did not disclose the true extent of its exposure to climate risks and that this failure to disclose sufficient information resulted in misleading company valuations and forecasts. We'll talk more about that when we discuss disclosures.

So, to "get your shop in order", start by incorporating sustainability risks into your risk management framework. Begin with narrative-style scenarios that set out potential consequences for your business: all DIFC firms should be able to do this. We expect you to think about credit, operational, market and liquidity risks (and any other relevant risks) and to incorporate your thinking into your Board-approved risk appetite. I am reading a lot of Tolkien these days with my children and am struck by the relevance of a line from The Hobbit: "It does not do to leave a live dragon out of your calculations, if you live near him." So make sure you are taking into account all your risks.

The next step is to develop risk metrics that assist in decision-making and the monitoring of progress against strategy and risk appetites. As supervisors, we then expect to see, over time, the modelling of stresses and complex scenarios to allow for risk quantification.

Internationally, larger insurers are developing more sophisticated modelling methods as the quality and availability of data improves, but challenges remain. The Network of Central Banks and Supervisors for Greening the Financial System (NGFS) notes that central banks are incorporating climate risk as a stress test for banks and insurers. Although we have long incorporated physical risks into actuarial models, preliminary results suggest the modelling of transition risks remains a nascent discipline. I expect new methodologies are likely to emerge over time.

Getting your shop in order means thinking about your **internal controls** as well. Let’s use underwriting as an example given the importance of these disciplines. DIFC underwriters should consider climate risk impacts when pricing risks. We recognise the lack of historic data complicates the underwriting process. Nonetheless, as supervisors we expect to see at least a qualitative assessment. As tools and metrics develop, you will then be better positioned to monitor exposure concentrations in sectors or geographies with higher climate risks.

Qualitatively, underwriters can

- consider the track record and commitment of corporate clients to manage and mitigate the climate risks associated with the underwritten policies;
- undertake additional due diligence if external ratings indicate high exposure to climate risks; and
- follow a decision-making matrix for escalating policies exposed to high climate risks for senior underwriter approval.

I’ve put the spotlight on underwriting, but the work doesn’t stop there. **Board Members and Senior Managers** play a role, too. They should dedicate a reasonable amount of time and focus to address sustainability requirements when setting business strategy and monitoring risks. Clear roles and responsibilities should be assigned to the Board and its committees via terms of reference and to senior management via job descriptions. An explicit allocation of responsibility is more likely to result in accountability for mapping, monitoring, and controlling sustainability risks.

We want to see senior management articulate climate risk-related impacts on business models and financial planning. They should demonstrate an understanding of the opportunities and threats in the short, medium, and long term.

When it comes to communicating climate risks to the Board, the Financial Stability Institute (FSI) at the Bank for International Settlements noted impediments in its November 2019 report on climate risk in the insurance sector. The FSI identified the lack of Board expertise to listen and challenge and a lack of executive expertise to explain issues clearly. We therefore recommend DIFC firms assess whether training on climate risk would be beneficial. Board and senior management succession plans can also be used to help add climate risk skills and understanding to a firm's top leadership.

Once the Board and senior management are well versed on sustainability matters, DIFC firms should consider how **awareness and responsibilities can permeate the wider organisation**.

- **Compliance functions** should consider the liability and reputational risks stemming from climate change.
- **Internal audit** should review the adequacy of the risk management process and internal controls to determine whether all material risks, impacting an insurer's resilience, are being adequately mitigated and monitored.
- **Managers** should evaluate whether climate events may affect critical outsourcing providers and update the firm's business continuity plans accordingly.

The scope for embedding sustainability risk management is wide, and we support DIFC firms taking a proportionate approach. However, I do want to caution that smaller operations, such as those in the DIFC, may be more vulnerable to climate risks. Smaller insurers tend to have niche and specialist portfolios and so are less likely to benefit from the cushion of diversification. Consequently, it is even more important for firms with concentrated portfolios to identify, evaluate, and mitigate their exposure to adverse outcomes that could arise from climate change.

Second, Open a Larger Window into Your Shop

Now onto **disclosure,** the second step that insurers should take to build ESG into their business**.** How you address sustainability risk through your risk management, internal controls and governance is largely an internal matter that we at the DFSA are privy to as a regulator. On the other hand, sustainability disclosures are an opportunity for other important stakeholders to "look in through the shop window" – to assess your ESG performance and progress, and to make decisions themselves about whether to do business with you. If you believe that "the less said, the better" about your ESG work, remember others may interpret your paucity of disclosures unfavourably as a signal that you are not able to manage your sustainability risks.

The **Task Force on Climate-related Financial Disclosures (TCFD)** was established in 2015 by the Financial Stability Board (FBS) to identify information needed to assess and price climate-related risks prudently, and it published its recommendations in June 2017. Many jurisdictions have adopted these recommendations as a benchmark for relevant, consistent, and comparable disclosures. They are an obvious starting point for the convergence of a global climate disclosure framework. The recommendations cover the core elements of governance, strategy, risk management, and metrics and targets. They are voluntary and applicable to all financial sector organisations.

We support the TCFD's recommendations. We believe their implementation will facilitate better assessments of firm-level climate risks and more complete analyses of financial stability risks. We believe transparency will motivate firms to collect data, identify, and monitor performance metrics and imbed sustainability and wider ESG considerations into operations. This should enhance competitiveness and build trust and cooperation with customers, investors, and communities.

We want to see more informative disclosures, more often.

Unfortunately, **the road ahead is long, and progress has been slow.** The Sustainable Insurance Forum (SIF) conducted a survey in 2019 of members in 15 jurisdictions, with data collected from 1,170 insurers. The Forum found that only 15-20% of insurers plan to deliver TCFD-aligned disclosures. That's alarming because almost three-quarters of those same insurers expect climate change to impact their business. Furthermore, the results indicate that the largest insurers are driving action in this area. Smaller players have yet to act. Most concerning is the Forum's finding that the insurance sector exhibits some of the smallest improvements in disclosure practices when compared to other financial and corporate sectors. We can do better.

The Forum found that survey participants had a low awareness of the TCFD recommendations or viewed them as not applicable. Some believed their existing disclosures were sufficient. Others noted capacity and resource limitations.

If these findings mirror the situation for DIFC insurance firms, then the DFSA would be concerned. We want insurers to demonstrate to the market that they are resilient in the face of external challenges because doing so increases confidence in the stability of the DIFC as a hub for global finance. Greater confidence in the DIFC's approach to sustainable finance will lead to continued growth in the ecosystem here, creating more opportunities for consumers and businesses to ultimately benefit from the growth in sustainable finance and innovation.

The **results from this particular survey seem to be systemic.** We've all heard pledges from various companies to achieve "net-zero" emissions. Yet earlier this month the New Climate Institute, a German think tank, shared a study that found that corporate net zero targets aim to reduce net emissions by only 40% at most, not 100% as suggested by the term "net-zero". The report also found that 2030 targets fall well short of the ambition required to align with the Paris Agreement goals and avoid the most damaging effects of climate change. Furthermore, companies' uptake of readily available emission reduction measures showed little sense of urgency.

In that vein, **market participants are savvy and weary of “greenwashing”**, that is, giving a false impression that products, services, and operations are more environmentally friendly than they actually are. The DFSA is sensitive to the risks of greenwashing and mischaracterisation of financial products purporting to deliver ESG benefits because we believe sustainable is attainable – but only when you really try.

I encourage DIFC firms to refer to the publicly available TCFD guidance. Please assess how you can implement the recommendations. If you’re just getting started, share a narrative about potential effects that climate change can have on your business and what you’re doing to mitigate adverse outcomes. Another starting point for insurers is to provide geographic data on physical assets insured and concentrations of risk in vulnerable locations; knowing where those assets are will help others to understand the climate-related risks to your portfolio.

While I would much prefer for the market to solve the disclosure challenges by itself, the evidence suggests that progress is sparce and uneven. Time is a luxury we no longer afford. So it’s not surprising that we are hearing an **increasingly louder debate around the role of supervisors** to bring about the necessary transformations for more transparent and high-quality sustainability disclosures.

At the Abu Dhabi Sustainable Finance Forum in January, I spoke about the objectives of developing a green taxonomy to create a clear definition of sustainable activities and a common benchmark to drive informed decision-making. Having a taxonomy reduces the risk of greenwashing and will help to achieve the UAE’s international climate commitments and contribute to the UN’s Sustainable Development Goals. In this regard, the DFSA launched last year an industry-supported Task Force on Sustainable Finance to help us think through what it looks like to get your shop in order (risk management) and how to open a larger window for outsiders to look in through better and more consistent disclosures. We are all in this together. A partnership between policymakers, industry, and regulators is critical to achieve results in the few years remaining in which we must curb the increase in average temperatures.

Third, Have a Shop Floor for Everyone

I’ve addressed the environmental aspects of ESG, the “E”, but it would be remiss of me not to mention the **social and governance aspects, too – the “S” and the “G”**. Insurance sector participants need to solve environmental considerations alongside the social implications of risk mitigating actions.

This leads to the third step for insurers that I will conclude with, which is to ensure that you have a shop floor for everyone. As insurers you have at your disposal the ability to increase premiums, lower policy limits, or exclude cover. You could also stop offering insurance to a certain group of policy holders. However, the transition to a sustainable future necessitates considering the implications that changes in insurers' risk tolerance could have for access to insurance – and what leaving vulnerable communities out of scope could mean for society.

Between my service as a regulator at the Federal Reserve in New York and here at the DFSA, I spent four years at the Bill & Melinda Gates Foundation where I was the senior advisor on supervisory and regulatory policy. The initiative I joined sought to help unbanked or underbanked people and those living in impoverished and rural areas to lift themselves out of extreme poverty by gaining access to formal financial services. In that capacity, I supported regulators and central bankers in low- and middle-income countries to consider policy and technology innovations that could expand access to formal financial services.

Bill has cited research by the Climate Impact Lab that extreme heat can increase mortality rates for the youngest and oldest members of society and especially those with significant health challenges. The Lab found that higher income countries were better able to reduce increases in mortality through investments in climate adaptation, such as cooling systems. Bill warns that low-income countries and especially those located close to the equator – where temperatures are likely to be only hotter – could face significantly higher mortality rates.

How can reinsurers help? I'll share a personal opinion. The International Fund for Agricultural Development – a specialised agency of the United Nations – notes almost half of the world's people – 3.4 billion people – live in rural areas within low- and middle-income countries. Most of them rely on small farms for their own nutrition and income. If extreme weather and climate change reduces the arability of their land, they will face even more significant challenges in meeting their basic needs.

While reinsurers don't provide agricultural insurance products directly to consumers and farmers, they can reinsure those that do. Reinsurers can help build resilience for rural communities that face the risk of losses of income from agriculture and potentially even higher mortality rates.

Opportunities also exist for insurers to offer value-added supplemental services, such as specialty climate-related risk advisory services. You can increase awareness towards sustainable finance by helping customers transition to greener attitudes. Insurers can look for ways to incentivise policyholders to adopt and transition to green practises by offering lower premiums and allowing for upgrades to more energy-efficient technologies and practices.

Sustainable is Attainable

Achieving sustainable development could become the defining accomplishment of our generation. While climate change may lack the image of immediate destruction that a comet striking the earth poses, the longer-term effects of climate change present significant risks to the global economy, our health, our quality of life, and even our mortality.

Sustainable is attainable, but for it be so, we must set measurable and achievable goals. We must confront conventional thinking so that we manage ESG risks and opportunities as a strategic imperative and not a token public relations exercise. Coordinated efforts, experimentation and innovation are essential. I am an optimist. I expect the momentum of the last two years will help get the insurance industry on the right track so that a sustainable future is a reality and not science fiction.

Let’s end where we started, with Coldplay. I challenge all of us to ask ourselves the same question Chris Martin poses in the song “Clocks”: “Am I part of the cure? Or am I part of the disease?” To be part of the cure, I look forward to working closely with the DIFC Insurance Association so that the DFSA, alongside the DIFC’s insurance sector, can work together to build a more sustainable economy and financial system and a more resilient world. Thank you for your attention.

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[2] Dubai Financial Services Authority, the Central Bank, the Insurance Authority, the Securities and Commodities Authority, the Financial Services Regulatory Authority of the Abu Dhabi Global Market, the Ministry of Climate Change and Environment, the Dubai Islamic Economy Development Centre, the Dubai Financial Market, Nasdaq Dubai, and the Abu Dhabi Securities Exchange.