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Consultation paper on draft Opinion on the supervision of the use of climate change risk scenarios in ORSA

Fields marked with * are mandatory.

Responding to the paper

EIOPA welcomes comments on the draft Opinion on the supervision of the use of climate change risk scenarios in ORSA.

Comments are most helpful if they:

- respond to the question stated, where applicable;
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA using the EU Survey tool **by Tuesday, 5 January 2021, 23:59 CET** by responding to the questions below.

Contributions not provided using the EU Survey tool or submitted after the deadline will not be processed.

Publication of responses
Contributions received will be published on EIOPA's public website unless you request otherwise in the respective field in the survey below. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents [1] and EIOPA's rules on public access to documents[2].

Contributions will be made available at the end of the public consultation period.

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[1] Regulation (EC) No 1049/2001 of the European Parliament and of the Council of 30 May 2001 regarding public access to European Parliament, Council and Commission documents (OJ L 145, 31.5.2001, p. 43).
[2] Public Access to Documents
[3] Regulation (EU) 2018/1725 of the European Parliament and of the Council of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45/2001 and Decision No 1247/2002/EC (OJ L 295, 21.11.2018, p. 39).

About the respondent

* Please indicate the desired disclosure level of the responses you are submitting.

- (x) Public
- ( ) Confidential

* Stakeholder name

German Insurance Association

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Questions to Stakeholders

Q1: Do you agree that it is important to foster a forward-looking management of climate change risk by insurance undertakings?

- (x) Yes
- ( ) No

Please explain.

A forward-looking management of climate change risk can be important to insurance undertakings depending on their business model and risk profile. Insurers with material climate change risks should (and already have to) consider these in a forward-looking manner where appropriate. Solvency II requires undertakings to consider all risks they face in the short and long term and to which they are or could be exposed in their risk-management system and own risk and solvency assessment (ORSA). However, it should be acknowledged that the required extent, complexity, type (e.g. quantitative vs qualitative) and frequency (e.g. annually vs once every five years) of this assessment may differ from one insurance undertaking to another and within an insurance undertaking from one sub-risk (life, non-life, health, assets etc.) to another as the risk does. These differences should enable an appropriate and proportionate management. For example, it must be possible to handle and assess risks arising from the short-term P&C business differently, particularly in assessing technical provisions.

Furthermore, insurers without material climate change risks should not be required to consider climate change risks. In particular, undertakings with non-material climate change risks should not be obliged to apply quantitative climate change scenario analysis. It must suffice to qualitatively estimate the impact and use this estimation for deciding whether an in depths analysis for ORSA is necessary. This further, thorough analysis then includes further qualitative and/or quantitative elements in an appropriate way considering the individual risks.

There is no standardized approach that fits all. This is what ORSA is about: Each company must deal with its own risks in an appropriate way depending on their nature, scale and complexity. On the one hand, an insurance undertaking with 100% premium volume in natural catastrophe related risks may have to put a lot of effort into managing climate change risk. On the other hand, an undertaking with just a few percent of premium volume in natural catastrophe related risks and short-term contracts may obviously treat climate change risk in a simpler way.

Generally, there are short term contracts in P&C. Serious changes in claims payments within this time horizon are caused by extreme weather events, not by climate. Climate risks evolve over time spans of roughly 30 years. Trends caused by climate change can lead to yearly adaptations of premiums. Insurance companies make use of risk mitigation techniques as reinsurance to cover extreme events.

Further, considering reserve risk the insurance industry takes into account a trend of higher frequency (storm, hail, …). However, it is not important whether trends stem from the climate change or from different causes.

Q2: Do you agree that Annex 2 provides a balanced view of the costs and benefits of the draft Opinion?

- ( ) Yes
- (x) No

Please explain and provide any suggestions.

It is of high importance that costs and benefits are balanced for applying scenario analysis. The effort for a long-term analysis of the impact of climate change is enormous. The results, however, are of low meaning, because missing data leads to low quality models. It should be acknowledged that models for projecting climate change are predominantly academic in character. These models differ significantly in the outputs of their results. This means there is a significant uncertainty. Additionally, the outputs of these models as changes in temperatures and precipitation cannot be directly transferred to expected claims, underwriting strategies etc. In short, current models are not yet sufficiently developed to be used in such a way intended by EIOPA.

Each single analysis of an undertaking reveals different results, such that there is no meaningful basis for decision-making.

Additionally, many existing contracts are too short to face the climate change within the contract boundaries.

Thus, we do not agree with EIOPA's statement "costs are outweighed by the benefits".

Q3: Do you agree that undertakings should in their ORSA not only assess climate change risks in the short term, but also in the long-term to inform strategic planning and business strategies?

- (•) Yes
- ( ) No

Please explain.

Yes, we agree that the assessment should principally be short and long-term. However, the terms of the assessment of climate change risks depends on the business model and specific risks of the insurer. Long-term products, material risks and long-term investments have to be assessed by insurers using the long-term scenarios, but other products, risks and investments do not. A proportionate approach must suffice if adequate.

Considering non-life there is no unique and definitive answer for all undertakings. It depends on the written business: proportion of premium volume or risk related to natural catastrophes in comparison to the totals, time needed to take measures against negative developments such as a sudden increase in number of storms and floods, a significant rise in reinsurance premiums or the impossibility to obtain reinsurance cover at all, time to take for the measures to be fully effective etc. If premium volume or risk related to natural catastrophes is not substantial compared to total business a quantitative long-term projection would be unnecessarily burdensome. The cost of such a projection would not be justified. Also, if an undertaking can take fully effective measures within a short time-horizon a short-term projection is adequate. This could for example be the case if an undertaking can adjust premiums yearly. In these cases, it makes more sense to put the effort in the assessment with a short-term perspective. Further, a short-term perspective can include trends - and do so - if trends are measurable.

Considering an asset manager’s perspective, a climate change risk-assessment in the short, but also in the long-term could be an advantage. However, we also see the challenges of quantifying a risk that has never occurred before, for short-term and especially for the long-term-view. This applies above all to transition risks, the occurrence of which depends on a variety of circumstances (political decisions, inventions, etc.). Even if these primarily materialise in the long term, a short-term occurrence due to inventions or political decisions, for example, cannot be ruled out. However, these are imponderables that are not covered by models in such a way that sufficiently convincing results can be achieved. This generally makes it hard to develop and then calibrate corresponding models, particularly one that goes beyond a sectoral view. Because it should be clear that, e.g. not all companies of the energy sector are laggards. The question is how to distinguish the better from the worse in order to make a differentiated assessment of the portfolio risk. This is very important since an undifferentiated analysis could result in reallocation transactions worsening the portfolio diversification and improper treatment of “rather green than brown” or currently transforming energy companies with all the negative consequences like higher funding costs for them. Therefore, transparency regarding companies’ environmental footprint and their sustainability development goals and the availability of this data is important.

Beyond that, insurers did observe and measure any new developments of all new emerging and all known risks in the past and will do so in the future. It is a substantial part of the business model (underwriting, investments etc.) to react dynamically to these developments. As new risks appear or change, new products are developed while others are taken off the market

Q4: Paragraph 3.3 specifies that the time horizion of the long-term scenario analysis could be longer than the time horizons currently considered by undertakings in their ORSA, for example a magnitude of decades may be appropriate. Is this explanation in your view adequate or should the explanation be more or less specific?

- ○ Explanation is adequate
- ○ Explanation should be more specific
- ◉ Explanation should be less specific

Please explain.

The explanation should be less specific because the situation in life / health insurance is different to P&C. The adequate time horizon depends on contract boundaries. In P&C undertakings can react more quickly on the change of risk. Therefore, long-term scenarios are only to be applied in a proportionate manner depending on the business model and specific risks of the insurer.

As written in Q2 and Q3, the results of a long-term analysis are not meaningful because of the high uncertainty. For this reason, in its second discussion paper on stress testing methods, EIOPA also refers to climate-related stress tests as an "important learning process with a more explorative nature". The goal of Solvency II is to ensure that the existing benefit commitments can be fulfilled at all times. ORSA reports are not intended to mitigate climate change.

Q5: Do you think that the examples in Annex 3 and Annex 4 cover the main transition and physical risks to which undertakings may be exposed?

- (x) Yes
- ( ) No

If not, please provide suggestions for additional examples of risks.

It is a good collection of possible events. However, this list ignores the fact that undertakings manage the risks on a regular basis by e.g. changing premiums, termination of contracts or adaptation of policies. The time span of climate change is in general longer than possible adaptations for the insurance industry.

Apart from risks resulting from climate change, it is an essential part of the industry’s strategy to monitor emerging risks.

Q6: Do you agree that the long-term scenario analysis should at least distinguish two scenarios, where appropriate:
- a scenario where the temperature increase remains below 2°C, preferably no more than 1.5°C, and
- a scenario where the global temperature increase exceeds 2°C?

- ( ) Yes
- (x) No

Please explain.

We do not consider the specification of fixed scenarios to be beneficial as the ORSA should remain company specific. For some – but not all – undertakings it may be necessary or reasonable to apply scenarios as suggested. If there is no substantial financial risk even in a worst-case scenario determined on a company specific basis, it should be unnecessary to assess other scenarios.

See also answers to Q1, Q2 and Q3. It should be acknowledged that models for projecting climate change are predominantly academic in character. These models differ significantly in the outputs of their results. This means there is a significant uncertainty. Operational results would be of low meaning, because missing data leads to low quality models. Additionally, the outputs of these models as changes in temperatures and precipitation cannot be directly transferred to expected claims, underwriting strategies etc. Yet another aspect is the developing standards for construction. An increase of extreme weather events does not necessarily correlate to an increase in claims because of prevention and adaption measures. In short, current models are not yet sufficiently developed to be used in such a way intended by EIOPA.

Q7: Do you agree that scope, depth and methodologies of undertakings' quantitative (scenario) analyses of climate change risks should be expected to evolve, considering that undertakings need to gain experience and build technical capacity?

- (x) Yes
- ( ) No

Please explain.

It is usual practice for undertakings to evolve their risk management. Thus, no further requirements are needed.

Since small and medium sized undertakings do not have the resources and the required data for the development of such complex analysis as requested by EIOPA reinsurance companies, pools of insurers or associations could support carrying out this task

Q8: Do you have suggestions to improve the guidance provided in Annex 5 to assist competent authorities in supporting undertakings to apply scenario analysis in their ORSA?

- ( ) Yes
- (x) No

If yes, please provide your suggestions.

Q9: Do you agree that competent authorities should encourage larger undertakings to disclose climate-related information, in line with the Commission's Guidelines on non-financial reporting on climate-related information?

- ( ) Yes
- (x) No

Please explain.

In general, GDV supports the objectives of the European Commission to review the Non-Financial Reporting Directive (NFRD) in order to improve the availability and quality of non-financial information. It is primarily the transparency of climate-related information that is most urgent and should be enhanced by companies subject to the NFRD.

In the consultation paper, EIOPA refers several times to the Non-Binding Guidelines (NBGs) on Non-Financial Reporting: Supplement on Reporting Climate-Related Information (2019/C 209/01). These NBGs are a supplement to the NBGs on Non-Financial Reporting from 2017 (2017/C 215/01). The European Commission's intention of developing the NGBs was to support companies in fulfilling their non-financial reporting obligations in accordance with the NFRD. However, as they are non-binding, and according to the NFRD, companies can choose to apply the guidelines. Companies are also free to choose another reporting framework, a combination of frameworks, or no reporting framework at all to fulfil their non-financial reporting obligations.

Furthermore, in reporting practice, companies choose reporting frameworks that best address their most relevant internal and external stakeholders.

To summarize, this means, firstly, that undertakings cannot be expected to collect and disclose all information based on non-binding guidelines. Secondly, as it is part of the review of the NFRD, the trilogue will have to determine the non-financial reporting obligations for companies subject to the NFRD. EIOPA should not predetermine the results of this process by referring to the NBGs of the EU Commission which have never followed the process of the trilogue. Finally, while ORSA is used for internal purposes, in particular for its own risk assessment and management, external reports are intended to inform stakeholders. There is a danger that the different objectives and requirements will be mixed up.

Additionally, referring to the disclosure of climate-related information, there is already regular extensive reporting about natural catastrophes by GDV ("Naturgefahrenreport"). This report contains relevant data in an aggregated form for the German market.

Q10: Does the draft Opinion strike the right balance between setting common expectations and allowing undertakings to do their own risk assessment?

- ○ Yes
- ● No

If not, please explain in what areas the draft Opinion could benefit from more or less consistent approaches.

No, the Opinion does not strike the right balance. A more differentiated approach to the topic would be useful. The choice of methods and scenarios depends on many aspects such as the individual risk, materiality, possibility of measures, availability of reinsurance etc. This should be clearly acknowledged by EIOPA and NCAs.

Further, we would recommend that the opinion should be clearly stated as non-binding expectations.

See also answers to Q1 and Q3.

Q11: Do the expectations put forward in the draft Opinion achieve a proportionate approach to climate change risk analysis in ORSA, fitting small-, medium- and large-sized undertakings?

- ○ Yes

- [x] No

If not, please provide your suggestions to improve proportionalty of the draft Opinion.

> The proportionality principle must hold for assessing climate change risks as well as for other risks. The significance and materiality of the risk is crucial.
>
> Generally, it cannot be expected that small and medium sized undertakings have the same resources for performing the same sophisticated analyses as other undertakings. A simple and proportionate approach is needed. It is not evident how such an approach could look like considering the expectations mentioned by EIOPA in the draft Opinion. Reinsurance companies, pools of insurers or associations could help developing scenario analyses in co-operation with science.

* Q12: Do you have any other comments on the draft Opinion?

- [x] Yes
- [ ] No

If yes, please provide these other comments.

> The insurance industry would have preferred an informal, bilateral and voluntary exchange between insurers and NCAs to discuss aspects like feasibility, data availability, proportionality etc. The results of such a dialogue could have been better tailored to the industry.
>
> We are worried that the discussed climate risk scenario analysis would cause enormous efforts and costs, in particular in the case of quantitative assessments, which are not proportionate to the limited meaningfulness and usefulness of the results.

Contact

[Contact Form]