

To: Long Term Investments & Sustainable Finance PG
cc: Solvency II Working Group
From: Investment Team
Date: 20-04-2021
Reference: ECO-LTI-21-039

Subject: EIOPA opinion on the supervision of climate change risk scenarios in ORSA

Summary

Yesterday, EIOPA published its [opinion on the supervision of the use of climate change risk scenarios in ORSA](#). EIOPA's opinion sets out expectations on the supervision of the integration of climate change risk scenarios by insurers in their ORSA. EIOPA will start monitoring the application of this opinion by the national supervisory authorities two years after its publication.

The secretariat has assessed the final opinion (see preliminary assessment below). In case of comments, please write to investments@insuranceeurope.eu.

While EIOPA acknowledges that methodologies are still developing and that insurers need to gain experience and are expected to evolve the sophistication of the scenario analyses, EIOPA insists that competent authorities (CAs) should expect undertakings, where appropriate, to subject the identified material risks to a sufficiently wide range of stress tests or scenario analyses, including the material short and long-term risks associated with climate change.

In terms of content, according to the opinion:

- The (re)insurance industry will be impacted by climate change-related physical and transition risks. However, only a minority of insurers assess climate change risks in the ORSA via scenario analysis (and using a short-term time horizon). Therefore, it is essential to foster a forward-looking management of these risks to ensure the long-term solvency and viability of the industry.
- National supervisory authorities (NSAs) should expect insurers to integrate climate change risks in their system of governance, risk-management system and ORSA, similar to all risks undertakings are or could be exposed to. In the ORSA, insurers should identify material climate change risk exposures in the ORSA and subject these material exposures to a risk assessment.
- Climate change risks should be assessed not only in the short-term, but also in the long-term using scenario analysis to inform the strategic planning and business strategy. Insurers should subject material climate change risks to at least two long-term climate scenarios, where appropriate:
 - a climate change risk scenario where the global temperature increase remains below 2°C, preferably no more than 1.5°C, in line with the EU commitments
 - a climate change risk scenario where the global temperature increase exceeds 2°C
- EIOPA expects national supervisors to collect qualitative and quantitative data to perform a supervisory review of the analysis of short and long-term climate change risks in the ORSA. Instruments for data collection should be the regular supervisory reporting, most notably the ORSA supervisory report.

Preliminary assessment of the opinion

On the positive side:

- In line with the industry position that climate change risk scenario analysis should be included in the ORSA only if climate risk is material, EIOPA explicitly mentions **materiality** in paragraph 3.1, by stating that *“in the ORSA, undertakings should do an assessment to identify material climate change risk exposures and subject the material exposures to a risk assessment.”*
- While EIOPA mentions the use of two long-term climate scenarios for material climate change risks (see paragraph 3.18), the insurer **keeps discretion on the specificities of the scenarios and is not subject to use a standardised set of quantitative scenarios in the ORSA.**
- EIOPA partially recognises the **difficulties related with running long-term climate change risk scenarios** as noted in:
 - paragraph 3.22: “quantitative analyses of long-term climate change scenarios aim for a lower level of precision of balance sheet projections and are conducted at a lower frequency than short-term risk assessments in ORSA.”
 - paragraph 3.24: *“Long-term climate scenarios with a wide range of physical and transition risks will also be less susceptible to short-term developments. The long-term climate scenarios as well as the assessment of the impact of those long-term scenarios on material exposures could be updated on a non-annual basis, if properly justified by an absence of new material risk exposures. Moreover, the long-term scenario analysis could be partially updated, as additional material exposures are identified, or new methodologies and data become available.”*
- EIOPA notes explicitly that while there is a need for consistency, non-public ORSA supervisory report and **disclosures under the NFRD** have different objectives (see paragraph 3.30).

On the negative side, the EIOPA opinion is largely unchanged with respect to the draft opinion of 5 October 2020. The most concerning points (see also [Insurance Europe response](#)) are the following:

- Even if aware of the challenges in terms of required simplifications and assumptions, the opinion insists on using **climate scenario analyses in the ORSA**, even if they might not be fit for the solvency assessment. EIOPA ignored that there may be other more appropriate tools for an insurer to manage its risks. This is in line with the section on costs and benefits (see Annex 2) where EIOPA says it is confident that the costs will be outweighed by the benefits of considering short and long-term climate change risks in their ORSA.
- EIOPA continues to put the attention on **quantitative scenarios with time horizons longer than those considered in the ORSA** (“of magnitude of decades”), even if these scenarios are often unreliable and not useful to assess balance sheet impacts. The final opinion (paragraph 3.3) now includes the following: *“In contrast to the usual expectation of short-term, mid-term and long-term time horizons in the ORSA, time horizons from a climate change perspective tend to be considerably longer, e.g.:*
 - *Current climate change: “up to today” records of the impact of climate change;*
 - *Short-term climate change: projected view of climate change for the next 5-10 years;*
 - *Mid-term climate change: projected view of climate change for the next 30 years (by mid-century);*
 - *Long-term climate change: projected view of climate change for the next 80 years (by end of century).”*
- EIOPA stresses that CAs should encourage **climate-related disclosures** as *“this should contribute to the dissemination of comparable and reliable climate-related information, while recognising the potential benefits for undertakings in terms of enhanced dialogue with stakeholders, higher confidence of policyholders and better corporate reputation”.*
- While there is an understanding that **climate change risk analyses are evolving and that its quantification should follow a proportionate approach** (see paragraph 3.25), the final opinion does not encourage the **application of proportionality**. Only provided limited additions are included, where the most significant is the one noting that *“undertakings without any prior experience can start off analysing long-term climate scenarios in a largely qualitative way”* (see paragraph 3.27).