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Opinion on sustainability within Solvency II

EIOPA-IRSG-19/026
EIOPA Insurance and Reinsurance Stakeholder Group meeting
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1. Context and objectives

EIOPA sustainable finance action plan

Covers prudential, conduct and financial stability areas, incl.:

- EIOPA advice to COM (30.04.2019) on sustainability risks and factors in Solvency II and Insurance Distribution Directive
- Scenario analysis on transition risk
- Opinions on IORPII implementation on ESG risks and Governance documents
- Insurance protection gap for NatCat
- Collecting evidence on short term pressure from financial sector on corporations
- Disclosure of sustainability risks and sustainable investments for personal pensions, IORPs and IBIPs

1. Context and objectives

COM call for opinion: main objective

Provide an opinion on the impact of SII on sustainable investments and current practices in underwriting taking account of sustainability risks

Evidence used

- Public call for opinion (33 respondents, 3 confidential) https://eiopa.europa.eu/Pages/About-EIOPA/Organisation/Sustainable-Finance-.aspx
- Confidential request for information (NCAs)
  - o 153 solo undertakings (20 % of total assets at EU level)
  - o 31 groups (38 % of total assets at EU level)

Consultation from 3.6-26.7. Delivery to COM:30.09.2019

We look forward to your response!

2. Key messages of the opinion

- Forward-looking approach to be implemented, in ORSA, via the use of a **standardised set of scenarios** translating global warming in scenarios for impact on the (re)insurers’ balance sheet

- Historical data is not good predictor for climate change; absence of data and methods should not lead to complacency

- No evidence to justify different capital requirements

3. Different areas of the Opinion

3.1 Time horizon

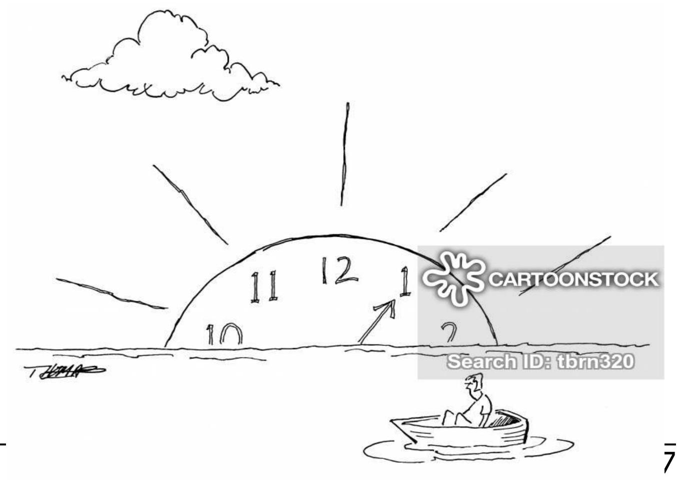
Prudential and climate change time horizons differ

- Global warming is likely to reach 1.5° C between 2030 and 2052 if it continues to increase at the current rate (IPCC Report 2018)
- The SCR shall correspond to the VaR of the basic own funds of a (re)insurer subject to a confidence level of 99,5% over a 1-year time horizon (Art. 101 SII Directive)

EIOPA opinion:

No change to SII time horizon

But need to implement a prudential forward-looking approach for climate change via l**ong-term scenario analysis in ORSA, possibly based on standardised scenarios**



3.2 Valuation of assets and liabilities

Valuation of assets: evidence received

- o Availability and quality of information on sustainability risks and sustainable investments may not be sufficient
- o Undertakings refer to using ESG ratings
- o Need to take into account risk inherent in the valuation technique and in the inputs

EIOPA opinion:

- Importance of public disclosure to inform prices
- Transparency of ESG ratings
- Need for scenario analysis to assess uncertainty and future developments

3.2 Valuation of assets and liabilities

Valuation of liabilities: evidence received

- Climate change risk not explicitly considered by undertakings; “implicitly” captured via historical data

<u>EIOPA opinion</u>

- Short term business – annual validation of assumptions may be sufficient to integrated developments. Longer term non-life business (>2 years): sensitivity or scenario analysis is needed.
- Good practices: Ensure historical loss data is up-to-date, Consider events not captured by historical loss dataset, Use forward-looking CAT modelling, Apply stress testing or scenario analysis
- Longer term life business: economic scenario generators?

3.3 Investment and underwriting practices

Investment practices: evidence received

- Close to 1/3 of groups and undertakings do not plan to implement sustainability considerations in investment strategy

<u>EIOPA opinion</u>

- Need for transparency on sustainability ratings
- Need to assess transition risks in the portfolio.

3.3 Investment and underwriting practices

Underwriting practices: evidence received

- Majority of groups and undertakings do not currently take explicit account of climate risks in U/W policies and pricing.
- Some expect increase in premia. Risk mitigants: reliance on national (re)insurance schemes and reinsurance

EIOPA opinion

- Need to consider actuarial analysis when underwriting climate-related risks
- Short term increase in pricing – long term risk to insurability (protection gap!)
- Risk mitigating action: “**impact underwriting**”. Embed risk mitigation and adaptation in underwriting. Development of products and risk management practices which aim at reducing risk.

3.4 Capital requirements

Market risk general - evidence received

- SII is a risk-based framework – no incentive or disincentive for sustainable investments
- No conclusive evidence on risk differentials between "green" and general assets.
- Lack of database for long-term trend analysis
- Absence of green/brown taxonomy

EIOPA opinion:

- Need to obtain more granular data on the risk profiles of "green"/"brown" investments
- Further work expected on standards (e.g. green bonds)

3.4 Capital requirements

Natural catastrophe risks – evidence received

- Most consider that the current calibration of NAT CAT sufficiently capture climate-related developments; regular updates would allow for capturing developments

EIOPA opinion:

- Regular recalibration of the standard formula for NAT CAT should take into account future developments (e.g. also "secondary" hazards, such as wildfire, drought…)
- But need a forward-looking approach!
- CAT modelling community to increase transparency on methods and data for CAT models

3.5. Internal models

Evidence received:

- Most undertakings do not plan to integrate sustainability factors in the market risk module of their internal model

<u>EIOPA opinion:</u>

- The regulatory framework does not prevent the integration of sustainability factors
- Use of external models: undertakings to engage with their providers on how climate change is integrated in the model
- Also here: historical data does not predict climate change… Hence: need for a forward-looking approach