

Insurance Europe overview of EIOPA final opinion on sustainability within Solvency II

Referring to: EIOPA final opinion on sustainability in Solvency II: [ECO-LTI-19-157](#)
Insurance Europe comments on the EIOPA draft opinion: [ECO-LTI-19-120](#)

Overview of EIOPA final opinion on sustainability in Solvency II

At first sight EIOPA's final opinion on sustainability in Solvency II appears close to the draft version. However, EIOPA has been receptive to a number of the Insurance Europe comments and, for the moment, it has not put forward some of the concerning proposals which were investigated during the consultation on the draft opinion, eg standardised quantitative climate scenarios in ORSA. In general, EIOPA is pushing for insurers to improve how they embed sustainability in their business, but it also appears more aware of the methodological and data limitations that the industry is facing in this area.

Valuation of assets

- EIOPA argues that **availability and quality of sustainability information should be improved**. **This** will better reflect sustainability risks/factors on market prices.
 - Comment: This is aligned with Insurance Europe position that continued improvement in public disclosure by investees helps better incorporate sustainability in market prices.
- EIOPA confirms that undertakings should understand the **external ESG ratings** on which they rely for their investments.
 - Comment: The wording has been toned down: EIOPA no longer says insurers should validate ESG ratings.
- On **alternative valuation methods**, EIOPA confirms its opinion that transparency is needed, where relevant, regarding where and which sustainability considerations insurers have considered.
 - Comment: Insurance Europe argued that the current requirements are already sufficient as they require insurers to consider the valuation uncertainty, which also includes sustainability considerations.
- On **scenario analysis**, EIOPA confirms that it as a useful tool for the assessment of uncertainties around climate change impact and for ensuring an appropriate valuation of assets over time.

Valuation of liabilities

- EIOPA notes that insurers should integrate sustainability in the valuation of liabilities, even if this is not straightforward. It argues that undertakings should ensure adequacy of the best estimate by performing sensitivity or scenario analysis. However, it acknowledges that the calculation of the best estimate should make use of the output of **forward-looking models**, "where appropriate", and "in a manner proportionate to the nature, scale and type of risks faced by an undertaking".
 - Comment: The latter is a new element aligned with Insurance Europe comment that not only the size and maturity of the undertakings' obligations matter, but also the risk level connected to them.
- EIOPA differentiates between **short-term and medium/long-term obligations**. Not only EIOPA explicitly recognises that short-term claims are less likely to be affected by sustainability risks, but it acknowledges that medium/long-term obligations need forward-looking modelling only where relevant.
 - Comment: This is in line with Insurance Europe message that for short-term business the uncertainty regarding climate change is small, while it may be relevant for long-term business.
- Regarding **mortality rates and Economic Scenario Generators**, specific recommendations have not been put forward.

- Comment: This is a positive outcome as Insurance Europe argued that:
 - climate change is not relevant for Economic Scenario Generators (reliable quantitative evidence that sustainability risks affect the Economic Scenario Generators, then providers should incorporate this information as input in their ESGs)
 - future developments of mortality rates are already considered in the calculation of the best-estimate and, even if climate change would affect mortality rates, it would be very difficult to accurately capture these mechanisms in these rates
- EIOPA asks undertakings to apply **best practices** in liabilities valuation to capture climate change.
 - Comment: The suggested best practices are unchanged, but EIOPA accepted the Insurance Europe wording "where relevant". This will give undertakings flexibility to develop their own good practices and choose individually the best method to capture climate change.

Investment practices

- EIOPA stresses that insurers should take into account sustainability factors in their investments, as well as underwriting activities, because they are "prudentially relevant". This means that it is expected that undertakings use **stewardship/engagement** on both the asset and liability sides of the B/S.
 - Comment: On one side, this is a strong statement that stresses the role that insurers are expected to play as both investors and providers of protection. On the other side, EIOPA explicitly mentions that "further work is needed".
- In comparison with the draft opinion, EIOPA also recommends that undertakings consider whether climate change has an impact on insurers' ability to hold assets in the long-term or their cash flows.

Underwriting practices

- EIOPA stresses that insurers should embed **risk mitigation and adaptation strategies** in their underwriting policy. As an example, it introduces the concept of "**impact underwriting**" defined to include the development of new insurance products, adjustments in the design and pricing of the products and the engagement with public authorities. EIOPA reiterates that there is scope for measures involving business and retail clients as well as public-private cooperation frameworks, eg for data gathering and risk assessments at national and European level.
 - Comment: The elaboration of this concept is a result of Insurance Europe request to have more clarity on this aspect of the opinion. On the engagement with public authorities, Insurance Europe stressed in the response to the consultation that a number of insurers already cooperate with local governments in public-private sector partnerships to share their expertise in risk awareness and management.

Capital requirements

- EIOPA confirms its decision not to use capital requirements as a tool for promoting sustainability as Solvency II should remain a risk-based framework. EIOPA explains that any change to capital requirements that differentiates the **treatment of green and/or brown assets** needs to be based on clear evidence of risk differentials.
 - Comment: EIOPA's opinion is therefore aligned with Insurance Europe position, which is against changes in capital requirements based on the degree of sustainability of assets. The secretariat notes that EIOPA does not exclude a differentiation between the risk profiles of assets based on sustainability characteristics in the case that significant data evidence becomes available.
- EIOPA believes that further work is needed to ensure that the **natural catastrophe risk module** reflects climate change-related perils. This will likely translate into a more frequent update in the SCR calibrations for natcat (forward-looking). EIOPA considers that further work is needed to investigate whether additional climate change-related perils such as droughts and wildfire could be better captured under the natural catastrophe risk submodule.
 - Comment: Insurance Europe agreed with EIOPA that regular recalibration of the parameters for the natural catastrophe risk module of the standard formula should aim at capturing climate related developments. In addition, it noted that the recalibration process should be transparent with respect to the data used and the methods applied.

Internal models

- EIOPA makes no specific recommendations on internal models. In general, it suggests that internal model users integrate sustainability risks not only relying on historical data, but also via the development of a more **forward-looking approach** with specific scenarios.

Challenges in integrating sustainability in Pillar 1 requirements

- EIOPA clearly recognises that the assessment of climate change depends on **materiality** of climate change-related risks and is subject to the **proportionality** principle.
 - Comment: This is a positive acknowledgment, in line with long advocated Insurance Europe messages.
- EIOPA notes that companies may use **qualitative scenarios** as a first step to assess risk implications from climate change. Where appropriate and in case of material risk exposure, it stresses that a qualitative approach needs to be complemented with **quantitative scenarios**. EIOPA also recognises that further work is needed to define a consistent set of quantitative parameters for climate change scenarios in the ORSA, risk management and governance practices. EIOPA also recognises that the specificities of each undertaking are a key element to consider in some parameters.
 - Comment: This is a positive acknowledgment and it is in line with Insurance Europe message that standardised quantitative scenarios could become an impediment to carry out such a company-specific ORSA and that the ORSA should remain company-specific.
- EIOPA considers that **mandatory requirements for public disclosure** on sustainability risks should be considered (Pillar III) – they directly refer the EC guidelines on climate-related reporting, issued under the Non-Financial Reporting Directive.