

# Consultation on draft supervisory opinion on the use of climate change risk scenarios in the ORSA

## General Comments

### ORSA should remain an own risk assessment

Contrary to macroprudential supervisory monitoring by which a common climate scenario trajectory with key parameter settings might be useful to explore climate change risks across the insurance industry sector we deem it essential that scenarios within an ORSA exercise be specific to the insurance undertaking's risk profile concerned and only be envisaged if their impact is material to the insurer in the short and longer term particularly if the decision is at the discretion of the insurer (as described in the next section). The decision to perform forward looking analysis on climate change risks in the ORSA should remain at the discretion of a specific insurer and be relevant to its own risk situation. The insurer should also decide of the best way to undertake such an exercise, both in terms of time horizon and granularity. In its attempt to assess climate change impacts under the ORSA, an insurer must rely on its own views and understanding. This is all the more necessary that there are strong unknowns and uncertainties in the evolution and impacts of climate change which may produce very different outcomes. Additionally, most items are interdependent and some approaches appear artificial.

### Research on Climate change risk

There are an increasing number of workstreams set by regulators and/or supervisors across jurisdictions to investigate climate change risks and the implications that these may have on the insurance sector. There is no doubt that climate change will have a global impact on society; the climate research is therefore only efficient if performed centrally by dedicated experts, be it from universities, research institutions, reinsurers etc. Climate science research should identify the specific risk factors to the insurance industry and provide clarity on specific risk threats and their applicability provided it will impact geographic regions and perils differently. Supervisors and insurers will need to adjust accordingly.

## 1. Question 1

*Question 1: Do you agree that it is important to foster a **forward-looking management of climate change risk** by insurance undertakings? Please explain. (5000 character(s) maximum) including spaces and line breaks, i.e. stricter than the MS Word characters counting method.)*

- Yes
- No

*Please explain*

Climate change has an impact on both sides of the (re)insurers' balance sheets. Fostering **forward looking management** of climate change risk is a valuable approach as long as it acknowledges all the limitations and uncertainties of such an exercise.

Climate change is a gradual process and (re)insurers have the possibility to adapt their risk profile through adjustments in premiums and the reinsurance coverage alongside adapting their investment profile / asset allocation. For non-life undertakings, climate change impacts in the insurance liabilities are de facto captured and evaluated within the risk modelling that is accomplished under the core process to premium and reserve settings by which any evolution of the features of the risk drivers' behaviours are automatically included.

Capturing the trends out of the most recent experience is therefore a core feature of the process. As such the effects of climate change risk are manageable in most jurisdictions. Also (re)insurers should be aware of the potential volatility in climate change related risks over a short-term period of time. This does not exclude that looking back into the past can also provide valuable insights on those climate events which do occur on a more regular basis. For example, comparing the claims pattern from a climate related event that took place several years ago with another one that occurred in a more recent past could provide some valuable information regarding the behaviour adaptation following a climate related event, the impact of changes in building codes/regulation, etc.

It is also vital that insurers have the maximum flexibility in applying the most appropriate tools and assumptions to their own risk management frameworks, and in line with their own specific business profile. In this respect, the consideration of climate scenarios in the ORSA should not lead to higher capital requirements and meaningless or too uncertain scenarios should not be included as to the governance procedure over the ORSA.

A **proportionate approach** is needed since the materiality of climate change risks differs across entities and may change over time. Insurance companies that do not identify significant climate risks in their risk profile should not be forced to use climate change risk scenarios.

## 2. Question 2

*Question 2: Do you agree that Annex 2 provides a balanced view of the **costs and benefits** of the draft Opinion? Please explain and provide any suggestions. (5000 character(s) maximum) including spaces and line breaks, i.e. stricter than the MS Word characters counting method.)*

- Yes
- **No**

*Please explain*

Costs outweigh the benefits

We are of the view that **the costs actually outweigh the benefits** when approaches in an ORSA are not proportionate to the insurance undertakings concerned own risk profile on the one hand, and when scenarios extend to terms that go beyond business plans strategic horizons and beyond the remits of what is needed for key management decisions on the other hand.

As mentioned under question 1, (re)insurers have the possibility to adapt their risk profile to a changing climate. We think that the path that climate and society at large is following and will follow

is actually unfolding at a pace providing enough inputs that can be captured in good time through insurance undertakings' due risk management processes unless the planet is facing a "global cascade of tipping points".

### Climate change Stress tests

Different supervisory authorities have been launching exploratory exercises to assess climate change. It is key that if EIOPA plans to launch a Climate change Stress test exercise in the coming months, it defines the objectives of the exercise in a clear manner alongside its rationale with a full description of threats with causes and effects. One take-away of the French exploratory climate scenarios initiative is that multi decade approaches do not provide insightful results due to the many strong limitations, uncertainties and simplifications unavoidably undertaken in the exercise. As a result, costs not only largely outweigh the benefits but we fail to find any value in such an externally prescribed exercise. Insurers would rather find value in the scenarios they deem appropriate to their exposures and vulnerabilities in proportion to their own risk profile and at the granularity required to be able to grasp an impact.

### Focus on climate change risks

In Annex 2, EIOPA mentions that only a limited number of insurers include climate change risks in their ORSAs. However, EIOPA does not indicate the reference date and the timing of those ORSAs and whether the undertakings have the ability to change the processes to include climate change related risks. In any case the focus that climate change risks should have in the ORSA needs to be further clarified.

### Time horizon

It is also worthwhile noting that climate change scenarios with a big naming as such do not really find their place in the ORSA as the horizons can be qualified as short term with regards to the multi decade pace at which climate evolutions are unfolding. Hence on these short horizons of ORSAs, climate evolutions are actually already trapped and captured in the claims traditional modelling and ORSA's sensitivity testing together with all the tools and risk management processes insurers are actually continuously using to monitor and assess their risks. As a matter of fact, climate evolutions are already captured under the non-life catastrophe perils and modelled to the best of undertaking's knowledge; these approaches actually comprise much more insight and granular useful information than any high-level view on a planet temperature path.

### ORSA Governance

Already through their internal due risk management processes insurers are equipped to capture the risk drivers of their risks and to monitor their evolution that they incorporate in their ORSA scenarios that they constantly adapt.

### Proportionality

An important element not mentioned in EIOPA's Opinion is Proportionality. Climate stresses and attention in the ORSA should be proportional to the actual risk profile of the insurer. A pre-set requirement could introduce a tunnel vision in which other important developments in the risk environment are missed.

### 3. Question 3

*Question 3: 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? Please explain. (5000 character(s) maximum) including spaces and line breaks, i.e. stricter than the MS Word characters counting method.)*

- Yes
- No

*Please explain*

We believe that both short term and long-term climate change risks are relevant to the ORSA. A long-term approach might also be applicable to other relevant not climate related risks. As mentioned under question 2, quantitative scenarios with a time horizon longer than 5 to 10 years are not very useful. Climate change is a gradual process and (re)insurers strategic planning and business strategies do not generally have horizons longer than 10 years. It is also important to integrate climate change as a key factor in the strategic planning and business strategy process.

### 4. Question 4

*Question 4: Paragraph 3.3 specifies that the **time horizon** 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? Please explain. (5000 character(s) maximum) including spaces and line breaks, i.e. stricter than the MS Word characters counting method.)*

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

*Please explain*

It is obvious that climate change takes place within a magnitude of decades. For the society as a whole, scenario analysis of general developments may be useful. For an individual undertaking, the quantitative perspective upon a magnitude of decades is not sensible considering the huge complexity and uncertainty of the risk drivers and vulnerabilities connected to climate change. As mentioned under question 3 most (re)insurers do not use generally horizons longer than 10 years. This is due to the experience that any quantitative outlook beyond is pure speculation and will be overshadowed by other developments that we cannot predict today.

We believe that the risk management due processes that insurers have in place already allows them to capture right in time what is needed to inform key management decisions and run insurance undertakings in a safe and adequate manner. (Re)insurers can therefore adapt their strategy on a gradual development like climate change. It is important for (re)insurers to have a good understanding of the potential volatility of climate related risks on the short term and how to manage them.

Also see answer to question 2.

## 5. Question 5

*Question 5: 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? If not, please provide suggestions for additional examples of risks. (5000 character(s) maximum) including spaces and line breaks, i.e. stricter than the MS Word characters counting method.)*

- Yes
- No

*Please explain*

The list provides a good overview but EIOPA's approach needs to be more balanced and should leave room to management actions and mitigation effects such as the possibility for insurers to change the terms and conditions and/or policy underwriting criteria and the increasing resilience of exposures at risk.

**Physical risk:** Some developments can have a more nuanced impact on the actual risk experienced in the climate related events:

- EIOPA does not mention the possible positive impact that climate related developments can have on underwriting risk. For example, solar panels on roof tops can lower the claim amounts due to hail because a solar panel is easier to replace than a roof.
- Business owners, who experienced climate related events in the past, have increased their defences against new climate developments. For example, greenhouses which have installed tempered glass are less vulnerable to hail damages.

With respect to life underwriting risk most life (re)insurers are exposed to both mortality and longevity risk. The increase of mortality due to heat waves may be (partly) compensated by a lower death rate thanks to milder winters. The combined effects of heat waves and milder winters depend on the exposures to longevity and mortality risk in different age groups. We suggest to add this to the table.

EIOPA presents various examples which could negatively affect the balance sheet. For example, EIOPA points out that the demand for office spaces could decrease; If this is the case, office spaces could be remodelled to housing which in turn would alleviate the current housing shortage in some areas, benefit the local communities and have a positive impact on the economy. EIOPA also indicates that drier weather would have a negative impact on farming. However, drier weather also means more sunshine hours which in turn increases the returns on solar panels and decreases the need for fossil driven energy.

## 6. Question 6

*Question 6: 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?*

*Pease explain. (5000 character(s) maximum) including spaces and line breaks, i.e. stricter than the MS Word characters counting method.)*

- Yes
- No

*Please explain*

We reiterate our answer to question 3 and underline that it is paramount that the nature and horizons of climate change investigations be left to the undertaking's decisions, definitions and choices at micro prudential ORSA level.

What is essential for a specific insurer is to have the tools and risk management processes in place that enable a continuous monitoring and update of the evolutions and trends in the risk drivers' behaviors that impact its own risk profile, irrelevant of whether these evolutions can or cannot be directly related to a specific defined level of climate change in temperature. We believe that this pragmatic approach is most relevant and useful as well as reflective of the way risks are adequately managed rather than running high level views of climate changes in temperature that still fall far short of what is needed to model an impact at the level of granularity of an insurance undertaking's risk driver and dependencies. We also have this concern that climate change risks are sometimes confused with broader green concepts.

Some scenarios may be provided to illustrate some aspects of climate change and may be used as benchmark or constitute best practice but they should not be standardized for all companies. The number of scenarios to explore should be very limited on the one hand because of the already very disputable nature of the alleged content of the scenarios and aligned with some widely spread consensus such as the Paris Agreement or IPCC reflexions. This kind of benchmark scenarios could form the basis of explorations at macroprudential stress test exercise level.

Prescriptive standardized scenarios are contrary to the principle that the ORSA should reflect the company's own risk analysis. Each company is better placed to choose the most appropriate scenarios and related specifications.

## 7. Question 7

*Question 7: 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? Please explain. (5000 character(s) maximum) including spaces and line breaks, i.e. stricter than the MS Word characters counting method.)*

- Yes
- No

*Please explain*

It is indeed reasonable to assume that scope, depth and methodologies of undertakings' quantitative analyses of climate change risks may evolve over time. We agree that the capabilities to analyse climate scenarios will increase in the future. A lot of research is done and will be done in the future by universities, meteorological institutions and commercial modelling companies. This will support the analysis of the impact of climate change on underwriting risk. On the asset side the difficulty remains in that expectations are immediately reflected in the prices. The asset prices and implied volatilities will adapt to new insights. A shift to low carbon investments by all institutional investors can create systemic risk.

It is also worthwhile reiterating like stated under our answer to question 4 that the risk management due processes that insurers have in place already allows them to capture what is needed to inform key management decisions and run insurance undertakings in a safe and adequate manner.

## 8. Question 8

*Question 8: 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? If yes, please provide your suggestions. (5000 character(s) maximum) including spaces and line breaks, i.e. stricter than the MS Word characters counting method.)*

- Yes
- No

*Please explain*

We would like to reiterate that the ORSA should keep the company's own examination and the scenario analysis should be left at the insurer's discretion based on its own risk assessment and at the level of granularity meaningful to its own exposures that often depend on deeply local information.

The guidance in Annex 5 is primarily focused on climate and macro-economic scenarios. For physical risk, expectations on climate adaptation are essential but also difficult to define. For example, sea levels can rise but flood defences can also be improved: The extent to which the climate change risk will evolve will depend on the balance between these developments.

EIOPA has listed a significant number of different elements to feature the climate change risk scenarios. This increases the complexity of scenarios with a horizon up to 10 years but in particular for small and medium size undertakings.

CAs should encourage and challenge large (re)insurers to carry out a first assessment of the undertaking's climate related risks that should comprise an identification of these risks, a qualitative assessment of the impact on the short term (i.e. 1-3 years) and longer term (> 5 years) and the potential volatility.

Data science is developing among insurers and is providing valuable enhanced insights on risk analysis and management, strengthening the quality and reliance of risk management processes; we referred to under question 4 and 7.

Assets are priced in markets well aware of climate issues. Market prices necessarily factor climate implications in a meaningful way. It is worthwhile pointing out that there is not a straightforward link between the (sudden) occurrence of climate change effects and asset prices; This means that assumptions/estimations would have to be made. And in order to obtain comparable outcomes standardization of those estimations is needed; Also, when assessing the treatment of "brown" investments care should be taken in order not to generate a "self-fulfilling prophecy". As the composition of asset portfolios changes regularly, this leads to difficulties in comparing annual revisions and year-on-year changes to the outcomes of the required analysis.

## 9. Question 9

*Question 9: 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? Please explain. (5000 character(s) maximum) including spaces and line breaks, i.e. stricter than the MS Word characters counting method.)

- Yes

- No

*Please explain*

We do but sustainability risk disclosures are already a practice for various insurers.

Considering the limitations mentioned under our response to question 2, notably that the impacts of climate change and climate change itself are not fully grasped, it is also potentially dangerous to become overly confident on views and outcomes just because of the ability to produce overly padded disclosures that might induce a false feeling of comfort in the mastering of climate risk. For example, long-term scenarios can only be assessed in a qualitative way. Undertakings would need time to develop this information.

It is also worthwhile reminding that some insurers may already produce disclosures on management of climate risks including forward-looking scenarios analysis in sustainability reporting or other relevant documentation. To assess climate risks, many supervisors could collect supplementary information on an ad-hoc basis through surveys and targeted requests.

## 10. Question 10

*Question 10: Does the draft Opinion strike the right **balance between setting common expectations and allowing undertakings to do their own risk assessment**? If not, please explain in what areas the draft Opinion could benefit from more or less consistent approaches. (5000 character(s) maximum) including spaces and line breaks, i.e. stricter than the MS Word characters counting method.)*

- Yes

- No

*Please explain*

EIOPA concludes from the undeniable proposition that climate change is a global challenge that insurance undertakings are at risk in general. We do not agree with this conclusion. The private insurance sector has mastered global changes in technology, military conflict, the breakdown of communism etc. with a remarkable ability to adapt. This is due to the strong incentive to be successful in a competitive environment under any circumstances. There is no evidence that climate change prevents this mechanism from working. On the contrary, too prescriptive bureaucratic exercises, which are just compliance oriented, and speculative scenarios may provide a false feeling of control over the climate change process.

Please also refer to answers to questions above.

We would like to reiterate that the decision to perform forward looking analysis on climate change risks in the ORSA should be at the discretion of a specific insurer and relevant to its own risk situation. The insurer should decide on the best way to undertake such an exercise, both in terms of time horizon and granularity. EIOPA's Opinion is too prescriptive and there is too much focus on long-term scenarios, whereas scenarios up to a horizon of 5 to 10 years are more useful. Solvency assessments

with a horizon of more than 10 years are less reliable as there are too many factors influencing the solvency level.

In its attempt to assess climate change impacts under the ORSA, an insurer must rely on its own views and understanding. This is all the more necessary that there are strong unknowns and uncertainties in the evolution and impacts of climate change which may produce very different outcomes. Additionally, most items are interdependent and some approaches appear artificial.

A proportionate approach is needed since the materiality of climate risks differs across entities and may change over time. Insurance companies that do not identify significant climate risks in their risk profile should not be forced to use climate scenarios.

We are of the view that the costs actually outweigh the benefits when approaches in an ORSA are not proportionate to the insurance undertakings' own risk profile on the one hand and when scenarios extend to terms that go beyond strategic business plans horizons and the remits of what is needed for key management decisions on the other hand.

## 11. Question 11

*Question 11: 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? If not, please provide your suggestions to improve proportionality of the draft Opinion. (5000 character(s) maximum) including spaces and line breaks, i.e. stricter than the MS Word characters counting method.)*

- Yes
- No

*Please explain*

There is not much distinction as to how small, medium and large undertakings should integrate climate change risks in their ORSA. The EIOPA's Opinion sets the expectations on small undertakings too high and is lacking proportionality in broad terms as mentioned under our answer to question 10.

## 12. Question 12

*Question 12: Do you have any **other comments** on the draft Opinion? If yes, please provide these other comments. (5000 character(s) maximum) including spaces and line breaks, i.e. stricter than the MS Word characters counting method.)*

- Yes
- No

*Please explain*

It is worthwhile reminding that climate change risks materialise over a long-term horizon (e.g. physical risks of climate change will only take place over decades) which exceeds the three-year period generally used under the ORSAs or other solvency monitoring tools including macro prudential stress tests.

Please also refer to the feedback of the industry trade associations on the stress testing methodology.