



Monetary Authority of Singapore

**GUIDELINES ON
ENVIRONMENTAL RISK MANAGEMENT
(INSURERS)**

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1 INTRODUCTION

1.1 These Guidelines aim to enhance the insurance sector's resilience to and management of environmental risk through setting out sound risk management practices. The Guidelines apply to all insurers, including insurers carrying on business in Singapore under a foreign insurer scheme established under Part IIA of the Insurance Act (Cap. 142). The Guidelines are applicable to insurers' underwriting and investment activities, and other activities that expose insurers to material environmental risk.

1.2 The Guidelines apply on a group basis for locally-incorporated insurers¹. Insurers that are branches or subsidiaries of global groups may take guidance from their Group's environmental risk management frameworks, as long as the frameworks meet the expectations set out in the Guidelines.

1.3 MAS recognises that the scale, scope and business models of insurers can be different. MAS expects an insurer's approach to managing and disclosing environmental risk to mature as the methodologies for assessing, monitoring and reporting such risk evolve. An insurer should implement these Guidelines in a way that is commensurate with the size and nature of its activities as well as its risk profile.

1.4 MAS will update these Guidelines as appropriate to reflect the evolving nature and maturity of risk management practices. The examples of environmental risk management practices featured in these Guidelines are meant to be illustrative, and are neither prescriptive nor exhaustive.

2 SCOPE

2.1 Environmental risk arises from the potential adverse impact of changes in the environment on economic activities and human well-being². Environmental issues that are of concern include climate change, loss of biodiversity, pollution and changes in land use. These environmental challenges call for urgent collective actions to address environmental risk. Climate change stands at the forefront of these concerns, with the Intergovernmental Panel on Climate Change ("IPCC") estimating that continued carbon emissions in line with historical rates would likely lead to global warming of 1.5 °C between 2030 and 2052³. There has also been a significant rate of decline in biodiversity worldwide, alongside a significant alteration

¹ For a locally-incorporated insurer that is headquartered in Singapore, this refers to the group including the holding company in Singapore, as well as the insurer's subsidiaries and branches in Singapore and overseas, where applicable. For a locally-incorporated subsidiary of a foreign insurer, this refers to the subsidiary's operations in Singapore and its downstream subsidiaries and branches in Singapore and overseas, where applicable.

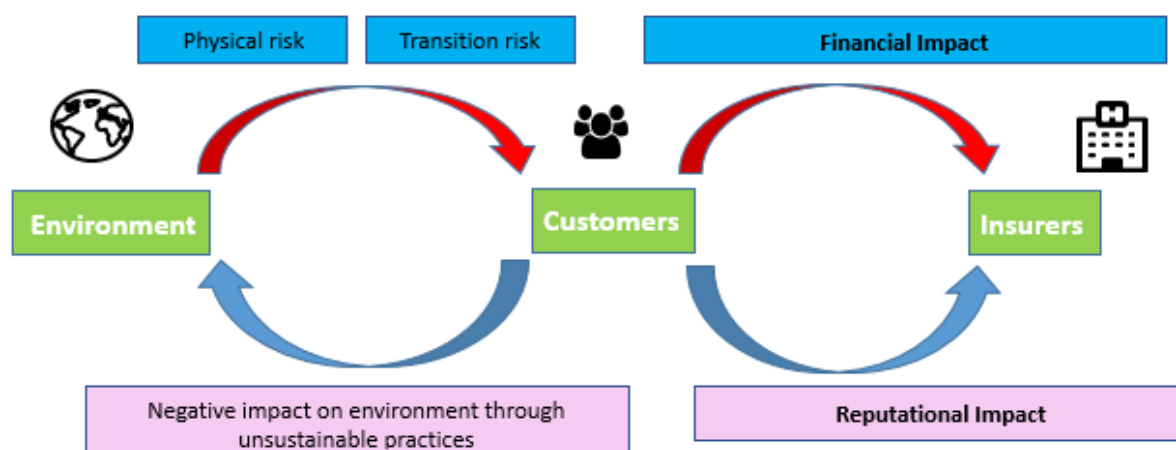
² Based on the concept of natural capital, nature comprises of a stock of resources (e.g. water, forest and air), which provides ecosystem services (e.g. food, coastal protection and absorption of pollution) that underpin economic activities and human well-being. Drivers of environmental changes can adversely impact natural capital and disrupt the provision of ecosystem services, leading to reduced flow of benefits to the economy and people.

³ IPCC, *Global Warming of 1.5 degrees, Summary for Policymakers*, 2018.

of three-quarters of the land and more than 60% of the marine environment caused by human actions⁴.

2.2 Environmental risk poses potential financial and reputational impact to insurers (refer to diagram below). The financial impact on insurers' portfolios and activities can arise through physical and transition risk channels⁵. Physical risk arises from the impact of weather events and long-term or widespread environmental changes. Transition risk arises from the process of adjustment to an environmentally sustainable economy, including changes in public policies, disruptive technological developments, and shifts in consumer and investor preferences. The impact of environmental risk can vary by geography, line of business, sector, customer characteristic and other factors. As such, the extent to which environmental risk is relevant and material to an insurer will vary depending on the insurer's business strategies and activities.

Potential financial and reputational impact of environmental risk on insurers



2.3 Environmental risk can translate into financial risk to insurers, including:

- a. Market risk: Insurers may be exposed to a decline in valuation and increased volatility in their investments (particularly in carbon-intensive sectors and companies that have contributed to significant environmental degradation) as a result of shifts in investor preferences.
- b. Operational risk: Severe extreme weather events can disrupt business continuity by negatively impacting the insurer's infrastructure, systems, processes and staff.

⁴ Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services, *Global Assessment Report on Biodiversity and Ecosystem Services*, 2019.

⁵ These channels are more commonly associated with climate change given the current focus on transition to a low-carbon economy. Where applicable, insurers should also consider physical and transition risk channels in relation to other aspects of environmental risk beyond climate change, as methodologies for managing and disclosing such risk continue to evolve.

- c. Insurance risk: Environmental changes can have a direct impact on general insurers as more frequent and severe natural catastrophe events can result in higher claims and underwriting losses. Life insurers are also impacted by such environmental changes through climate change effects (e.g. higher water/air temperature, increase in carbon dioxide levels) on morbidity and mortality risks. Environmental risk may also lead to higher liability risk, which include the risk of environmental-related claims under liability policies as well as direct claims against insurers for failing to manage environmental risk. For instance, insurers may be exposed to greater liability risk stemming from directors and officers policies, where the management of the insured may not have considered or responded to the impacts of climate change and environmental risk
- d. Liquidity risk: Natural disasters can cause widespread damage on physical property and incur significant costs (e.g. construction and repair), when the insurance risk materialises, leading to a surge in need for funds, and exacerbating liquidity stresses in insurers. Insurers may also experience difficulties in liquidating assets impacted by weather events, or stranded in the transition towards an environmentally sustainable economy. Investors, who are increasingly environmentally-conscious, may also cut back on sources of funding for insurers that underwrite activities with a negative impact on the environment.

2.4 Reputational risk can arise from insurers providing insurance coverage for customers that carry on business activities which have a negative impact on the environment. Negative perception of such underwriting activities can adversely affect insurers' abilities to maintain or establish business relationships.

2.5 It is crucial for insurers to build resilience against the impact of environmental risk as part of their business and risk management strategies. Besides implementing robust environmental risk management policies and processes, insurers can play a key role in the transition towards an environmentally sustainable economy by channelling capital through their underwriting and investment activities. A gradual and smooth transition would alleviate physical and transition risks, by reducing the probability of a "too little, too late" scenario, where physical costs of environmental changes may be exacerbated and policymakers would need to implement mitigation measures in a belated and disruptive manner. Contributing to sustainable activities would also mitigate reputational risk for insurers. Insurers can also contribute to global collective action by engaging with stakeholders such as customers, regulators, rating agencies, academia and civil society, to promote mutual understanding on environmental issues across sectors and geographies.

3 GOVERNANCE AND STRATEGY

3.1 The Board of Directors ("Board") and senior management play critical roles in incorporating environmental considerations into the insurer's risk appetite, strategies and business plans. These include identifying environmental risk and opportunities, and evaluating the actual and potential impact of these risks and opportunities on the insurer's strategies and plans. These should take into consideration the insurer's responses to the objectives set out under international agreements such as the Paris Agreement, as well as

national policies. Board and senior management should consider both the short term (within the insurer's business planning horizon) and the longer term (given that the impact may arise beyond the maturity of current portfolios and run into decades) when assessing the impact of environmental risk and opportunities.

3.2 Board and senior management should maintain effective oversight of the insurer's environmental risk management and disclosure, including the policies and processes to assess, monitor and report such risk. Board and senior management should have an institution-wide view of the insurer's environmental risk exposures and oversee the integration of such risk into the insurer's enterprise risk management framework. Where environmental risk is deemed material to the insurer, it should designate a senior management member or a committee to oversee environmental risk, to ensure that issues are reviewed at a sufficiently senior level.

3.3 The Board, or a committee delegated by it⁶, is responsible for:

- a. approving an environmental risk management framework and policies to assess and manage the insurer's environmental risk exposures on an ongoing basis;
- b. ensuring that environmental risk, where material, is addressed in the insurer's risk appetite framework, including the setting of qualitative and quantitative measures as appropriate. For example, the insurer could establish a qualitative risk appetite statement that articulates its approach towards managing environmental risk, while quantitative risk appetite measures could include limits on aggregate exposures to sectors or customers with higher environmental risk;
- c. setting clear roles and responsibilities of Board and senior management, including personnel who are responsible for oversight of the insurer's environmental risk; and
- d. ensuring that directors have adequate understanding of environmental risk and senior management is equipped with appropriate expertise for managing environmental risk.

3.4 Senior management is responsible for:

- a. ensuring the development and implementation of an environmental risk management framework and policies, as well as tools and metrics to monitor exposures to environmental risk, including resilience of the insurer's strategy to different environmental scenarios;

⁶ For an insurer incorporated in Singapore, the committee should be a Board-level committee. For an insurer incorporated outside Singapore, the committee could be a Board-level committee, or a management committee or body responsible for the oversight of the institution in Singapore. Oversight of environmental risk management could be performed by a combination of local and global committees.

- b. reviewing regularly the effectiveness of the framework, policies, tools and metrics and making appropriate revisions, taking into account changes in the insurer's risk profile and business strategies;
- c. establishing an internal escalation process for managing environmental risk (including material environmental risk exposures and exceptions to the environmental risk management framework or policies), and ensuring that appropriate and timely actions are taken to address the risk;
- d. updating the Board on material environmental risk issues in a timely manner; and
- e. allocating adequate resources with appropriate expertise, including through training and capacity building, to manage the insurer's environmental risk.

4 RISK MANAGEMENT

Policies and Procedures

4.1 As required under MAS Notice 126 (Enterprise Risk Management), an insurer should have in place an enterprise risk management ("ERM") framework which provides for the identification and quantification of relevant and material risks, including environmental risk⁷.

Risk Identification and Assessment

4.2 The insurer should identify material environmental risk (particularly for sectors with higher environmental risk) and assess the potential impact on the insurer.

4.3 The insurer should apply risk criteria to identify sectors with higher environmental risk. The risk criteria may include the level of greenhouse gas emissions, vulnerability to extreme weather events, and linkages to unsustainable energy practices, deforestation and pollution⁸. For sectors with higher environmental risk, the insurer should develop sector-specific policies, which clearly articulate the insurer's expectations towards an existing or prospective customer, and where possible, take into account internationally recognised sustainability standards and certification schemes⁹, as well as the customer's strategy to manage its environmental risk.

4.4 The insurer should take a consistent approach to environmental risk and issues across different functions (e.g. underwriting and investment functions), where possible.

⁷ It is recognised that environmental risk management practices and methodologies are more established for climate risk at this stage. Insurers may take a progressive approach towards environmental risk management, starting with more well-established areas, and then progressing to other environmental risk types as generally accepted methodologies and practices emerge.

⁸ For reference, the Association of Banks in Singapore's Guidelines on Responsible Financing has set out a list of industries with elevated environmental, social and governance risks.

⁹ For example, the International Finance Corporation Performance Standards, Equator Principles and Roundtable on Sustainable Palm Oil.

Risk Management and Monitoring

4.5 The insurer should actively manage and monitor its environmental risk exposures. At the customer level, the insurer should monitor on an ongoing basis for any adverse environment-related activity, or potential non-compliance with the insurer's policies.

4.6 Based on its risk assessment, the insurer should engage each customer¹⁰ that poses higher environmental risk, and encourage the customer to improve its environmental risk profile and transition towards sustainable business practices over time, while maintaining the insurer's risk management standards. In determining the extent of such engagement, the insurer may consider the materiality of the environmental risk, the customer relationship and its willingness and ability to improve its environmental risk profile, and the availability of alternative options to effectively mitigate the insurer's exposures to environmental risk. The insurer should also perform an analysis and assess its exposures to environmental risk where material.

4.7 The insurer should provide all relevant information on its material environmental risk exposures to its Board and senior management to monitor progress against the insurer's risk appetite and business strategies, and to support decision making on environmental risk management. In addition, exceptions noted during the monitoring process should be addressed promptly and surfaced to senior management, or the Board, where warranted.

4.8 The insurer should have in place a clear allocation of responsibilities for management of environmental risk in accordance with the three lines of defence model. Business line staff should assess environmental risk before accepting new businesses and in the ongoing management of business relationships, particularly for sectors with higher environmental risk. The risk management function should monitor business line implementation of the insurer's environmental risk management policies, including challenging practices and decisions where appropriate, while the compliance function should ensure adherence to applicable rules and regulations. The internal audit function should consider as part of its independent review, the robustness of the insurer's risk management framework in managing environmental risk.

Scenario Analysis and Stress Testing

4.9 The insurer should develop capabilities in scenario analysis and stress testing consistent with MAS Notice 126 to assess the impact of material environmental risk on its risk profile and business strategies, and explore its resilience to financial losses under a range of outcomes. The insurer should identify and simulate scenarios, which are plausible and relevant to the insurer, while factoring in the interlinkages between environmental risk and other risks¹¹. For stress testing purposes, the insurer should incorporate these risks both

¹⁰ In this context, these will be the insurer's corporate customer.

¹¹ Insurers should keep abreast of good practices in this evolving area, e.g. the Task Force on Climate-related Financial Disclosures' *Technical Supplement: The Use of Scenario Analysis in Disclosure of Climate-related Risks and Opportunities*, 2017, and NGFS' *Climate Scenarios for Central Banks and Supervisors*, 2020. Insurers may also

qualitatively and quantitatively into the scenarios¹² and project its financial conditions under a base scenario and stress scenarios.

4.10 The insurer should include, where relevant, short-term and long-term environmental scenarios (using conservative and regularly reviewed assumptions) into its scenario analysis and stress testing for strategic planning and risk management purposes. The analysis may incorporate an assessment of physical and transition risks across a range of climate-related scenarios, including increases in global temperature, and whether the transition to a low-carbon economy occurs in an orderly or disorderly fashion. For example, on physical risk, the insurer may estimate how changes in climate and extreme events can affect claims incurred. On transition risk, the insurer may analyse the impact of varying carbon taxes on customers' cash flows and creditworthiness. The more severe scenarios could include the implementation of aggressive climate change mitigation policies globally, for example, a sharp rise in carbon taxes, or much stricter environmental regulations. These scenarios should also incorporate forward-looking information, as an assessment that relies solely on historical data might systemically underestimate potential risks, in view of the uncertainties and long-term horizon associated with changes in the environment¹³.

4.11 The insurer should use the results of its scenario analysis and stress testing when reviewing its environmental risk management policies and practices. The insurer should also maintain proper documentation of the key features of the scenario analysis and stress testing, including the choice of scenarios, reasonableness of assumptions, assessment of results, considerations on the need to take actions, and actions taken to address the risk.

Capacity Building

4.12 The insurer should equip its staff, including through capacity building and training, with adequate expertise to assess, manage and monitor environmental risk in a rigorous, timely and efficient manner. The insurer should regularly review such capacity building programmes to incorporate emerging issues relating to environmental risk management.

5 UNDERWRITING

Integrating Environmental Issues

5.1 Underwriters should be provided with the means to check the potential impact of the proposed transaction on the environment, from both publicly available and proprietary sources, and work with external experts to enhance the quality of data collected to better understand a customer's environmental risk profile.

consider referring to scenarios aligned with scientific climate change pathways, including from the IPCC or International Energy Agency.

¹² In particular, quantitative parameters that correspond to specific stress testing scenarios may be informed by modelling work. Examples of such modelling include the use of statistical models to determine the frequency of flooding events, or the use of modified economic models to estimate economic or financial impact.

¹³ Central Banks and Supervisors Network for Greening the Financial System, *Technical Supplement: Macroeconomic and financial stability: Implications of climate change*, 2019.

5.2 Insurers should develop internal guidance for processes on risk detection and risk escalation, while taking into account its overall risk management framework and risk appetite. These should be embedded as part of the insurer's underwriting policy. Environmental risk appetite and processes may require greater customisation to fit into the existing processes.

Decision-Making on Environmental Risk

5.3 The insurer should assess each customer's environmental risk as part of its underwriting assessment, particularly for sectors with higher environmental risk. The assessment should include, where relevant, an analysis of the severity of the environmental risk, as well as capacity, commitment and track record of the customer in managing such risk. The assessment should also consider the ability and willingness of the customer to introduce risk mitigation measures. The insurer may refer to external ratings on environmental performance, develop its own risk assessment and rating methodology or incorporate the customer's exposures to climate transition risk in its assessment. The insurer may also consider imposing underwriting conditions to require a customer with higher environmental risk to take steps to manage its environmental risk within an acceptable timeframe. These conditions may include developing a sustainable transition strategy, and adhering to applicable certification standards. The insurer may also work with its customer to establish specific and meaningful environmental performance targets (e.g. carbon emission reduction and improvement in energy efficiency), which the customer can progressively meet over time. For a customer that does not manage its environmental risk adequately, the insurer should consider a range of mitigating options such as reflecting the cost of the additional risk in the insurance premiums, applying limits on the underwriting exposure, and re-assessing the customer relationship, including declining future transactions and exiting the relationship. Part of the decision-making on environmental risk is to also consider if the customer has taken action to remedy or mitigate the environmental risk, which might make it acceptable. A customer's performance history regarding the management of environmental risk may inform the assessment of the effectiveness of planned mitigation measures. The scope and extent of this assessment may be calibrated based on factors including the sector, customer's operations, and the nature and size of the transaction.

Escalating Environmental Risk to Decision-Makers

5.4 Transactions with higher environmental risk should be subject to the insurer's enhanced due diligence, which may include site visits to the customer and separate review by in-house or external personnel with environmental risk expertise. Where applicable, such transactions should be escalated to an internal committee or appointed individual for approval. All decisions are expected to be documented appropriately.

Measuring and Monitoring Underwriting Exposures

5.5 The insurer should develop quantitative and qualitative tools and metrics to monitor and assess its underwriting exposures to environmental risk, where material. For example, these metrics may be used to assess the insurer's underwriting exposures to geographical areas and sectors with higher environmental risk, or measure the carbon intensity of

customers in high-risk sectors. The insurer may also evaluate its assessment with international climate targets and benchmarks, such as the Paris Agreement. Beyond climate change, metrics may be used to evaluate the dependencies of key customer segments on ecosystem services and natural capital. This may include assessing the impact of biodiversity loss on crop production, and profitability of relevant industries such as the food production and processing industries¹⁴. In determining the environmental risk metrics, the insurer should consider the materiality of the environmental risk factors, and risks of greater materiality and severity should be prioritised and monitored more closely. Where the potential impact of environmental risk is assessed to be material, the insurer should take appropriate mitigating measures. For example, the insurer could develop plans to manage significant concentration in its portfolio to geographies and sectors with higher environmental risk.

6 INVESTMENT¹⁵

Ongoing Monitoring

6.1 Insurers should put in place appropriate processes and systems to monitor, assess and manage the potential and actual impact of environmental risk on individual investments and portfolios on an ongoing basis, where material.

6.2 The insurer should consider environmental impacts both from a macro, top-down, as well as from a more granular bottom-up asset selection perspective to the extent practicable. Customers from sectors deemed to be of higher environmental risk should be selected for additional scrutiny.

6.3 The insurer should consider developing mechanisms and metrics that provide a reasonable indication of the environmental risk inherent in their investment portfolios. The insurer should consider monitoring the evolution of any such identified metrics in order to assess impacts and effectiveness of any action implemented over time.

6.4 The insurer may use its own indicators to assess the environmental impacts from companies engaged in or related to these activities and other activities the insurer deems relevant. The insurer may consider using publicly available information as well as proprietary information, research, models, and ratings from internal or external providers to inform its portfolio analysis and assessments.

6.5 Should there be developments (such as occurrence of natural disasters and changes in regulations) that could materially affect the operations and financials of an investee company or substantially affect its broader investment portfolio, the insurer should promptly re-assess the risk and return profile of the individual investment or portfolio as applicable.

¹⁴ Network for Greening the Financial System, *Overview of Environmental Risk Analysis by Financial Institutions*, 2020, and De Nederlandsche Bank, *Indebted to nature: Exploring biodiversity risks for the Dutch financial sector*, 2020.

¹⁵ Insurers with investment activities should also refer to the relevant sections of the Guidelines on Environmental Risk Management (Asset Managers), for sound practices on the management of environmental risk with respect to investments.

This would allow the insurer to make an informed decision on whether to continue with the investment, make adjustments to the composition of the portfolio, or put in place other mitigating measures to better manage the environmental risk in the investment or portfolio. The insurer should also escalate these material environmental risk exposures and exceptions in accordance with its internal escalation process to ensure appropriate and timely actions are taken to address the risk.

6.6 Consistent with Section 4 of these Guidelines, the insurer should undertake a comprehensive review of its investment portfolios regularly under relevant stress scenarios, to assess what the longer-term impact of environmental changes are.

6.7 The insurer should consider appropriate changes over time to mitigate the impact of any significant risks on their portfolios, whether through specific investment or divestment actions.

Promotion of Responsible Business Behaviours

6.8 The insurer should consider engaging with companies individually and asset managers, as appropriate, to help shape the corporate behaviour of investee companies positively through engagement, proxy voting and sector collaboration. This includes supporting investee companies' efforts in the transition towards more sustainable business practices over time, while maintaining their risk management standards. Insurers should establish a process to prioritise issues and companies for engagement that is consistent with the interests of its customers and aligned with the insurer's investment objective and strategy. Insurers should maintain proper documentation of such engagement efforts, where applicable.

6.9 The insurer should consider collaborative engagement with other investors for efficiency, enhanced influence and legitimacy when engaging investee companies, and to build knowledge and skills¹⁶. The insurer should encourage companies in which they invest to provide relevant corporate environment-related disclosures (to the extent appropriate and applicable), to foster greater awareness of environmental risk, and engender responsible behaviour.

7 DISCLOSURE

7.1 The insurer should, at least on an annual basis, disclose its approach to managing environmental risk in a manner that is clear and meaningful to its stakeholders. The insurer is encouraged to disclose the potential impact of material environmental risk on the insurer¹⁷, including quantitative metrics such as exposures to sectors with higher environmental risk. The insurer's disclosure may be consolidated at the group¹⁸ or head office level.

¹⁶ Insurers can draw on resources made available as part of the Principles for Responsible Investment (PRI), including the Introductory Guide to Collaborative Engagement and the PRI Collaboration Platform.

¹⁷ The insurer should make the disclosure in a sustainability report, annual report and/or on its official website.

¹⁸ Group refers to the ultimate holding company, its subsidiaries and any other company or entity treated as part of the ultimate holding company's group of companies according to the Accounting Standards.

7.2 The insurer's disclosure should be in accordance with well-regarded international reporting frameworks¹⁹, such as recommendations by the Financial Stability Board's Task Force on Climate-related Financial Disclosures ("TCFD"). The TCFD recommendations provide a useful framework for the disclosure of climate-related risks as follows²⁰:

- a. Governance, including the Board's oversight and management's role in assessing and managing climate-related risks and opportunities;
- b. Strategy, in relation to the actual and potential impact of climate-related risks and opportunities on the insurer's businesses, strategy and financial planning, where such information is material;
- c. Risk management, with regard to how the insurer identifies, assesses and manages climate-related risks; and
- d. Metrics and targets, to assess and manage relevant climate-related risks and opportunities where such information is material²¹.

7.3 The insurer should review its disclosure regularly to improve its comprehensiveness, clarity and relevance, taking into account generally accepted measurement practices and methodologies.

¹⁹ For example, standards and frameworks set by the CDP, Climate Disclosure Standards Board, Global Reporting Initiative, International Integrated Reporting Council, and Sustainability Accounting Standards Board.

²⁰ TCFD, *Recommendations of the Task Force on Climate-related Financial Disclosures*, 2017.

²¹ For example, TCFD recommends the disclosure of Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas emissions, and the related risks. Scope 1 emissions are direct emissions from owned or controlled sources. Scope 2 emissions are indirect emissions from the generation of purchased energy. Scope 3 emissions are all indirect emissions (not included in Scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions.