Position Paper

Insurance Europe comments to the EIOPA opinion on sustainability within Solvency II

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General comments

The European insurance industry supports the transition to a more sustainable economy and is committed to integrating sustainability further into its business model. Current examples of sustainable practices by insurers include: prevention and adaptation, loss protection/compensation and long-term sustainable financing of the economy by increasingly investing in sustainable assets.

The current Solvency II framework is not a barrier to the integration of sustainability. In particular, sustainability risks are incorporated into the current Solvency framework, through an undertaking's risk management, governance and the own risk and solvency assessment (ORSA). In this context, it is key to highlight that Solvency II should focus primarily on sustainability risks that are relevant for their economic and financial standing.

With respect to the EIOPA's draft opinion, the insurance industry appreciates that:

- The general valuation principles of Solvency II already allow insurers to integrate financially material sustainability risks. The valuation focus in Solvency II should remain on market values.
- Continued improvement in the quality and scope of public disclosure on sustainability risks is appreciated. Provided there is available quantitative evidence, this will allow better incorporation of climate change risks on the assets and liability sides of an undertaking.
- With respect to capital requirements, the sector believes that any differential treatment between green assets or brown assets should be based on a proven difference in the underlying risks.

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However, Insurance Europe notes that:

- The direct incorporation of a uniform quantitative approach into the ORSA, based on a standardised set of climate change scenarios, would contrast with the very nature of the ORSA, which is company-specific and with a unique time horizon.
- With respect to the use of a forward-looking approach insurers should be given maximum flexibility to use the most suitable tools to deal with sustainability risks in line with their undertakings' specificities. Good practices should be based on high-level non-binding principles.
- Proportionality should be duly considered in any proposed requirements.

Key messages by topic

On the challenges of integrating sustainability risks in prudential Pillar 1 requirements

- Insurance Europe agrees that no change in the time horizon for capital requirements would be required to integrate climate change considerations. The impact of climate change in the long term can be captured with complementary tools, such as scenario analysis. These tools should be suitable for the specific situation of the undertaking.
- Insurers should consider sustainability risks, and in particular climate change risks, in a forward-looking manner. In this respect, Insurance Europe notes that:
  - Sustainability risks are already incorporated into the current Solvency framework and no new requirements should be implemented.
  - Undertakings should maintain sufficient flexibility to reflect and integrate sustainability risks in line with their specific business model. This will allow them to effectively integrate material sustainability risks in their internal processes.
- The European stress testing exercise may be helpful to incorporate a forward-looking approach. The industry looks forward to engaging with EIOPA on its biennial European stress testing exercise, to ensure that its design and the calibration of the scenarios are appropriate.
- Long-term scenario analysis in risk management, governance and ORSA could also enable insurers to develop a forward-looking approach with regard to financially material sustainability risks, provided:
  - Undertakings have full flexibility.
  - Proportionality is considered: small insurers with simple risk profiles should not prepare scenario analyses at all.
- Given the long-term horizon of sustainability risks, a qualitative approach is equally valuable for risk management, governance and ORSA. In addition, access to a set of non-binding high-level principles would be useful to help each insurer determine whether and how to incorporate sustainability risks in its risk management, governance and ORSA, in line with its specific business profile and without impeding a company-specific ORSA.
- On the ORSA, the industry believes that standardised quantitative scenarios could become an impediment to carry out such a company-specific ORSA. The ORSA should remain company-specific.

On the valuation of assets

- The general valuation principles of Solvency II allow for integration of all material risks, including financially material sustainability risks. Asset valuation in Solvency II does not need to be changed and should remain based on the use of current market values.
- The industry appreciates continued improvement in the quality and scope of public disclosure on sustainability risks. Public disclosures can help better incorporate sustainability factors in market prices.
- External sustainability information should be disclosed in a more appropriate user-friendly document, while the SFCR should contain references to sustainability only with respect to relevant sustainability risks affecting the solvency and financial situation of the undertaking (current requirements in Art. 263 and 296 are sufficient).

On the valuation of liabilities

- EIOPA's suggested good practices for integrating sustainability in the valuation of liabilities cannot be generalised to all undertakings, as their applicability depends on the products and circumstances of an undertaking and the nature and scale of the risks.
- With respect to the integration of sustainability in the valuation of liabilities, the industry notes that:
  - More clarity is needed on what EIOPA expects from insurers that must "develop and use forward looking cat modelling".
  - Maximum flexibility should be given to insurers regarding stress-testing and scenario analysis.

  Market participants should be able to develop their own good practices and individually choose the best method for capturing future developments including climate change.
- Forward-looking modelling is difficult and overly sophisticated for some insurers to implement. In this respect, it is key that the principle of proportionality is reflected.
- Future developments of mortality rates are already considered in the calculation of the best-estimate life technical provision. Any substantial change in the best-estimate is regularly considered. If there is reliable quantitative evidence that climate change risks affect the technical provision calculation, then it should be taken into consideration.
- Even if there were channels through which climate change would affect mortality rates, it would be very difficult to accurately capture these mechanisms in these rates.
- Climate change is not substantially relevant for economic scenario generators. Their calibration should be based on observed market-values.

On investment practices

- Insurers apply various references and classifications to guide their sustainable investments strategies.
- Increased transparency and targeted information on companies are crucial prerequisites to include sustainability risks in the investment strategy.
- Sustainable investments are subject to the same targets and measures of expected return as any other investments. Insurers' approach to investing is not different for sustainable assets compared to any other investments.
- Insurers have a duty of diligence and care for their policyholders. It is their task within the prudent person principle to address financially material sustainability risks in the assessment of investments.

On underwriting practices

- The sector encourages EIOPA to further clarify the definition of "impact" underwriting and its scope, especially in the context of Solvency II.

On capital requirements

- In general, the sector agrees with EIOPA that no clear conclusions can be drawn as to the difference in risk profile of sustainable and non-sustainable assets. There is no clear available evidence that shows risk differences between green assets or brown assets at aggregate level. Any differential treatment of investments should be based on a proven difference in the underlying risks.
- On property risk, the insurance industry reiterates that using IPD indices with substantial weights on the UK real estate market is inappropriate. UK data do not capture the specificities of other real estate markets in the EU and are highly volatile compared to them.
- Recalibration of the parameters for the natural catastrophe risk module of the standard formula on a regular basis should aim at capturing climate related developments. The recalibration process should be transparent with respect to the data used and the methods applied.
- Regular recalibration of natural catastrophe risk parameters will capture climate-related developments sufficiently well, since they occur over a long-time horizon. Therefore, the insurance sector is sceptical about changing the design of the natural catastrophe risk module of the standard formula.

On internal models

- The insurance sector agrees that internal model design and calibrations do not prevent internal model undertakings from accounting for sustainability factors.

Challenges on integrating sustainability risks in prudential Pillar 1 requirements

Q1. Do you agree that no change in the time horizon for capital requirements would be required to integrate climate change considerations? Please elaborate.

Yes.

No change in the time horizon for capital requirements would be required to integrate climate change considerations. In this respect, the insurance sector agrees with EIOPA that climate risks do not materialize in one year, but over time. It also believes that using a longer time horizon would not be an appropriate solution to this issue, as it would not help assess when and how solvency would be affected. If anything, a longer time horizon for the SCR would likely lead to over-capitalization of the industry and higher uncertainty in the SCR levels, especially due to the difficulty with climate change prediction.

Moreover, the risk of severe events, eg those caused by climate change, is already captured in the capital requirements computations. In fact, with respect to the current capital requirements calculations, undertakings must withstand shocks that happen with a 1 in 200 probability in a one-year time horizon. Therefore, current requirements are sufficient for their purpose, ie to ensure that undertakings can deal with severe unexpected shocks (losses) and still meet their obligations to policyholders over the following a one-year period.

Insurance Europe also agrees that the impact of climate change in the long term could be captured with complementary tools, such as scenario analysis. These tools, including scenario analysis, should be suitable for the specific profile of the undertaking and represent only one of the potential tools that an undertaking could use to deal with sustainability risks.

Q2: Do you agree that insurers should consider sustainability risks, and in particular climate change risks, in a forward-looking manner? If yes, how should this be incorporated into current or new requirements? If not, please elaborate.

Yes.

In principle Insurance Europe agrees that insurers should consider sustainability risks, and in particular climate change risks, in a forward-looking manner, especially when these risks are expected to have a future material impact on the balance sheet of the insurance company.

The insurance industry notes that sustainability risks are already incorporated into the current Solvency framework and that no new requirements should be implemented. In fact, according to Art. 44 of the Solvency II Directive, undertakings already have to identify, assess, manage and monitor the risks to which they are or could be exposed. This includes sustainability risks.

Regarding the implementation of a forward-looking approach, the insurance sector believes that undertakings should be given sufficient flexibility to reflect their specific business model and integrate sustainability risks in their relevant processes and business decisions. The principle of proportionality also needs to be reflected in the consideration of sustainability risks in a forward-looking manner: the size and maturity of the undertakings' obligations, the risk level connected to those obligations, the nature and the regionality of the insured risks need to be considered.

Sufficient flexibility must be maintained to allow undertakings to reflect and integrate sustainability risks in line with their specific business model. Considering the specific risk profile of each undertaking, it is of utmost importance to allow undertakings to develop and apply own risk assessment methodologies. Uniform

requirements cannot take into account geographical specificities related to climate change risk and reflect the undertaking's individual risk situation adequately.

While the ORSAs may have a forward-looking perspective with regard to material sustainability risks, insurers should decide whether it is the right instrument to capture climate change risks over time, in line with their specific business profile. At the same time, the insurance sector acknowledges that EIOPA is currently investigating two proposed sets of climate change scenarios in the context of a separate workstream, namely the currently biennial European stress testing exercise. The insurance industry believes that the European stress testing exercise may be helpful to incorporate a forward-looking approach. The industry looks forward to engaging in this separate workstream, to ensure that its design and the calibration of the scenarios are appropriate.

With respect to both long-term scenario analysis and stress testing, EIOPA's expectations need to be clarified. In particular, the insurance sector stresses that:

- It is unclear how to separate the various effects of sustainability risks (or climate change risk) from other factors.
- While historical data is not enough to predict climate change risks, forward-looking company data (pathways) is not available in a systematic manner and is not of sufficiently high quality.
- There are no agreed scenario assumptions and methodologies to project key variables, including insurance uptake/exposures and vulnerabilities into the future, for instance for a period 2030-2040.

Q3: Do you agree that long-term scenario analysis in risk management, governance and ORSA should enable insurers to develop a forward-looking approach with regard to sustainability risks, and in particular climate change risks? Please elaborate.

Yes.

Long-term scenario analysis in risk management, governance and ORSA could enable insurers to develop a forward-looking approach with regard to financially material sustainability risks. However, insurers should have the possibility to decide whether and how to incorporate a forward-looking approach, especially within their ORSAs. In particular, undertakings need to have full flexibility to reflect:

- Differences in time horizons: climate change has a longer time horizon compared to that of long-term scenario analysis in risk management, governance and ORSA.
- Company specificities: the analysis of sustainability risks is dependent on the company-specific strategy and risk assessment. The measurement and quantification of sustainability risks is necessary only when these effects are financially material for the undertaking.

With regard to proportionality, it should be possible for small insurers with simple risk profiles not to prepare scenario analyses at all. A qualitative assessment, with the possibility to use scenario analysis, should be sufficient in this case. This considered, the insurance sector notes that it might be useful for the sector to have access to a set of non-binding high-level principles to help each insurer determine whether and how to incorporate sustainability risks in its risk management, governance and ORSA, in line with its specific business profile and without impeding a company-specific ORSA.

In general, the insurance industry notes that, given the long-term horizon of sustainability risks, a qualitative approach is equally valuable for their analysis in risk management, governance and ORSA. While financially material sustainability risks can be considered both from a qualitative and quantitative view, the undertaking should decide which quantitative or qualitative tools are most appropriate to consider sustainability risks. In particular, while the ORSAs may have a forward-looking perspective, each insurer should decide whether it is the right instrument to capture climate change risks that will materialise over a longer time. This will depend on the insurer's strategy, which usually provides for a longer-term perspective than the business plan.

Q4: What are your views on incorporating a standardised set of quantitative scenarios in the ORSA, e.g. derived from the IPCC representative concentration pathways (RCP) - which are likely to evolve over time? Can you please elaborate on which scenarios you would use and which time span should be covered by such scenario analysis, specifying your approach for the valuation of assets, liabilities and your own solvency assessment (for standard formula and internal model users)?

The insurance industry believes that the ORSA should remain company-specific. A standardised set of quantitative scenarios could become an impediment to carry out such a company-specific ORSA. While the insurance industry acknowledges that it might be helpful to have access to a set of non-binding high-level principles, it is key that each insurer remains free to decide how to incorporate sustainability risks in its risk processes.

The industry highlights that there are a number of issues associated with the development of a standardised set of quantitative scenarios in the ORSA, including the lack of consensus among experts regarding the choice of scenarios and their evolution in the future. Defining a standardised set of quantitative scenarios for all countries across the EU is even more challenging (see the existing modules for natural catastrophe risk). Therefore, the ORSA would not be the right place to introduce a standardised set of quantitative scenarios. Stress tests at European level would be a more appropriate tool in this respect.

While EIOPA should follow up on the RCP, the industry highlights that some of the issues associated with quantitative scenarios may be better addressed through qualitative scenario analysis. Climate-related scenarios should ideally cover a wide range of plausible climate change conditions, but also consider fixing other boundary conditions (as variables or assumed constants) relevant to population development, urbanization and concentration, land use, migration to the coasts, early adaptation measures, changes to the build environment, ie factors currently changing the physical risk landscape at a fast pace. This broad and dynamic approach may be better addressed through qualitative analysis.

The industry encourages EIOPA to remain cognisant of various initiatives in individual member states, eg the PRA/FCA Climate Financial Risk Forum.

Valuation of assets

Q5: Do you agree that the principles of valuation of assets of Solvency II allow for the consideration of sustainability factors? Please elaborate.

Yes.

The insurance sector fully agrees with the valuation hierarchy of Solvency II (Art. 10 in the Delegated Regulation). The general valuation principles of Solvency II allow for integration of all material risks, including financially material sustainability risks. In a deep liquid and transparent market, market asset prices reflect all known and quantifiable information, including information on sustainability risks. The industry therefore believes that asset valuation in Solvency II does not need to be changed and should remain based on the use of current market values.

In point 7.17, EIOPA argues that "the availability and quality of information on sustainability risk and sustainable investments, may not be at a level of granularity and consistency today that allows for full reliance on the market valuation". While the industry recognises that not all market valuations perfectly capture information associated with sustainability factors, any artificial adjustments of asset prices would risk leading to unintended consequences. Instead, Insurance Europe believes that this type of uncertainty is better handled with other tools, eg risk management. Given the degree of uncertainty, and the fast-developing nature of this policy area, the insurance sector encourages EIOPA to work with the industry to develop its approach to this issue.

This considered, the industry appreciates continued improvement in the quality and scope of public disclosure on sustainability risks to support market evaluation. Improved information on sustainability risks will support market evaluation. In addition, it will help insurers ensure consistent valuations of assets and liabilities in terms of used climate change scenarios. Finally, as already highlighted in occasion of the consultation on EIOPA's technical advice on the integration of sustainability risks and factors in Solvency II and IDD, the consideration of sustainability factors must not result in a contradiction or limitation of the principle of freedom of investment (Art. 133 of the Solvency II Directive). Also, such consideration and related investment best practices should not contradict the requirement to act in the best interest of existing stakeholders of the company, including its policyholders.

Q6: How in practice could the valuation of assets adequately (better) reflect sustainability risks?

Please see answer to question 5.

The insurance industry reiterates that the principles of sustainability should be highlighted in the market value trend and it agrees that improved public disclosures can help better incorporate sustainability factors in market prices.

The industry stresses that identification and assessment of climate change risks on a company-wide scale is complicated:

- There is a lack of clear definitions and rules for the classification of sustainable activities.
- Climate-related corporate disclosure is at its early stages of development, which in turn negatively affects data availability and quality.
- Models and methodologies that consider sustainability in asset valuation are new. Also, there is no consensus on the validity of used scenarios, including climate change trends and future technological developments.
- Even when data are available, there are significant data inconsistencies between data providers and environmental, social and governance (ESG) rating agencies, eg on carbon footprint. Moreover, such data is expensive, especially for small- and medium-sized insurers who are fully dependent on

external data providers and ESG-rating agencies. This situation can be even worse when there are oligopolistic structures in the ESG market and coverage issues.

For these reasons, the industry believes that a minimum standardization and oversight on data providers and ESG agencies could be beneficial in terms of data quality.

Q7: Should prudential disclosure requirements (e.g. Articles 263 and 296 of the Delegated Regulation) be amended to explicitly include sustainability considerations? Please elaborate.

No.

The current requirements in Art. 263 and 296 are sufficient. In fact, they require insurers to consider the valuation uncertainty and to state the assumptions underlying the valuation approach, which might also include sustainability considerations. Therefore, no changes are required to the Articles.

The industry also stresses that a distinction needs to be made between:

- The need to publicly report sustainability considerations – in this respect, regulations are already introducing sustainability-related disclosures (eg Non-Financial Reporting Directive and Disclosures Regulation).
- The current Solvency and Financial Condition Report (SFCR) framework and sustainability disclosures in it – in this respect, the industry raises its concerns about the current effectiveness of SFCRs, which contain extensive information and are rarely read by external stakeholders. In order to increase its impact, the SFCR should be focused on the key target groups.

The industry believes that external sustainability information should be disclosed in a more appropriate user-friendly document, while the SFCR should contain references to sustainability only with respect to relevant sustainability risks affecting the solvency and financial situation of the undertaking.

Finally, the industry notes that multiple changes in disclosures times over time might not be efficient for the disclosures users and for insurers. Such changes are burdensome for insurers and do not enhance understandability and comparability of information for disclosure users.

Q8: Should other enhancements / changes to the current regulations be envisaged regarding the consideration of sustainability factors in the valuation of assets?

No.

No other enhancements / changes to the Solvency II regulation are needed. Requirements on improved disclosures need to be addressed to a broader group of companies to facilitate the consideration of sustainability risks in the valuation of assets. This will also ensure that ESG data is available at affordable prices.

Sustainability/ESG ratings will unavoidably affect the market value of assets insurers will invest in. Therefore, a regulatory framework should ensure that sustainability ratings, which are provided by independent assessors, are comparable and reliable for investors. As the coverage of ESG rating agencies expands, the large majority of insurance companies will need expertise and resources to assess the sustainability ratings. At the same time, obtaining specific sustainability-related information could end up being unreasonably demanding, especially for small insurers fully relying on third party providers. In this respect, proportionality needs to be duly considered.

Q9: Do you have additional views and evidence to be considered with regard to the exposure to physical risks?

No.

The insurance sector notes that green-labelled assets may be equally exposed to physical risks as brown-labelled assets (eg offshore wind power).

Q10: Do you have additional views and evidence to be considered with regard to the exposure to transition risks?

No.

Insurance Europe agrees with EIOPA that the exposure to transition risks depends to some extent on the sector of the investment and that sectors most impacted are those involved with / exposed to carbon intensive activities (ie risk of stranded assets). However, a holistic approach, inclusive of all ESG risks, might be more appropriate. Climate transition risk analysis should cover the whole investment portfolio and not only a limited number of asset classes that currently appear most exposed. This is because exposures to transition risk can substantially change over time due to a multiplicity of factors. In this respect, insurers are well placed to assess material transition risks, especially in consideration of their role in the prevention of claims/damages.

With a view to the level playing field and appropriate and harmonized valuation of assets (eg mortgages, covered bonds), it is essential that EIOPA's considerations are aligned with those of the European Banking Authority (EBA) on asset valuation and risk management. As a consequence, risk-related regulatory requirements for insurers and banks cannot be contradictory.

Valuation of liabilities

Q11: Do you agree with the good practices EIOPA is suggesting for undertakings to apply for integrating sustainability in the valuation of liabilities? Would you have further suggestions?

No.

The good practices that EIOPA suggests for integrating sustainability in the valuation of liabilities cannot be generalised to all undertakings, as their applicability depends on the products and circumstances of each undertaking, as well as on the nature and scale of their risks. While the first two "good practices" appear reasonable and are commonly used, more clarity is needed on what EIOPA expects concretely with "develop and use forward looking cat modelling". With respect to stress-testing and scenario analysis, the industry believes that maximum flexibility should be given to insurers. Overall, given the great uncertainties in this area, the insurance industry believes that good practices should be based on high-level principles that allow for flexibility.

The sector notes that there may be a number of reasons why undertakings do not include explicit climate-change related risk adjustments in their Best Estimate, as evidenced in paragraph 7.32. In particular, the insurance sector agrees with the statement in 7.36 that the annual validation of assumptions is fit for purpose for short duration business.

Premium provisions cover claims incurring in the future, and climate changes could potentially affect these future claims. There are two ends to the spectrum:

- For undertakings with only short-term business (at most one-year duration) and claims with a short settlement period (a few months), only the climate change impact in the following year matters. As climate changes will not evolve over the premium provisions' run-off period, the uncertainty regarding climate change is rather small, often accounted for by means of a reinsurance cover for the duration of the contracts. In these cases, a proportional method to implicitly capture climate change effects is the extrapolation of the past development (total development without restriction to natural catastrophe risk) to the future, taking into account materiality aspects. This is already good actuarial practice when calculating technical provisions.
- For undertakings with long-term business and claims with long-term settlement periods, long-term development may be relevant. Therefore, it should be explicitly captured, also by means of complex methods. Some of the current practices suggested by EIOPA can be valuable methods, eg using up-to-date data considering Events Not In Data (ENIDs), stress-tests, scenario-analysis and models with a long forecast time horizon. Professional judgment is also key, as in some cases stress-tests and scenarios analysis are unlikely to provide new insights. Finally, Insurance Europe notes that solvency requirements need to be met in addition to the best estimate and, therefore, the best estimate should not contain any unjustified prudence.

This considered, while the first two suggested practices might be reasonable, the insurance sector believes that market participants should be able to develop their own good practices and choose individually the best method for capturing future developments including climate change. If EIOPA nevertheless decides to go on with its proposal, more appropriate wording would be (new wording in bold) either:

- "Undertakings should, **where relevant**, apply the following good practices:"
- "Undertakings should apply the following good practices **in a manner proportionate to the scale and type of exposures they face**:"

Q12: What is your view on adopting a forward-looking modelling approach in the calculation of the best estimate to assess climate change-related risks? Please elaborate.

The sector believes that forward-looking modelling presents a range of technical difficulties outside the control of individual insurers. Forward-looking modelling may become highly speculative over long-time and is resource intensive, which raises proportionality issues. The sector notes that all best estimates should already capture relevant sustainability risks based on available information.

The provisions for claims take into account losses that have already occurred and those claims are estimated on the basis of past settlement data. Climate change is not expected to affect loss settlement. It is irrelevant, whether the losses/events were caused by climate change. Therefore, the forward-looking approach is not applicable for claims provisions.

The calculation of premium provisions can be done in a forward-looking manner. Premium provisions are determined from future cash flows. The main factor of the premium provisions is the combined ratio. This ratio includes the expected average claims expenditure for natural catastrophe events. The insurance cover period is of relevance and sets a limit on the time span that needs to be considered. Materiality aspects should be considered, especially against the background that the premium reserve usually is small compared to the overall best estimate. Moreover, for life insurers, climate change could even have some positive effects.

Q13: What would you consider to be proportionate good practices for such a forward-looking modelling approach in the calculation of the best estimate?

The insurance sector agrees with EIOPA that the principle of proportionality needs to be reflected. In this regard, EIOPA refers to the size and maturity of the undertakings' obligations. The risk level connected to those obligations, the nature and the regionality of the insured risks also needs to be considered.

In order to avoid excessive burden on small insurers, the introduction of thresholds can be used to exclude them from the most burdensome requirements. For example, in the case of stress testing and scenario analysis, the industry believes that maximum flexibility should be given to insurers to choose how to assess financially material sustainability risks in their processes, either in a quantitative or qualitative way.

Q14: Do you agree that climate risks may affect the technical provision calculation for the life insurance? Please elaborate.

In principle, climate risks may impact some assumptions used in the calculation of life technical provisions, eg mortality for elderly/fragile people may increase due to heatwaves and natural catastrophes (unrelated to age and health). However, the extent to which this will affect mortality tables is not clear and positive effects for some insurers are also possible.

Nevertheless, this is probably going to be a less significant risk in Europe in comparison with other continents (see answer to Q15).

Q15: Do you agree that the two main assumptions/areas where climate may impact the calculation of life technical provisions are the Economic Scenario Generators and the mortality rates? What about morbidity rates? Please elaborate.

No.

Future developments of mortality rates are already considered in the calculation of the best-estimate life technical provision. Mortality rates are influenced by several aspects and climate is not the most important one. Furthermore, the insurance sector does not see any impact to morbidity rates with relevance to life and invalidity insurance issues. Life insurers keep careful check on mortality and morbidity assumptions.

Any substantial change in the best estimate is regularly considered. If there is reliable quantitative evidence that climate change risks affect the technical provision calculation, then it should be taken into consideration.

Q16: Is climate change relevant for Economic Scenario Generators? If yes, how could climate change be included in Economic Scenario Generators? Please elaborate.

No.

The sector believes that climate change is not substantially relevant for Economic Scenario Generators (ESGs). As mentioned by EIOPA before, the core principle of Solvency II is a market-adjusted valuation of technical provisions. Therefore, calibration of ESGs should be based on observed market-values. If there is reliable quantitative evidence that sustainability risks affect ESGs, then ESGs providers should incorporate this information as input in their ESGs.

Insurance Europe notes that under a risk neutral approach, climate change should have no impact. When ESGs are utilized for a risk-neutral simulation, the focus of the calibration will be on the reproduction of derivative market prices. In a risk-neutral context, the possible impact of climate change should be indirectly reflected in the value of assets, not in the construction of economic scenarios and risk neutral assumptions. The ESGs should be calibrated to market price data as tightly as possible so that the pricing of insurance liabilities and other contingent claims that are not priced in the market will have prices that reflect liquid market prices as accurately as possible.

Q17: Is the impact of climate change relevant on the mortality rates? If yes how could climate change be included in mortality rates? If no, please elaborate.

No.

In the short to medium term, it is unlikely that climate change will have any significant impact. Climate change may have a wide range of effects on mortality drivers: decreased winter-related mortality (eg illness, exposure) alongside increased summer-related mortality (eg heatwave). The overall effect of climate change on mortality rates will be difficult to capture given current data availability and models.

Investment practices

Q18: Do you identify other relevant practices to include sustainability risks in (re)insurers' investment strategy and decisions?

No.

Increased transparency and targeted information on companies are crucial prerequisites to include sustainability risks in the investment strategy. This will also improve not only the consideration of sustainability risks as required in the prudent person principle, but also their consideration in the insurers' risk assessments.

In this respect, EIOPA presents broad practices to include sustainability risks in (re)insurers' investment strategy and decisions. Although somewhat overlapping, Insurance Europe would like to draw attention to the following classification of Socially Responsible Investment (SRI) by Eurosif, a European association for the promotion and advancement of sustainable and responsible investment across Europe (which also closely aligns with other frameworks available to the industry):

1. Sustainability themed investment
2. Best-in-Class investment selection
3. Exclusion of holdings from investment universe
4. Norms-based screening
5. ESG Integration factors in financial analysis
6. Engagement and voting on sustainability matters
7. Impact investing

Based on the above classification, Eurosif's collects data on investors' use of SRI strategies and presents it in a public report.

Other existing references and classifications which guide insurers' sustainable investment strategy include:

- UN guiding principles on business and human rights
- OECD MNE guidelines and national business recommendations
- Equator principles

Q19: Do you have any further views on the analysis of returns on sustainable assets?

No.

Sustainable investments are subject to the same targets and measures of expected return as any other investments.

Insurers' approach to investing is not different for sustainable assets compared to any other investments. Insurers have a duty of diligence and care for their policyholders, and this duty applies to all types of assets they invest in. The investment assessment is multifactorial. The matching of assets and liabilities, the risk-return profile and the level of market risk are among the key factors that are taken into account when deciding on the asset allocation. Sustainability is also increasingly becoming relevant in the execution of asset allocation policies of insurers.

Q20: To what extent do you align your investment strategy and decisions with your underwriting strategy and decisions in respect of sustainability risks?

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Q21: Which good practices do you identify to deal with transition and physical risks in (re)insurers asset portfolios?

As stated before, insurers have a duty of diligence and care for their policyholders. It is their task within the prudent person principle to address sustainability risks in the assessment of investments, as long as they are financially relevant for the undertaking. The consideration of sustainability factors could be part of a general risk/return assessment of assets. To a certain extent, also the ORSA could be used to examine these risks, provided each insurer is given flexibility on whether and how to do so.

This considered, diversification is a key risk management strategy to deal with any kind of risk. A well-diversified portfolio with different kinds of assets in terms of geography, sector and other considerations will, on average, have a lower risk than concentrated portfolios. Any part of the portfolio that has a higher degree of concentration, eg sovereign bonds or real estate, may require a more in-depth risk analysis. A global investment strategy is the best and most efficient way to support the sustainability transition and deal with climate-related risks.

Finally, as already highlighted in occasion of the consultation on EIOPA's technical advice on the integration of sustainability risks and factors in Solvency II and IDD, the consideration of sustainability factors must not result in a contradiction or limitation of the principle of freedom of investment (Art. 133 of the Solvency II Directive). Also, it has to be ensured that such consideration and related investment best practices do not contradict the requirement to act in the best interest of existing stakeholders of the company, including its policyholders.

Underwriting practices

Q22: Do you consider "impact underwriting" described in the opinion to be a relevant way to take into account sustainability in underwriting policy?

Yes.

The insurance industry appreciates the fact that EIOPA recognises the importance of risk mitigation and adaptation strategies, which have always been key for the insurance sector and which European regulators have worked on for a number of years. In this respect, the sector encourages EIOPA to further clarify the definition of "impact" underwriting and its scope, especially in the context of Solvency II. It needs to be clarified that "impact underwriting" should only take into account considerations which are based on or related to risk, as part of the underwriting process.

The industry believes that "impact underwriting" could be particularly relevant in cases where risk mitigation and loss prevention could make a significant difference. In this respect, a distinction should be made between:

- Retail clients — In this case, insurers have limited leverage. For non-life insurance, insurers can include risk mitigation and prevention strategies in the product design for damages such as fire or theft. In those cases, the prevention is individual.
- Companies / local authorities — In this case, insurers might have more impact. Companies and local authorities' can implement risk mitigation and adaptation strategies at their level. Thus, the "impact underwriting" is more relevant. A collaboration between insurers, companies and local authorities could raise awareness of risks and standardise risk categories. The effect will be twofold: the policyholder will try to prevent risks and the insurer will be able to segregate the different risks.

Focusing on natural catastrophes, the sector notes that prevention should be collective and be implemented by local authorities as well as companies, eg due to legal obligations. Collaboration with local authorities and companies helps to improve data quality and even create new databases on the vulnerability to climate change, eg on the resilience of housing regarding the construction material, structural integrity, etc.

Q23: Do you explicitly consider risk mitigation and adaption strategies addressing climate change in your products? Please elaborate.

a) What would be the main benefits/obstacles of the generalisation of such a practice?

b) Which measures would you recommend to assess the risk mitigating effect of such underwriting?

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Q24: Do you identify other good practices than those described above?

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Q25: What are your views on climate change potentially widening the protection gap for natural catastrophe (re)insurance?

It may happen in some markets and extreme cases due to higher frequency and cost of claims, but the private industry is expected to be able to deal with these issues in most cases. The main problem will not be that some risks will no longer be insurable, but that households and businesses may no longer be able to stay in their current location and may have to relocate.

A number of insurers cooperate with local governments in public-private sector partnerships to share their expertise in risk awareness and management, eg to provide affordable insurance and high penetration rates. Flood risk in some countries represents a good example.

Q26: Do you have evidence on Solvency II impacting the insurance protection gap (e.g. for natural catastrophe risks) in light of climate change? Please elaborate.

No direct evidence available. No impact from Solvency II is expected on insurance protection gap in Europe (see answer to Q25).

Q27: Market risk:

a) Do you support the views on the treatment of sustainability risks in the market risk module?

Yes.

The insurance sector agrees that in principle the current Solvency II framework does not represent a barrier to investments in sustainable assets and that some market risk categories might be more affected by sustainability considerations, ie "property risk", and possibly counter party default risk in relation to mortgage loans.

The industry also agrees with EIOPA's acknowledgement in point 9.15 that investing in a sustainable manner often requires long-term engagement. Therefore, barriers to follow a long-term investment strategy also represent barriers to investing sustainably.

The industry is not in favour of the inclusion of a green supporting factor or a brown penalising factor in the SCR calculation. In general, there is no clear available evidence that shows risk differences between green assets or brown assets at aggregate level. In this respect, the sector supports EIOPA's view that any differential treatment of investments should be based on a proven difference in the underlying risks (point 9.16).

If asset classes in the standard formula framework should be refined with respect to the exposures to physical, transition and sustainability risks, the best way forward would be to investigate correlations and risk parameters of specific asset classes with high-quality data.

b) Do you have further evidence which should be considered?

No.

The sector agrees with EIOPA that no clear conclusions can be drawn as to the difference in risk profile of sustainable and non-sustainable assets. There is no clear available evidence that shows risk differences between green assets or brown assets at aggregate level. If there is any evidence that green or brown assets are exposed to different risks than other assets of the same asset class, these risks should be taken in account. In fact, the prudent person principle requires insures to consider financially relevant sustainability risks in their investment portfolio. This aspect is already stressed within EIOPA's technical advice on the integration of sustainability risks and factors in Solvency II.

Once the work on the EU taxonomy on sustainability is complete, and corporates start reporting accordingly, all investors will be better positioned to assess their asset allocations against climate change objectives. In this respect, the insurance sector reiterates that:

- The ESG factors need to be considered together and on a case by base approach. This will avoid instances where, on the one hand, a "green" asset has negative social impact, and on the other hand, a "brown" asset has positive social impact.
- The EU taxonomy is not a prudential tool designed to identify assets that have a higher/lower exposure to physical, transition and sustainability risks or to assess the sustainability risks of investments. The taxonomy provides a sustainability classification of economic activities. However, the classification of assets for prudential reasons should be based on their specific exposure to physical and transition risks. In certain cases, the so called "green" assets may also be exposed to physical risks to a great extent (eg offshore wind power). Therefore, it is key to look at the risk exposure of the specific assets.

Q28: Property risk: Do you have additional views and evidence to be considered with regard to the integration of sustainability risks in property risk capital charges?

No.

The insurance industry reiterates that using IPD indices with substantial weights on the UK real estate market is inappropriate. UK data do not capture the specificities of other real estate markets in the EU and are highly volatile compared to them. This considered, the insurance sector agrees with EIOPA that more transparency can help address real estate exposure to physical and transitional climate risks (eg long-term nature of property investments). As a solution, EIOPA states that a comparable IPD total return index and a sustainable investment index are needed.

While such indices may be a useful source of information, both a clear definition of green/sustainable property and more granular data would be needed in order to calculate a different risk profile for a subset of the property risk. Such an approach would be challenging for a number of reasons:

- the difficulty to appropriately capture both physical risks and energy efficiency
- the geographical differences throughout Europe, especially for physical risks
- the lack of data at market level and at asset level
- the lack of reliable data on Scope 3 emissions, etc

The industry stresses that asset-level information is key to assess sustainability and climate risks in the real estate context. Focusing on this aspect, it is clear that information is even more inadequate:

- Real estate (market/performance) indices rely on small samples of properties, funds, investments (eg IPD) which are not representative of the EU market and often do not capture appropriately sustainability, eg by taking into account SCOPE 3 emissions.
- Certified "green buildings" (as a proxy for sustainable real estate) represent a small share of the overall property market, meaning that the creation of a sustainable index will be extremely challenging, eg due to representation and sample size. Even using energy certificates for buildings in the countries where they are compulsory would only be a rough proxy for their greenness and it would come with a series of issues, eg an energy certificate might only be required for a sale/rental of existing buildings or may not consider other aspects, eg use of insulation materials.

Q29: Equity risk:
a) Do you have comments on the analysis of risk differentials for listed equity? Please elaborate.

No.

The insurance sector agrees with EIOPA that equity prices are multifactorial and therefore sustainability risks and factors are difficult to isolate, and that the necessary long-term data required for analysing potential risk differences does not exist.

Due to existing issues, the insurance industry believes that it is premature to differentiate capital requirements for sustainable listed and unlisted equity based on risk differentials, even though it might be possible in the future. Equally important, a binary green/brown approach is not a precondition for insurers adopting efficient asset allocations against climate change considerations.

Apart from that, the following aspects are also relevant:

- The underlying investments have a dynamic component which insurers can affect through dialogue with the management and use of voting rights, when relevant.
- Some underlying activities are necessary for the transition or hard to categorise, which makes the risk assessment even more controversial, eg there is no real alternative for metallurgical coal necessary for steel production.

Therefore, the risk analysis needs to be on a case by case base and consider sustainability risks holistically. This will enable insurers to be efficient in their role of investors and potential partner of changes.

b) Do you have additional views and evidence to be considered with regard to the integration of sustainability risks in listed equity risk capital charges? Please elaborate.

No.

c) Do you have additional views and evidence to be considered with regard to the integration of sustainability risks in unlisted equity risk capital charges? Please elaborate.

No.

d) Which data sources or research conducted would be relevant to consider for unlisted equity risk capital charges?

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Q30: Spread risk:

a) Do you have additional views and evidence to be considered with regard to the integration of sustainability risks in spread risk capital charges?

On one hand, the insurance industry notes that it is easier to identify sustainable fixed income assets, eg green project bonds, than sustainable equity assets. On the other hand, the sector agrees with EIOPA that the volume of data required for a reliable calibration of spread risk on green bonds is not large enough and too recent. In addition, many issuers of green bonds issue both green and regular bonds, which makes it difficult to argue that the capital charge on these two types of bonds should be different. Therefore, while it may be easier to identify the financial instruments it may still be very difficult at this stage to differentiate spread risk capital requirements for sustainable assets.

b) Which data sources or research conducted would be relevant to consider for the integration of sustainability risks in spread risk capital charges?

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c) What are your views on the methodology for a green bond index?

EIOPA's proposed methodology appears reasonable. The sector also agrees with the limits of the proposed analysis in terms of available data for a reliable calibration.

The other key issue is that sustainability risks might affect the spread through other means or variables. Therefore, the proposed methodology should also be complemented with an analysis aimed at capturing these instances in a reliable manner.

d) Do you have additional views and evidence to be considered with regard to the integration of sustainability risks in unrated debt capital charges?

No additional views.

e) Which data sources or research conducted would be relevant to consider for the integration of sustainability risks in unrated debt capital charges?

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Q31: Do you agree that climate change should be captured in a forward-looking manner in the ORSA for market risk especially by incorporating a quantitative approach based on a standardised set of climate change scenarios?
If no, please elaborate. If yes, which scenarios/tools could be used for quantitative assessments and which time span would you apply?

No.

The insurance sector believes that climate change considerations on market risk should be considered as long as they are expected to have a material impact on an insurer's balance sheet. However, the ORSA is company-specific with differences in time horizons and in exposures to sustainability factors. Standardised quantitative scenarios would be contrary to the objectives of the ORSA.

It is key that each insurer remains free to decide whether and how to incorporate climate change considerations in its ORSA. For this reason, it is more natural for each company to focus on the impact of such factors on its profile based on general principles rather than on a prescribed standardised set of scenarios with a prescribed time span.

Q32: Do you agree that regular recalibration of the parameters for the natural catastrophe risk module of the standard formula will allow to capture climate related developments, including the impact of climate change? Please elaborate.

Yes.

Climate change does not happen as a sudden event, but it is expected to evolve over time. Recalibration of the standard parameters on a regular basis should aim at capturing climate related developments. Recalibration will allow to define more relevant parameters as models become more precise to estimate the impacts on the medium to short term.

As stated in the consultation paper, the SCR calibration is designed to support risk assessment for a 12-month period. The recalibration process should be transparent with respect to the data used and the methods applied. It is key that only high-quality data is used for the recalibration so that unstable predictions and high volatility are avoided. Historical data is most suited to ensure the fulfilment of these criteria.

Q33: Would you advise changing the design of the natural catastrophe risk module of the standard formula to capture climate related developments, including the impact of climate change? If no, please elaborate. If yes, please provide an alternative method.

No.

Regular recalibration of natural catastrophe risk parameters using recent data will capture climate related developments sufficiently well since they are gradual changes that occur over a long-time horizon. Furthermore, all perils are included in the current design. Therefore, the insurance sector is sceptical about changing the design of the natural catastrophe risk module of the standard formula. However, whenever the recalibration of the parameter takes place, it is advisable to check the emergence of new risks that should be included.

Q34: Do you agree that climate change should be captured in a forward-looking manner in the ORSA for natural catastrophe underwriting risk especially by incorporating a quantitative approach based on a standardised set of climate change scenarios? If yes, which scenarios/tools could be used for quantitative assessments and which time span would apply?

No.

The insurance sector finds it reasonable to address considerations on natural catastrophe risk in relation to climate changes in the ORSA, provided they are expected to have a material impact on an insurer's balance sheet. However, in line with the response to question 31, the insurance sector notes that each ORSA is company-specific with differences in time horizons and exposures to sustainability factors.

As finding a meaningful standardised set of quantitative scenarios might be difficult, the insurance sector suggests EIOPA to focus on the development of non-binding qualitative principles rather than a prescribed set of quantitative scenarios.

It is key that there is flexibility on how each company integrates sustainability risks in its ORSA.

Q35: How do you take into account the long term view of climate related developments, including the impact of climate change for the management of your natural catastrophe risks?

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Internal models

Q36: Do you agree the rules relating to internal model design and calibrations do not prevent internal model undertakings from accounting for sustainability factors, with particular regard to the climate risk that existing insurance and reinsurance obligations are exposed to? Please elaborate.

Yes.

The insurance sector agrees that internal model design and calibrations do not prevent internal model undertakings from accounting for sustainability factors of the climate related risk that they are exposed to. In fact, some insurers take into account the climate-related evolution of some variable included in the internal models, eg pandemics evolution in the calculation of their provisions. Additionally, lack of experience and largely unclear trends make parameterization of the climate risk extremely challenging.

Q37: Could you provide further explanation/examples on how sustainability factors, with particular regard to the climate-change risks are taken into account in your internal model?

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