Insurance Europe response to the consultation on Joint ESAs Guidelines on integrating ESG risks in stress tests

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Q1. *Please add here any comments on "**Title I - Subject matter, scope and definitions**"*

It should be noted that the available data and models for biodiversity and deforestation risks are still in their infancy, at this stage there are no reliable biodiversity and deforestation models on which quantitative stress tests can be prepared.

Q2. *Do you agree with the list of objectives? Do you have any **additional suggestions** (addition, removal, precision, etc.)?*

Guideline 15 & 28 - Timeframes:

- Climate change risk is significantly more complex, long-term, and multidimensional than any financial or underwriting risk (re)insurers have previously assessed. Time horizons should reflect the unique nature of climate-related risks and allow for flexibility to avoid redundant scenario analyses where no material change is expected. For instance, many physical risks show little variation over 5-year increments in stress testing, whereas more meaningful insights emerge over 30-year periods—an approach already reflected in many natural catastrophe (NatCat) models.
- However, it should be noted that the long-term horizon involves a multitude of parameters to consider (e.g., assumptions on business growth, management actions, policy on rates served). These elements are difficult to project over such long horizons and can make the results hard to exploit or compare.

Q3. *Do you have any comment or suggestion on paragraphs 16-18 on "**materiality assessment**"?*

Guideline 17 & 18 - Materiality assessment:

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- Offering clearer guidance on specific areas of focus for (re)insurers—beyond the broad environmental, social and governance (ESG) label—would help competent authorities direct their oversight more effectively.
- It should be emphasised that the requested assessments should be made on the basis of data available to supervisory authorities, without the need to prepare additional reports.
- In the industry's understanding the assessment at this stage should be more qualitative in nature, with stress testing being the quantitative part.

Q4. *Please add here any additional comments on "Title II - Requirements regarding consistency, long-term considerations and common standards for assessment methodologies in stress testing of ESG risks -* ***4.1 Objectives****"*

- **Guideline 13** is drafted very broadly. To ensure proportionality, ESG stress tests should not apply to small undertakings, including mutuals, where the administrative and resource burden would outweigh the prudential benefits.
- **Guideline 23 & 24**: It is understood from these two articles that there is an intention to consider systemic risk and interconnections between sectors. This aspect remains quite new and could lead to higher shocks on financial institutions that are heavily represented in insurance investments portfolios (and currently not significantly shocked in such exercises). Moreover, this would require an unprecedented level of coordination.

Q5. *Do you have any comment or suggestion on paragraphs 27-28 on "****scope****" and paragraph 28 on "****time horizon****"?*

It is still not clear, and it would be useful to get more information from the supervisors on how to implement these long-term scenarios, as there are no business plans covering a period longer than 5 years.

Q6. *Do you have any comment or suggestion on paragraphs 29-32 on* ***scenario design and application****?*

Guideline 32 – Alternative scenarios:

- The industry expects consistency in scenario narratives with the other existing sustainability disclosures such as Corporate Sustainability Reporting Directive (CSRD) and Own Risk and Solvency Assessment (ORSA).
- The section on test types and management responses remains overly general. There is a risk that the guidelines could be potentially interpreted as imposing a single, uniform approach on how entities should evolve and respond to ESG stress test outcomes. Such an approach would not reflect the diversity of undertakings' business models, exposures and strategies.

Q7. *Do you have any comment or suggestion on paragraphs 33-35 on "****top-down vs. bottom-up approaches****"?*

Guideline 33 – Top down vs Bottom up:

- Climate stress test exercises are long and costly, so expanding the scope to other ESG risks will increase the burden. To minimise additional burdens, the industry prefers top-down approaches. Here, the competent authorities have stronger control over the process.

- Second-round effects can also be tested effectively through top-down approaches. This was demonstrated in the top-down "Fit-for-55" system-wide climate stress test.
- Past top-down exercises have sometimes focused mainly on the asset side, which is not sufficient for (re)insurers. It is therefore important that NCAs assess impacts on both sides of the balance sheet.
- Furthermore, the industry notes the following:
    - Without clearly defined criteria the choice of methodologies/approach (top-down, bottom-up, hybrid) is up to the authorities. This may make it more difficult to ensure full comparability of results across countries and sectors.
    - It is stated that different sectors should coordinate in designing stress tests; however, this may prove to be a misguided approach, as a maximalist harmonisation often leads to imposing methodologies that are ill-suited to one sector simply because they are deemed appropriate for another.
    - In addition, certain reporting requirements (eg E1.9 form, Quantitative Reporting Template (QRT) S.06.04) necessitate bottom-up analysis.

Q8. *Do you have any comment or suggestion on paragraphs 36-39 on "**level of granularity**"?*

Guideline 37 is excessive. The requirement to consider "at a minimum" the portfolio, sector, geographic, counterparty, and risk category levels of granularity is disproportionate and risks creating unnecessary complexity. The removal or at least reconsideration of GL 37 is suggested.

Q9. *Do you have any comment or suggestion on paragraphs 40-43 on "**balance sheet assumptions**"?*

Guideline 40's requirement to base stress tests not only on static balance sheets but also on transition plans is too far-reaching. Such a methodology would rely heavily on subjective assumptions and estimates, reducing the management value of the results. In addition, it would impose a significant organisational burden. **The industry therefore proposes deleting the reference to "transition plans" in Guideline 40.**

Guideline 41 – Dynamic vs Static balance sheet projections:

- Regarding dynamic balance sheet approaches: the ESAs should be aware that dynamic balance sheet approaches /projections of the balance sheet are computationally intensive and time-consuming, with limited added value—especially given the expectation to converge toward a high-level, strategic long-term outlook. Furthermore, dynamic balance sheet approaches risk to negatively impact the reliability of the results given the number of assumptions and level of expert judgment involved. By contrast, applying 'instantaneous' shocks to the latest available balance sheet may be less detailed in scenario narrative but often provides more reliable results.
- Management actions
    - While management actions can be substantiated for shorter horizons (3–5 years maximum), their extrapolation over very long-term horizons risks becoming speculative.
    - In fact, future management actions can also be subject to bias, since stress test scenarios already assume knowledge of key parameters such as GDP, inflation and market performance.
- For some markets (eg FR) both approaches were already considered in ACPR stress testing exercises, led to many questions being raised. For example, the definition of a static balance sheet is not always clear.
- In conclusion, both approaches can be considered, depending on the objectives of the stress test exercise and in consultation with the market participants. However, if a dynamic balance sheet approach is chosen, a key principle should be that future management actions should always be optional.

Q10. *Please add here any additional comments on "Title II - Requirements regarding consistency, long-term considerations and common standards for assessment methodologies in stress testing of ESG risks -* ***3.2 Principles and methodological considerations****"*

Guideline 48 - Model limitations and cross validations:

- While it is acknowledged that climate models inherently contain material limitations and simplifications—due to their early stage of development, limited data, and evolving methodologies—cross-validating with alternative approaches may introduce more confusion than clarity. Model validation processes are expected to progress gradually, allowing time for these models to mature appropriately.
- The recommendations remain overly general and are not always relevant. There appear to be no concrete mechanisms in place to ensure effective coordination between sectors (banking, insurance, markets) or between Member States, which could undermine the level playing field.

Q11. *Please add here any comments on "Title II - Requirements regarding consistency, long-term considerations and common standards for assessment methodologies in stress testing of ESG risks -* ***3.3 Organisational and governance arrangements****"*

Guidelines 53-54: Data Collection

- It is crucial that competent authorities rely, as much as possible, on already existing data. If ad-hoc data collections are deemed necessary, competent authorities should perform the data collection themselves and should not require additional information from undertakings in order to avoid imposing any additional burdens.

Guidelines 51 & 55: Accuracy of the results

- The ESAs have acknowledged the current data quality and model limitations in ESG stress tests. Consequently, it is not reasonable to set expectations regarding the "accuracy of the stress test results" as part of quality assurance process. Considering that "what-if" scenarios are highly hypothetical in nature, there is no standard to check the accuracy of the results. Expert judgment should be used not to qualify whether the results are accurate but whether they are **credible**.

Guideline 61: Public disclosure of information

- Publishing aggregate results of ESG stress tests is useful to raise awareness and highlight potential trends. As the obligation to publish results is left to the discretion of national authorities, practices may vary across jurisdictions, so results and conclusions should first be discussed with participants to address any interpretation issues before publication. Experience shows that such dialogue is very beneficial to NCA. In addition, disclosure should be balanced against the level of granularity, complexity and sensitivity of the information.
- However, publishing individual results of participants to bottom-up exercises is inappropriate and counterproductive.
    - This is inappropriate due to the fact that there are still too many uncertainties regarding methodology and data quality, and publishing such results could be misleading.
    - It can be counterproductive if public disclosure impact participants' reputation and/or financial conditions and drives them to withdraw from high-risk areas or divest from high-emitting industries. Such actions conflict with the goals of closing the protection gap and supporting high emitters in transitioning their business models.

Q12. *Do you have any **additional and/or general comments** on the Consultation Paper?*

- Overall, the document is highly general in nature, which presents both advantages and drawbacks. It sets out broad principles and a high-level framework for stress testing but remains vague on many key aspects. This lack of precision limits its practical scope and weakens the prospects for ensuring fair treatment across entities from different Member States and sectors.
- **Data foundation**: The industry supports the idea that the supervisory authority should assist undertakings in accessing reliable ESG data. Alternatively, it should establish an adequate data foundation itself and make it available to companies. A uniform and comprehensive data basis would:
    - Enhance the comparability of results.
    - Enable more in-depth quantitative analyses.
    - Help limit the effort required by companies.
- **Proportionality**: Guidelines 46 and 47 are drafted too broadly. To ensure proportionality, ESG stress tests should not be applied to small undertakings, including mutuals, where the burden would outweigh the prudential benefits.
- **Disclosure:** Aggregate results can be useful to raise awareness and highlight trends, provided they are first discussed with participants to avoid misinterpretation. However, publishing individual results of bottom-up exercises is inappropriate. Given current methodological and data uncertainties, individual disclosures would be misleading, risk reputational damage and could even drive unintended divestment decisions, conflicting with the aim of supporting transition and closing the protection gap.
- **Focus on material risks**: "Stress tests for the (re-)insurance industry should focus on material risks which can be assessed with reasonable accuracy. There is doubt that second- and third-order effects from sustainability risk effecting the (re-)insurance industry can today be estimated at good quality based on solid data and models. Supervisors should keep that in mind when specifying stress tests. Effective measures can be derived from stress tests result only when the result quality is sufficient."

Q13. *Do you have any comments on the Impact Assessment?*

- The industry supports Option A.2, as climate risks are of significant materiality. Should Option A.1 be selected, competent authorities would need to ensure a robust data foundation concerning 'Social' and 'Governance'.
- In addition, the industry prefers Option B.2. From the industry's perspective, a two-step materiality assessment is indispensable:
    - In the first step, the supervisory authority determines which risks or risk drivers should be considered from its point of view.
    - Subsequently, each undertaking conducts its own individual materiality assessment.
- Stress scenarios would only be analysed if the undertaking concludes that the respective risk or risk driver is material. The industry does not support any general definition of materiality thresholds or scenarios applicable to all undertakings.