

To: Sustainability Working Group, Solvency II Working Group
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Subject: DG FISMA Report on the monitoring of climate-related risk to financial stability

Summary

On 1 July 2024 DG FISMA (Directorate-General for Financial Stability, Financial Services and Capital Markets Union) published a [report](#) on the monitoring of climate-related risk to financial stability.

The DG FISMA report is based on the 2021 European Commission Strategy for financing the transition to a sustainable economy. It aims to take stock of the analytical work done in the EU, identify challenges in measuring the impact of climate-related risks on financial stability, and outline the policy responses adopted at the EU level. The report covers both the transition and physical risks relating to climate change.

Members will find hereafter the key takeaways and next steps of the report.

Key takeaways

- EIOPA's 2020 sensitivity analysis shows EEA insurers could face high losses (over 25%) in equity investments in carbon-intensive sectors, particularly fossil fuel extraction.
- The ECB/ESRB 2021 report predicts market risk revaluation losses for EU insurers in climate-sensitive sectors, with potentially significant losses (15%) for equity holdings in oil, gas, and automotive industries under a disorderly transition scenario.
- For physical climate risks, EIOPA's 2022 discussion paper finds:
 - Insurance companies have historically handled major European natural catastrophes well
 - Reinsurance plays a crucial role in mitigating impacts
 - Potential concentration risk with top reinsurers
 - Future evolution of climate hazards (windstorm, river flood, wildfire, coastal flood) may significantly impact the (re)insurance sector.
- Only about 25% of total losses from extreme weather and climate-related events in Europe are currently insured.
- The 2023 ECB climate stress test estimates insurance companies and pension funds may suffer relative losses up to 15% due to transition risks, depending on the scenario

Next steps

- Conduct the one-off stress testing exercise (in the context of 'Strategy for Financing the Transition to a Sustainable Economy'):
 - Joint effort by ESAs, ECB, and ESRB
 - Cross-sectoral, system-wide approach focusing on transition risks until 2030
 - Results expected by Q1-2025

- Evaluate risk differentials between assets based on sustainability drivers:
 - EIOPA to deliver a report in 2024
 - EBA to deliver a series of reports

- Develop further initiatives to curb greenwashing, based on:
 - European taxonomy definition of 'green' activities
 - Final ESA reports on greenwashing (expected May 2024)

- Implement new requirements for banks and insurers:
 - Adopt plans to identify and manage ESG risks (Banking Package review)
 - Develop plans to monitor and address sustainability-related financial risks (SII review)

- Assess integration of identified risks into micro- and macroprudential regulation:
 - Commission to publish a report in 2025

- Review the EU macroprudential toolkit for banks and non-banks:
 - Consider using existing instruments like systemic risk buffer, concentration limits, or borrower-based measures
 - Explore redesigning or enhancing other tools to address climate risks
 - Discussions are ongoing

- Extend systemic risk considerations to broader environment-related financial risks:
 - Cover non-bank financial intermediaries
 - Assess treatment of assets with unknown environmental exposures

- Investigate other environmental risks: The Commission plans to extend its focus beyond climate change to other environmental risks, such as those stemming from biodiversity loss and ecosystem degradation. The work on climate-related risks is expected to inform approaches to these related but distinct environmental challenges.

These steps aim to better understand, measure, and ultimately address climate-related risks to financial stability in the EU financial system.