



To: Mairead McGuinness
European Commissioner
Financial Services, Financial Stability and Capital Markets Union
Rue de la Loi / Wetstraat 200
1049 Brussels
Belgium

Subject: **Consequences of late EC Q&A setting the premium split approach for underwriting KPI under Taxonomy Article 8 reporting**

Brussels, 29-11-2023

Dear Commissioner McGuinness,

In November 2022, Insurance Europe wrote to the European Commission (see Annex) highlighting the importance of providing clarity to allow insurers to implement their processes and systems for reporting the underwriting KPI required by Taxonomy Article 8. The letter explained the industry's view that: where climate-related perils coverage is embedded in another, wider product, insurers should base their disclosure on the full premium for the product (Option 1) rather than only the share of premium covering specific climate risks (Option 2). Since then, Insurance Europe has been urging the Commission to provide feedback on this issue.

We understand that the College of Commissioners is currently reviewing the Q&A prepared by DG FISMA on Taxonomy Alignment for Financial Institutions with a view to publishing the Taxonomy Q&A by the end of the year. We therefore wish to reiterate our strong support for Option 1. As well as the practical problems involved in trying to allocate premiums to specific risks, a key argument for Option 1 and against Option 2 is that the latter can discourage the very outcome intended. This is because with Option 2 the reported KPI can give the wrong signals, making an insurer look worse the more risk-based rewards they offer to customers. We also note that we do not see any legal obstacles against Option 1, in fact measuring the premium at product level is supported by Technical Screening Criteria (TSC) 2 and TSC 3 which both refer to insurance products. See our original letter in the Annex for further explanation and arguments.

Insurance Europe strongly supports the letter sent to you on 16 November by the European Insurance CFO Forum highlighting the negative consequences of choosing an interpretation in line with Option 2. Its letter also highlights that publishing the Q&A in December 2023 would be far too close to the first reporting date. From an operational standpoint, this is too late for year-end reporting, which means that many insurance companies will not be able to implement the much more complex and problematic premium split approach if, in the absence of any guidance, they have been preparing for a full premium approach.

We hope that you will consider the elements presented above while deliberating on the Taxonomy Q&A for financial institutions and we would welcome an opportunity to discuss this important issue with you and your team.



Yours sincerely,

Andreas Brandstetter

Annex: Letter sent to European Commission in November 2022 seeking clarification on application of Technical Screening Criteria for the purpose of Taxonomy Article 8 reporting



To: Didier Millerot
Head of Insurance & Pensions Unit
DG FISMA
European Commission

Our reference: Click or tap here to enter text.

Subject: Insurers seek clarification on application of Technical Screening Criteria for the purpose of Taxonomy Article 8 reporting

Brussels, 28-11-2022

Dear Mr Millerot,

I am writing to you on behalf of Insurance Europe to express the industry's concerns regarding difficulties in interpreting how to report the KPI related to underwriting required by Article 8 Taxonomy Regulation and to urge the Commission to provide guidance.

Insurers are committed to supporting the ambitious goals set by the EC sustainable finance agenda. In this context, Europe's insurers are in the process of assessing the taxonomy alignment of their underwriting activity to report under Article 8 of the Taxonomy by applying the Technical Screening Criteria (TSC) defined in the Climate Delegated Act.

In the scope of this assessment, our members have experienced difficulties in interpreting some of the criteria listed. This was the case, in particular, for one question: **Where climate-related perils coverage is embedded in another, wider product, should insurers base their disclosure on the full premium for the product (Option 1) or only the share of premium covering specific climate risks (Option 2)?**

Our assessment (of which you will find the detailed explanation in annex) is that "Option 1", i.e. disclosure and categorization of the full premium for the product, is the right way to apply the TSC. However, considering the significance of the topic and the important reputational risk linked to sustainability disclosures, we believe that guidance is necessary to confirm that this is indeed in line with the co-legislators' intention. We therefore wish to invite the Commission to provide certainty on this topic, possibly as part of envisaged Q&A.

We would be happy to provide any further information or further discuss this topic with your team if necessary.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Olav B. Jones", with a stylized flourish at the end.

Olav Jones

Annex: Insurers' view on the most appropriate approach to determine taxonomy-alignment of an insurance product for the Article 8 underwriting KPI

Where climate-related coverage is embedded in another, wider product, **the full premium of this product qualifies as taxonomy-aligned (Option 1), provided that the technical screening criteria (TSC) are fulfilled.** The arguments in favour of taking this approach may be expressed as such:

- **The logical aim is for insurers to take actions and make changes so their relevant products contribute to the climate change adaptation objective. It therefore makes sense that the KPIs are measured at product level.** Option 1 also recognises that while it is often possible to use statistical modelling to allocate premiums to specific risks such as windstorm taking into account a multiyear basis, when an actual windstorm happens, the insurance business model only works because the insurer can use all the premiums in that particular year to cover the claims from that event. Insurers use and need the pooling effect not only to pool risks across customers but also across risks, whether that is a windstorm related risk, a fire risk or a theft risk on a property.
- **TSC 2 and TSC 3 both refer to insurance products.** TSC 2 requires that "the insurance products sold under the insurance activity offer risk-based rewards for preventative actions taken by policyholders". TSC 3 requires that "the insurance products sold under the insurance activity offer coverage for climate related perils"
- **Option 1 would avoid giving a lower KPI when an insurer adds or increases its risk-based rewards for customer adaptation into its products (screening criteria 2.1).** Option 2 would discourage the very outcome intended by this criterion because the reported KPI would give the wrong signals, making an insurer look worse the more such features are added to their products.

The Taxonomy has the intended purpose for insurers to support customers in efforts to protect themselves from climate change, by such means as incentivisation through lower premiums. Therefore, a key aim of including TSC for insurance underwriting is to encourage insurers to include adaptation features into the relevant products. This in particular relates to the product design related *criteria 2.1* which seeks to encourage insurance products which offer risk-based rewards for preventive actions taken by policyholders and specifically where a policyholder has invested in adaptation measures, lower premiums may be considered as a risk-based reward for preventive actions taken by policyholders.

In practice, insurers will not be able to reach an underwriting Article 8 KPI of 100% because the denominator of the KPI will include premiums for products which are out of scope of the screening criteria. We have used a very simplified example to show why only Option 1 would provide logical signals for insurers to introduce risk-based rewards for preventative action taken by customers:

- Assume the insurer sells only property insurance products and that the only relevant risk covered is windstorm (so that all policies in the portfolio cover climate-related perils).
- The insurer initially offers no risk-based incentives and so does not meet the TSC. Its KPI would therefore be 0% under option 1 and 2.
- The insurer makes changes to meet the TSC and, if we assume it is able to isolate them, has windstorm related premiums of €0.2bn out of total premiums to €1bn.
 - Under option 1, its KPI would be 100% (taxonomy-aligned product premiums/total premiums).
 - Under option 2, its KPI would be 20% since the €0.2bn of windstorm-related premiums would fulfil all technical screening criteria (taxonomy-aligned allocation for windstorm/premiums/total premiums)
- Now let's assume the insurer finds a way to introduce significantly more risk-based adaptation incentives and customers take these up. This results in only €0.1bn needing to be charged for windstorm and so €0.9bn overall premiums.

- Under option 1, its KPI would remain 100% since the €0.1bn windstorm-related premiums continue to contribute to fulfilling all technical screening criteria.
 - **Under option 2, its KPI would fall from 20% to 11% giving an incorrect signal that the insurer's underwriting is less aligned than before**
- **Option 1 reduces problems that Option 2 will create for comparability across insurers because the way each insurer allocates premiums to specific risks will depend on a range of company specific factors including the diversification impact of other risks in the portfolio, the diversification assumptions, expected claims costs and operational costs and how these are allocated.**

Calculating the exact share of premiums relating to individual risks within a policy (option 2) is a highly complex and assumption dependent process. Option 1 requires fewer assumptions and lower costs, therefore facilitating its implementation and increasing the appetite of smaller undertakings and international players in using the EU Taxonomy.

When there is separation of climate-related perils coverage and other coverages, it is not only complicated initially when attempting to set up the product, but also when there is a conflict between perils, and it is uncertain how separation should be determined. Even in countries with good databases, it may be, for example, difficult to determine the difference in damage caused by climate related flooding versus other causes (leaking pipes). Another example is electric overload, which could be from faulty wires or a lightning strike or be climate related. Option 2 would also increase operational burdens and implementation and otherwise unnecessary ongoing costs.

- **Option 2 based KPIs will very much depend on the specific local risks – those insurers covering areas of high climate related risk exposures (eg. high risk of natcat damage) may “look better” than those doing more in terms of adaptation but in areas with lower exposure, simply because the proportion of total premiums charged for climate related risks will be higher.**