

To: Solvency II WG  
From: Prudential Team  
cc:  
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Subject: For information - Main changes included in EIOPA's application guidance on how to reflect climate change in ORSA

## Summary

EIOPA conducted a public consultation on the paper "**Application guidance on running climate change materiality assessment and using climate change scenarios in the ORSA**", which ran from 10 December 2021 until 10 February 2022. (Final guidance [here](#))

EIOPA received 22 stakeholder responses to the public consultation and members will find below a high-level overview of the main changes made by EIOPA. EIOPA published a feedback statement ([here](#)) and in addition the secretariat assessed the main changes.

## Main changes

### EIOPA Feedback statement

#### ■ Time horizon

EIOPA received several comments on the time horizon, particularly on the mismatch between the **required quantitative long-term scenario** and the **business plan time horizon** (3-5 years). Some respondents highlighted that this would jeopardise the effectiveness of the scenario and its usability for steering management decisions.

Another concern was that it would not find application in the action plans/objectives of the undertakings, that are set for the short term. EIOPA's view is that **the time horizon of climate change is considerably longer than the one usually used in the ORSA**.

The challenge is to reconcile the very long-term dynamics of climate change with the operational ability to assess the impact of related risks based on the company's current business model. In order to achieve this, a new approach in the ORSA might be needed for the analysis of climate change risks.

#### ■ Creation of a de facto standard

Several comments expressed concerns over the application of the guidance by the market. In particular, some respondents pointed out that the market could consider the guidance binding and blindly apply the approaches proposed, without additional considerations on their specific risk profile.

**EIOPA agrees with the importance of diversity across approaches and models used for climate change reporting.** In this early stage, flexibility will be a key principle to foster the development of new and more effective models.

#### ■ Data availability

Some respondents expressed concerns over the current **availability and quality of data** which is essential to define the main features of the model and its calibration. EIOPA recognizes that data

availability and data quality might be an issue, particularly when combined with the uncertainty of climate change and unpredictability of events.

**In addition, collecting relevant climate-related data might be a complicated issue.** For this reason, EIOPA supports a high level of flexibility in the choice of the input sources.

## Other changes

### ■ **Non-binding was removed (page 3)**

"This application guidance is not ~~binding and not~~ a supervisory convergence tool in the meaning of Article 29 of Regulation (EU) No 1094/2010."

### ■ **Time horizon (page 14)**

In the section dedicated to Time horizon, a new paragraph was included highlighting the challenge represented by reconciling the long-term horizon of climate change (End of the century) and the horizon of the own risk assessment by the company (15 to 30 years).

### ■ **Transition risks (page 21)**

In the section related to the transformation of scenarios into climate change risks, a set of four transition pathways developed by the NGFS was introduced, including early policy action; disorderly transition scenario; too little, too late scenarios; and business as usual scenario.

### ■ **Physical risks (page 24)**

In the section about the transformation of scenarios into climate change risks, relative to physical risks, a set of metrics for evaluation was included. The indicators are based on the paper "Methodological principles of insurance stress testing - climate change component" (EIOPA, 2022) and aim to provide a comprehensive picture of the major drivers behind the impact of the prescribed scenarios on balance sheet items, solvency or other variables. Metrics are classified into Balance Sheet, Profitability, Technical and Direct.

### ■ **Adapting traditional techniques to climate change (page 106)**

In the section dedicated to climate change scenario analysis for the dummy life company, a paragraph relative to adapting traditional techniques to climate change was added. An important aspect of scenario analysis concerns the question whether the risk factors should be combined into one scenario. Depending on the risk drivers identified in the materiality assessment, the scenario can take the form of single risk factor single scenario and combined scenario.

### ■ **Transition / Physical risks (page 107)**

Still concerning climate change scenario analysis for the dummy life company, a paragraph was added including examples of possible shocks to be applied into the projections underlying the solvency calculations.

### ■ **Loss estimation (page 108)**

The paragraph on loss estimation was modified. The methodology for the estimation of the loss will depend on the metrics chosen for the analysis. A typical metrics for such an exercise is the Solvency ratio but other alternatives could be chosen.

### ■ **Elements to consider (page 108)**

The summary of the elements to be considered in the climate change scenario analysis for the dummy life company is modified. In this new version consideration of different approaches to measure climate change risk were included. (different time horizons between climate change and the ORSA and the fact that granularity of the shock should be consistent with the materiality assessment.)