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EUROPEAN INSURANCE
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Sustainable finance and Solvency II: EIOPA opinion

EIOPA Regular Use
EIOPA-IRSG-19-35

EIOPA Insurance and Reinsurance Stakeholder Group meeting
Frankfurt, 2 October 2019

Broad reach out to stakeholders

- Public call for evidence and confidential request for information to undertakings (Jan.-March 2019)
- Sustainable Finance workshops (23 Jan. and 11 June 2019)
- Public consultation on draft opinion (June-July 2019).
- Policy Steering Committee steering following consultation (14 August and 5 Sept. 2019)

Main comments from IRSG to the draft opinion



IRSG main comments (See EIOPA-IRSG-19-31)

No change in time horizon required

Historical trends no longer reliable indicator for future risks

Need to clarify expectations regarding scenario analysis - flexibility in ORSA

Helpful to have standardised set of quantitative scenarios – suggest EIOPA to focus on general principles

General valuation principles adequate

Prudential disclosure: underlying assumptions to be made explicit

Proportionality in BE valuation

Reflect also liability risks

“Impact underwriting” - where risk mitigation and loss prevention could make a significant difference – no prejudice to sound actuarial practices

Support for stewardship in investment strategy – examples of strategies

Protection gap acknowledged as potential future issue

No clear available evidence of risk differential between green/brown assets

Premature to differentiate capital requirements

https://eiopa.europa.eu/Publications/Opinions/EIOPA-IRSG-19-31_response_to_CP_on_sustainability.pdf

EIOPA's resolutions to IRSG comments (1/2)



- Welcomed IRSG's balanced comments to the opinion
- EIOPA recognised explicitly in its final Opinion:
 - o the need to strike a balance between achieving a harmonised approach to assessing the impact of climate related risks, while also facilitating more individual and tailored assessment of the undertaking specific impact
 - o the need for ORSAs to remain under the control of undertakings, while also assisting undertakings in how they may assess climate related risks.
 - o Scenarios to reflect the company specific nature of ORSA and at the same time have a forward looking element, qualitative and/or quantitative
 - o Importance of proportionality in valuation of BE: good practices should be applied in a manner proportionate to the scale and type of exposures faced by an undertaking

EIOPA's resolutions to IRSG comments (2/2)



- Recognised explicitly in its final Opinion:
 - o Disclosure: stress importance of availability and quality of information, incl. of ESG ratings
 - o Investment practices: EIOPA agrees that where insurers have long-term assets to match long term liabilities, they should consider whether climate change would impact either their ability to hold these assets over that time frame or their expected cash-flows.
 - o “Impact underwriting” could be relevant in cases where risk mitigation and loss prevention could make a significant difference – no prejudice to sound actuarial practices + further examples have been provided
 - o No changes to capital requirements – lack of evidence

The Opinion in a nutshell: what EIOPA does not recommend



The opinion does not recommend significant changes to the framework regarding valuation and capital requirements

- SII as a risk-based, forward-looking and market-consistent framework is generally equipped to accommodate sustainability risks and factors
- There is currently no evidence of relevant risk differentials between “sustainable” assets and status quo

The Opinion in a nutshell: what EIOPA does recommend



- Climate change increases **uncertainty** => recommend scenario analysis
- Promoting **good practices**:
 - There should be more alignment in undertakings between investment and underwriting practices when it comes to integrating climate change-related risks
 - Modelling of NAT CAT risks should be transparent and include climate-change related risks in a forward looking manner
- **Stewardship by (re)insurers**: extended to underwriting, consistent with actuarial practices
- In the future, **more conclusive data** might impact on current conclusions regarding capital requirements (e.g. for recalibration of NAT CAT capital requirements)



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Questions?

EIOPA Policy Department

Highlights from the Opinion in the different areas

Challenges related to the integration of sustainability risks in Pillar 1

Main content of the Opinion

- Climate and other sustainability risks can materialise suddenly and potentially in a discontinuous way
- Scenario analysis enables impact of this uncertainty to be considered
- Can be done both qualitatively and quantitatively
- Balance between consistency and parameters specific to the undertaking

Key points in the analysis/ evidence

- A Table (Table 8) on relevant topics for climate change scenarios has been added.

Next step on scenario analysis - we will ensure consistency and cooperation with relevant financial stability work

Main content of the Opinion;

- Parallel to advice on sustainability in Solvency II: prudentially relevant to require undertakings to take into account the impact of their underwriting activity on sustainability factors
- Impact underwriting: (Re)insurers should contribute to adaptation to and mitigation of climate change. But: not disregard sound actuarial practice.
- Example of “impact underwriting”, incl. the development of new insurance products, adjustments in the design and pricing of the products and the engagement with public authorities.

Key points in the analysis/evidence:

- “Impact underwriting” could be particularly relevant where risk mitigation and loss prevention could make a significant difference.

Main content of the opinion

- Solvency II assumes that market prices reflect all relevant risks. In order for market prices to better reflect the sustainability risks and factors, further improvements in the availability and quality of information relevant to their valuation is needed.
- Where undertakings rely on external ESG ratings, they should ensure that the rating methodology is sufficiently transparent to allow them to understand the ratings provided for their investments.

Key points in the analysis / evidence

- Various stakeholders believe that the improvement of data quality and collection of reliable information on sustainability parameters relating to investments would be one of the main steps in helping the market to correctly price sustainability risks.
- Considering the important exposure of (re)insurers, and the fact that the real estate sector is one of the largest greenhouse gas (GHG) emitters in the EU, it would be important, among other steps, that (re)insurers assess how their real estate portfolio reflects sustainability considerations.

Main content of the Opinion

- While there appears to be no gaps in the regulatory framework, it is not straightforward for undertakings to account for sustainability/climate change-related developments.
- Undertakings should apply, where appropriate, the following good practices: ensure historical loss data is up-to-date; Consider possible events not captured by undertaking's historical loss dataset; Develop and use forward-looking catastrophe modelling; Apply stress-testing or scenario-analysis.

Key points in the analysis / evidence

- Main challenges to include climate change-related risks in best estimates are climate change “uncertainties” and the nature of non-life insurance business.
- Table with the current practices for incorporating climate change-related risks in the calculation of the best estimate
- Table with the initiatives for including climate change in catastrophe models
- Reference to impact of climate change to life and health insurance

Main content of the opinion

- EU taxonomy and the disclosure of sustainability risks will improve the industry's efforts to consider transition as well as physical risks in setting their investment and risk management strategies
- Reference to EIOPA's advice on sustainability and SII Pillar 2: undertakings to take into account the impact of their investment activity on sustainability factors
- ALM: where undertakings have long term assets to match long-term liabilities, they need to consider how climate change impacts on their ability to hold these assets or their expected cash-flows

Key points in the analysis / evidence

- No difference in targets and measures for return on sustainable investments as other investments
- Challenges: lack of information, no common taxonomy or definition, difficulty in monitoring climate change risks
- Table on current practices incorporating sustainability risks into investment policy (exclusion, Best-in-Class, inclusion, use of voting rights, use of ESG criteria in the investment decision)

Main content of the opinion

- Within a risk-based framework like Solvency II, any change to capital requirements must be based on a proven risk differential compared to the status quo.
- Lack of evidence in the current available data to verify that sustainable assets have a lower risk than non-sustainable assets.

Key points in the analysis / evidence

- No new time series to analyse are proposed by the respondents
- Few respondents are raising issues on the general calibration of certain asset classes in SCR, but this outside the scope of this opinion.

Main content of the opinion

- The current Solvency II framework does not hinder the integration of current climate change-related developments in the calibration of the standard parameters for the natural catastrophe risk module of the standard formula.
- A regular recalibration of the standard parameters for the natural catastrophe risk module of the standard formula should take into account future developments, as well as the potential effect of climate change using the latest data and science available.

Key points in the evidence part

- The impact of climate change is mostly not explicitly reflected in the NAT CAT models, but any climate change to date will be implicitly included in the recent data they use to create their models.

Main content of the Opinion

- The framework and rules relating to internal model design and calibrations do not prevent internal model undertakings from accounting for sustainability factors or the climate change-related risks.
- Internal model users should not only rely on historical data to integrate sustainability risks and, in particular, climate change as the occurrence of future trends may not be captured in historical data. The development of a more forward-looking approach should be pursued.

Key points in the analysis / evidence

- Internal models evolve through time and can be adapted more quickly than the standard formula, to take account of new identified risks such as sustainability factors, and in particular climate change-related risks.
- Many internal model undertakings rely on external providers for their catastrophe model and assume climate change-related risks are taken into account because those models are parameterized from the latest data available and use the most recent available climate models.