MILLIMAN PAPER

Current trends in climate-related disclosures

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Introduction

The requirement or expectation for (re)insurers to produce publicly available climate-related disclosures is something that has received increasing focus both in the UK and globally over recent years. This has been driven largely by the work of the Task Force on Climate-related Financial Disclosures (TCFD), which was established by the Financial Stability Board (FSB) in 2015.

As TCFD requirements are introduced within the UK, insurers can aid their development of climate-related disclosures by leveraging work to meet other climate-related regulatory requirements—most notably, in the UK, Supervisory Statement 3/19 on Enhancing banks' and insurers' approaches to managing the financial risks from climate change published by the Prudential Regulation Authority (PRA) in 2019, referred to as SS 3/19.

In light of the emerging TCFD requirements in the UK and the ongoing focus on climate-related risk within the insurance industry, Milliman has conducted research into the status of TCFD reporting across the UK insurance industry, covering both life and non-life insurance providers.

This paper covers:

- A brief overview of the TCFD framework
- Regulatory expectations relating to the TCFD framework within the UK
- The results of our research, including discussion of identified areas of good practice and common challenges

What is the TCFD framework?

The TCFD was established with the aim of developing recommendations for disclosing clear, comparable and consistent information about the risks and opportunities presented by climate change. The final report on recommendations was published in June 2017, which contained 11 recommended disclosures under four overarching headings:

- Governance
- Strategy
- Risk Management
- Metrics and Targets

These recommendations are intended to apply globally to all types of organisations across both financial and nonfinancial sectors. The overall aim is that the widespread adoption of these recommendations would ensure that the effects of climate change become routinely considered in business and investment decisions. They would enable companies to demonstrate their consideration of climate issues, and should lead to an allocation of capital that will support a transition to a sustainable, low-carbon economy.

Since the recommendations were released, the task force has released various additional publications, including technical supplements, implementation guidance and annual status reports.

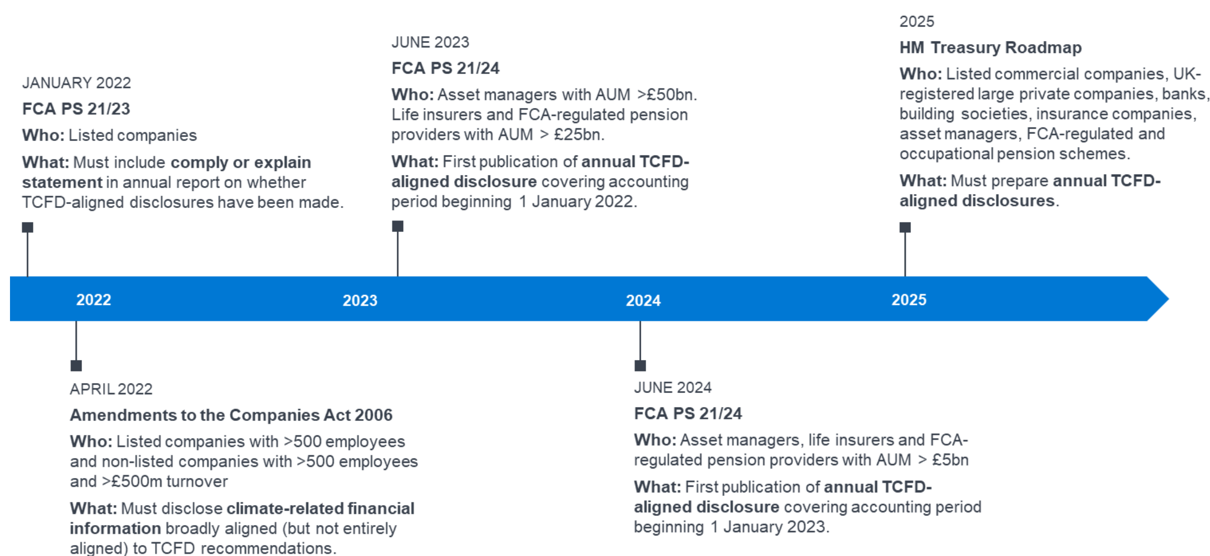
Regulatory expectations

Globally the TCFD is a voluntary framework, but under the HM Treasury Road map towards climate-related disclosures the UK was one of the first countries to adopt climate-related disclosures within local regulations. Under the road map, climate-related disclosures are due to become mandatory across the majority of the UK economy by 2025.

Building on this, the UK government introduced regulations requiring climate-related financial disclosures within the Companies Act 2006 for listed companies with over 500 employees and non-listed companies with over 500 employees and over £500 million turnover. The Financial Conduct Authority (FCA) also introduced TCFD requirements under Policy Statement 21/23: Enhancing climate-related disclosures by standard listed companies (PS 21/23) and Policy Statement 21/24: Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers (PS 21/24).

Overall, the result is that the vast majority of the insurance industry is going to become subject to some degree of TCFD requirements by 2025. However, the specific requirements that different companies will be subject to is quite a complicated picture. Figure 1 sets out the key climate disclosure milestones that apply for insurance companies in the UK.

FIGURE 1: TCFD MILESTONES FOR INSURANCE COMPANIES



For asset managers, life insurers writing insurance-based investment products and defined contribution (DC) pensions, and FCA-regulated pension providers, the FCA requires firms with assets under management (AUM) in excess of £5 billion to produce annual disclosures, with the timeframe for publishing the first disclosure depending on the size of the firm. For firms below the £5 billion threshold, TCFD-aligned disclosures will not be mandatory but there remains a supervisory expectation that disclosures will be produced. The FCA may also make further refinements to its requirements from 2024 onwards in response to evolving best practice.

For many other insurers not captured by PS 21/24, there is likely to be some expectation to produce climate disclosures either under PS 21/23 or the amendments to the Companies Act 2006.

Milliman’s research

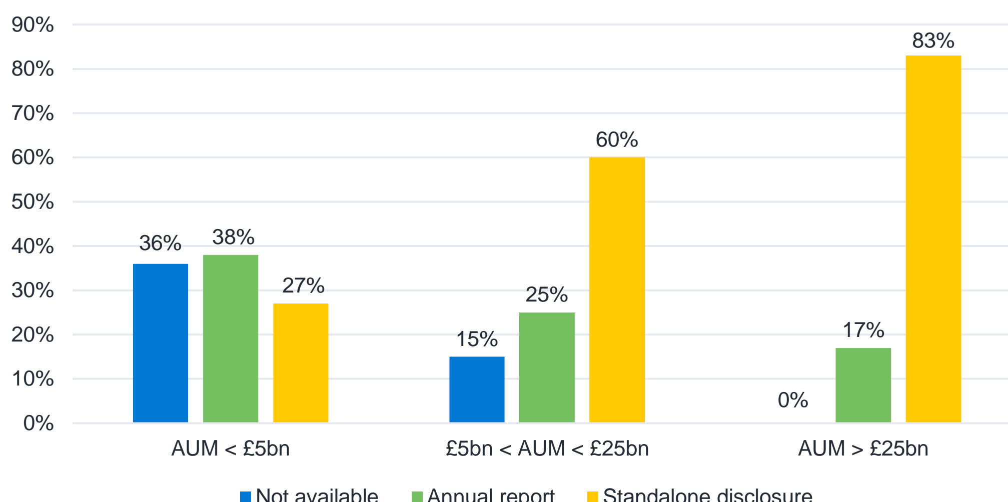
With these new climate-related disclosure requirements either already in force, or on the horizon, Milliman has conducted research into the status of TCFD reporting across the UK insurance industry. This research included an initial high-level assessment of 164 life and non-life insurers in the UK in order to establish general trends. We then performed a more in-depth assessment of selected climate-related disclosures in order to identify examples of good practice and areas where gaps and challenges are currently common.

INITIAL OBSERVATIONS

For each of the companies within our initial assessment, we first determined whether any climate-related disclosure, regardless of the level of detail or maturity, was publicly available on its website either within the annual report or in a standalone document.

Figure 2 shows the split of life and composite insurers that had made no public climate-related disclosures, those that had included some form of climate-related disclosure within their annual report and those that had produced a standalone climate-related disclosure.

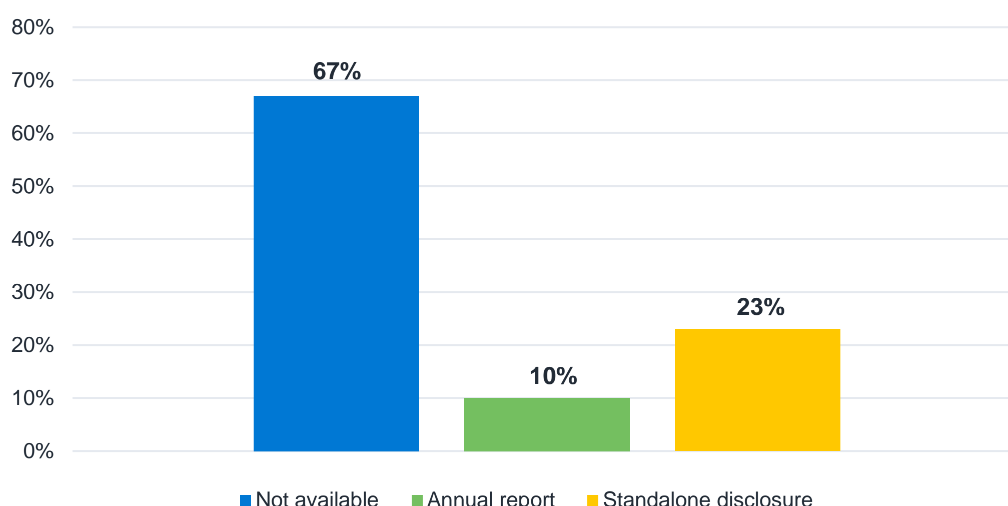
FIGURE 2: TCFD REPORTING ACROSS LIFE AND COMPOSITE INSURERS



Amongst life and composite insurers there is a clear trend depending on the size of the firm, which is unsurprising given that the introduction of the requirements under PS 21/24 are size-dependent. For the largest firms with AUM above £25 billion, all firms produced some form of climate-related disclosure, with over 80% producing a standalone report. The majority of medium-sized firms are also producing standalone climate-related disclosures. However, over a third of small firms are producing no climate-related disclosures at all. It is encouraging to see that there are firms across all size categories that are already publishing climate-related disclosures ahead of the required timeframes under PS 21/24, indicating a willingness for insurers to engage with these upcoming requirements.

Figure 3 shows the split of current climate-related disclosures across non-life insurers.

FIGURE 3: TCFD REPORTING ACROSS NON-LIFE INSURERS



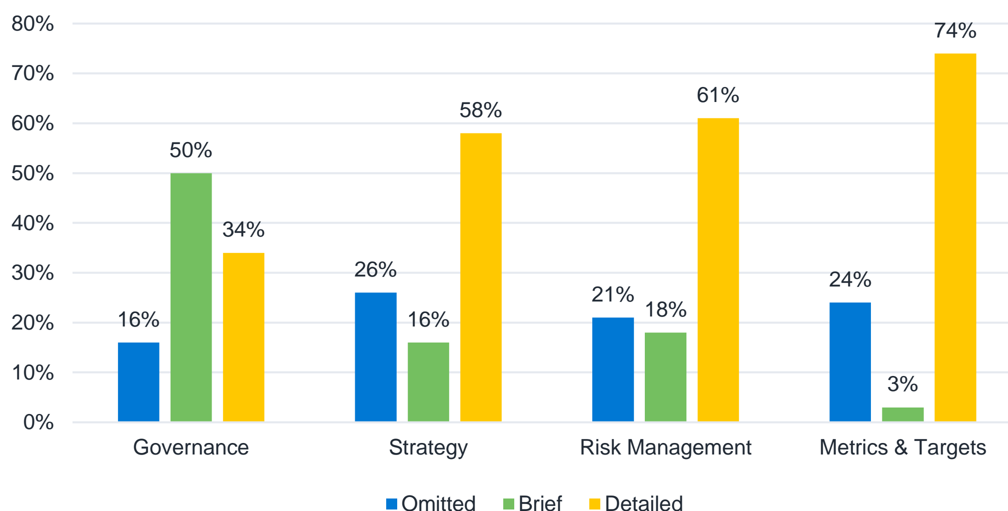
Amongst non-life insurers there are fewer firms currently producing climate-related disclosures, and the majority of firms are currently not producing any form of climate-related disclosure. This is perhaps unsurprising, given that most of the FCA's requirements coming into force in the next two years on this topic apply to the life insurance sector.

For both life and non-life insurers producing standalone climate-related disclosures, many do not yet appear to be in a routine of producing them on an annual basis, which may be due to limited resources available to produce a standalone public disclosure, and the fact that the data used to assess climate-related factors is not updated on a sufficiently regular basis. In addition, where standalone climate-related disclosures are produced, the framing of the TCFD requirements varies; whilst some insurers are producing reports explicitly referred to as their TCFD disclosures, others are including TCFD requirements in other related reports, such as Corporate Social Responsibility reports, Sustainability reports or Environmental, Social and Governance (ESG) reports. We also noted that a relatively small minority of insurers report only on the broader topic of ESG and not specifically on climate-related risks. However, the distinction between ESG and financial risks from climate change is an important one to make, given that the regulatory focus in the UK and the focus of the TCFD recommendations are specifically on climate-related risk. As a result, firms that publicly disclose only on their ESG activities are unlikely to be satisfying the TCFD recommendations or the expectations of the regulators in the UK.

COMMON THEMES ACROSS ALL PILLARS

As part of our initial assessment, we also reviewed the level of detail that firms with AUM above £5 billion include within their disclosures under the four TCFD pillars, taking into account each of the recommendations under each pillar. Figure 4 provides an overview of the level of detail observed for each of the four TCFD pillars.

FIGURE 4: LEVEL OF DETAIL BY PILLAR



We observed that the Metrics and Targets pillar is often disclosed in the greatest level of detail. This is perhaps unsurprising given that it is arguably the most prescriptive of the pillars. It is therefore potentially more straightforward to meet compared to the other pillars, which are more qualitative and therefore lend themselves to a spectrum of different approaches. The recommendations under the Strategy pillar are those most frequently omitted entirely from disclosures, which is also an area that we often see receiving less focus when it comes to embedding SS 3/19.

Overall, we found that the well-structured climate disclosures provided detailed descriptions of their approaches under each recommendation rather than making only high-level statements. Some companies provided additional information on the methodologies that they used in their scenario analyses and the results of these analyses, despite this not being an explicit requirement.

On the other hand, there were some common gaps and challenges identified across all four pillars. Many climate disclosures:

- Failed to address all components of each TCFD pillar, particularly the recommendation under the Strategy pillar relating to the resilience of the organisation's strategy.
- Failed to provide reasoning for omitting certain recommendations, for example due to materiality or relevance.
- Provided only vague details when describing the approaches taken to manage climate-related risks and how these approaches align with the company's overall risk management strategy.
- Faced challenges around the robustness, granularity and consistency of available data, which restricted the depth of analysis that could be performed.
- Focussed on the risks relating to climate change without also considering climate-related opportunities, despite this being explicitly drawn out under the TCFD recommendations.

GOVERNANCE

Under the Governance pillar, it is recommended that firms disclose their governance around climate-related risks and opportunities. This entails the recommended disclosures shown in Figure 5.

FIGURE 5: RECOMMENDED DISCLOSURES, GOVERNANCE PILLAR

A.	B.
Describe the board's oversight of climate-related risks and opportunities.	Describe management's role in assessing and managing climate-related risks and opportunities.

The good practice examples that we identified provided a clear view of the company's progress against targets in embedding climate-related risks into oversight the board of directors. Other well-structured climate disclosures described the process for informing the board and its committees on climate-related risks and opportunities. Some companies also provided charts showing how information flows between senior management, climate working groups, board committees and the board, or highlighted the link between the firm's governance framework and the board's climate-related roles and responsibilities. Good examples of climate disclosures also included:

- Detail on the roles and responsibilities of the board in managing climate-related risks and opportunities
- Information on climate-related agenda items that were considered by the board and any specific reviews undertaken so far
- Descriptions of how climate-related risks were considered when setting the firm's performance objectives

Looking at the common gaps under the Governance pillar, we observed that some disclosures provided less detail on the frequency of climate-related reporting to the board, whilst others failed to provide information on how senior management assesses and manages climate-related risks and opportunities. As a result, for such companies the extent to which senior management and the board take an active role in considering, managing and overseeing climate-related risks and opportunities is unclear.

STRATEGY

Under the Strategy pillar, firms are recommended to disclose the actual and potential impacts of climate-related risks and opportunities on their business, strategies, along with financial planning where such information is material. This entails the recommended disclosures shown in Figure 6.

FIGURE 6: RECOMMENDED DISCLOSURES, STRATEGY PILLAR

A.	B.	C.
Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term.	Describe the impact of climate-related risks and opportunities on the organisation's business, strategy and financial planning.	Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.

In our assessment some of the better examples under this pillar used infographics to highlight the risks and opportunities that the company has identified in its various locations of operation. Some reports also highlighted plans to quantify climate-related risks and opportunities to demonstrate their contributions to profitability and the overall company performance. Other good examples included:

- The impact of climate-related risks on assets, liabilities and business operations to assess the resilience of the company's strategy
- Clear information on the assumptions and data used in the scenario analysis and a description of plans to improve the quality of the data used in performing the scenario analysis
- A defined duration that is considered when describing climate-related risks in the short, medium and long term
- Specific actions to mitigate the financial impact of climate-related risks and monitor the firm's progress to date

On the other hand, some climate disclosures did not describe how climate-related risks and opportunities were considered when defining the company's strategic and financial planning. Many firms provided only limited information about when climate-related risks and opportunities were expected to materialise, and there was often a lack of clarity about how management uses climate-related information in its financial planning. Furthermore, some firms did not provide a description of the actual and potential sources of physical risks and transition risks identified across the defined time periods, or any actions being taken to mitigate the potential financial impact.

In order to address common gaps, there is a need for scaled-up investment and research to improve the quality of data that is used to assess climate-related risks and opportunities. Firms should look to expand their existing climate-related risk assessment frameworks by developing additional approaches to monitor and quantify changes in risk factors that could alter climate-related risks, e.g., population growth and competition for scarce resources. Following the expansion of the firm's risk assessment framework, firms should embed any new findings in their goals and plans for managing climate-related risks. Firms should also aim to develop climate-related resilience metrics and indicators that can be disclosed in their reports. For instance, insurers that have large investments in the property market could develop and highlight their resilience metrics relating to their property investments after considering the percentage of real estate holdings in flood zones, although they would also need to consider the extent to which their holdings could become exposed to flooding over different periods of time and under different climate scenarios.

RISK MANAGEMENT

Under the Risk Management pillar, it is recommended that firms disclose how they identify, assess and manage climate-related risks. This entails the recommended disclosures shown in Figure 7.

FIGURE 7: RECOMMENDED DISCLOSURES, RISK MANAGEMENT PILLAR

A.	B.	C.
Describe the organisation's processes for identifying and assessing climate-related risks.	Describe the organisation's processes for managing climate-related risks.	Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organsation's overall risk managent.

Overall, the Risk Management pillar was one of the more detailed areas of disclosure, and we observed a number of good examples where details on the approach to climate-related risk management were provided.

Most disclosures provided some level of detail on how climate-related risks are identified. However, only a few insurers set out a granular approach to identifying the climate-related risks to the company's liabilities, assets and wider business operating environment. Examples of some of the approaches disclosed include:

- **Liabilities:** Considering the risk characteristics for each of the company's key product lines. For life insurers, examples included the likelihood of different climate pathways leading to long-term mortality improvements or deteriorations for annuity business, and the risk of increased flooding and higher energy efficiency requirements impacting property prices for lifetime mortgages. For non-life insurers, examples included consideration of how increased frequency and severity of weather-related events will lead to increased property damage, and how changing customer behaviour, technology or government policies could impact claims experience. Some insurers also considered the knock-on impact that different climate pathways could have on reinsurance counterparties for any reinsured liabilities.
- **Assets:** Considering how climate-related risk could impact the probability of default on corporate bond holdings, and how the transition to a low-carbon economy may put downwards pressure on the value of certain assets.
- **Operations:** Considering how customer and investor perception, and evolving regulation and legislation may impact the environment in which the business operates, including considering the risks associated with inaction.

Whilst, in general, we found that very few companies disclosed information on assessing the materiality of climate-related risks, we did see some good examples, including an assessment of materiality before and after any available mitigation strategies. One particular firm also went further to describe how it incorporated short, medium and long timescales and probability thresholds into the assessment.

Some firms also provided details on the specific actions they are taking to manage any risk exposures identified as material. For life firms, disclosures currently primarily focus on investments, particularly market risk. Some good examples we saw included details of how climate criteria are being added into investment management agreements, e.g., sector exposure thresholds or exclusion lists. For non-life firms, some good examples that we saw were related to credit risk, where climate criteria and sustainability considerations had been added to credit risk policies. Other good examples related to natural catastrophe risk, where exposure management groups were monitoring the risk landscape, climate-related perils and the latest scientific knowledge to advise on which models should be used for each peril and how they should be adapted to reflect the best view of the risk.

Whilst not an explicit recommendation of the TCFD, a number of firms disclosed their scenario analysis methodologies. Some firms also provided information on how scenarios were tailored to focus on specific risk types or asset classes, and disclosed a detailed breakdown of scenario analysis results. For example, we identified a case where an analysis was conducted to identify which climate pathways could lead to corporate bond downgrades.

The common gaps and themes centred around insufficient details provided for some of the disclosures. For example, some disclosures referred the reader back to the risk management section of the annual report that at most only vaguely covers climate-related risks, and there could be a general lack of information on how climate change is embedded into the key elements of the overall Risk Management framework. As highlighted above, very few firms disclosed any information on their assessments of the materiality of climate-related risks. One of the key benefits of conducting a materiality assessment is that firms can use it to provide a more measured and proportionate climate risk management approach. Simpler approaches could be used to assess risks that have a low materiality, provided it is clearly justified and reviewed periodically.

METRICS AND TARGETS

Under the Metrics and Targets pillar, firms are recommended to disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where this is material. This entails the recommended disclosures shown in Figure 8.

FIGURE 8: RECOMMENDED DISCLOSURES, METRICS AND TARGETS PILLAR

A.	B.	C.
Disclose the metrics used by the organsation to assess climate-related risks and opportunities in line with its strategy and risk management process.	Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.	Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.

Good practice disclosures under this pillar were geared towards providing the reader with confidence around how metrics and targets are calculated and used. As highlighted earlier, the Metrics and Targets pillar was typically the pillar disclosed with the greatest level of detail. Therefore, the disclosures that stood out were the ones that went beyond the prescribed requirements, allowing stakeholders to have a better understanding of the reliability of the information being shared. For example, some firms helpfully disclosed which assets were in scope of their metrics, the methodology used to calculate these metrics, how the company uses the metrics and any limitations in their calculation or use.

Some disclosures also went further by tailoring their targets depending on the business function, as opposed to relying on blanket targets that may be unsuitable for certain business needs or are harder to achieve. For example, setting warming potential-based targets for the investment function and imposing climate-related criteria on internal and outsourced operations.

In terms of the greenhouse gas (GHG) emissions disclosures, Scope 3[1] emissions present the biggest challenge as they are the indirect emissions arising throughout the value chain of the company. A good example we observed here included listing all subcategories of Scope 3 emissions and specifying for each category whether it is covered or omitted in the Scope 3 figure disclosed, with justification for those that are omitted, and confirmation of whether Scope 3 emissions are included within published metrics and targets. Some firms also cited the sources used to support their Scope 3 emissions categorisation and calculation methodologies, such as the Partnership for Carbon Accounting Financials or the Greenhouse Gas Protocol's Technical Guidance for Calculating Scope 3 Emissions.

A key challenge when performing the calculations for these metrics is data quality. There is no explicit recommendation around this, but some firms provided details on their assessments of data quality and methodology used when calculating GHG emissions. This is an area where the FCA recognises that there will inevitably be gaps and limitations in data, but expects firms to be transparent about these gaps and map out plans to improve their use of data over time.

[1] Scope 3 encompasses emissions that are not produced by the company itself, and not the result of activities from assets owned or controlled by them, but by those that it is indirectly responsible for, up and down its value chain.

Lastly, we observed that the more insightful disclosures provided an in-depth description of the interim milestones that need to be met to achieve certain targets, and the actions required to meet these milestones. These actions were specific down to the business function and timescales required and included forward-looking estimates of the relevant metrics at certain points in time if the milestones are to be achieved.

As was common under other pillars, typical gaps and challenges under the Metrics and Targets pillar centred around a lack of sufficient detail on the scope of the metrics used. For example, are all business functions or assets included within a given metric, or just a subset? There was also a lack of quantitative information on performance against targets, such as the base year that current and future assessments of targets are based on, and the timeframes for when targets were due to be met. For such firms, it may be difficult in future disclosures to be able to make transparent and reliable statements on progress against targets.

Conclusion

It’s clear that the insurance sector has come a long way to be able to produce public disclosures on a topic that is still relatively new to most insurers. Our research has highlighted that there are many strong examples of how each pillar of the TCFD framework can be addressed, and best practice will no doubt continue to emerge and evolve over coming years. However, a number of gaps and challenges remain and some firms are understandably only at the early stages of developing their disclosures.

When developing climate-related disclosures, firms should keep in mind the overall aim of the TCFD recommendations, which is to encourage the routine consideration of climate change in business and investment decisions, to enable companies to promote their considerations of climate issues and to support the transition to a low-carbon economy. Firms should recognise the benefits that producing such disclosures could have for them rather than viewing the preparation of such disclosures as a tick-box exercise. It is also key that the details included in disclosures are representative of actual activities and areas of focus within the firm. There is a large degree of overlap between the recommended TCFD disclosures and the requirements for insurers in the UK that are regulated by the PRA under SS 3/19. Therefore many of the activities to support the TCFD recommendations should already be embedded within these insurer’s standard risk management cycles.

Overall, the insurance industry in the UK has responded positively to the TCFD requirements and has taken active steps in developing and enhancing disclosures. With the requirements in the UK continuing to roll out over the next two years, and the ongoing focus on this topic from the UK regulators, it is likely that attention on TCFD reporting is only going to grow.

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