

EIOPA'S WORK ON SUSTAINABLE FINANCE FOR THE INSURANCE SECTOR

European Union and Australia supervisory practice on climate risk

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CONTEXT

Climate change, pandemic crisis, are a source of risk

- Increasing severity and frequency of extreme weather events
- Increasingly interlinked risks and secondary effects (e.g. business disruption, 'cost of response')
- Protection gaps – risks to affordability and availability of insurance coverage, increasing risk of exclusions

Supervisors have the duty to protect consumers and secure financial stability

ESG risks are a risk driver over short-medium-long time horizon
Need to embed sustainability considerations in regulation and supervision
Pillar I, II and III / Conduct and prudential / Micro-Macro

Insurers and pension funds can have the opportunity and responsibility to contribute to society's resilience

'Double materiality'
Risk and opportunity - innovation
Through investment and underwriting practices
Shared resilience solutions to improve insurability of risk

Regulatory framework and industry pledges

EU Green Deal and strategies on sustainable finance and climate change adaptation
EU taxonomy
Global initiatives at NGFS, IAIS, SIF
'Net-zero alliances'

EIOPA'S MANDATE AND OBJECTIVES ON SUSTAINABLE FINANCE



Tasks and powers related to sustainability in EIOPA regulation 1094/2010, amended by Regulation 2019/2175 (Dec. 2019)

Take into account sustainable business models and integration of ESG related factors in the areas of its competence (Art. 1(3) and 8(1a));

Monitor and assess market developments (art. 8(1)(f)), including by

- Developing criteria for identifying systemic risks and an adequate stress testing regime, incl. potential environmental-related systemic risk. (art. 23)
- Putting in place a monitoring system
- Developing common methodologies for union-wide assessment of resilience of FI to economic scenarios taking into account risks stemming from adverse environmental developments and of the effect of environmental risks on the financial stability of FIs



Solvency II mandates (COM Proposal Proposal amending SII Directive 2009/138/EC, Sept. 2021)

- Mandate for recalibration of NAT CAT parameters at least every 3 years
- Mandate to report by June 2023 on a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental and/or social objectives
- Integration of scenario analysis in the ORSA



EIOPA strategic objectives

1. Insurers should manage and mitigate ESG risks appropriately (underwriting);
2. Insurers and pension funds should reflect policyholder and pension scheme members preferences for sustainable investments; and
3. Insurers and pension funds should adopt a sustainable approach in their investments based on principles of stewardship.

RELEVANCE OF THE 'DOUBLE MATERIALITY PRINCIPLE'

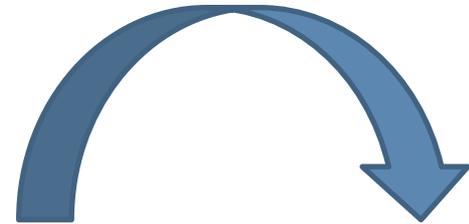


EIOPA'S COMMITMENT TO SUSTAINABLE FINANCE

2018-2019: Stimulate.
Put ESG on supervisory
map through
EIOPA SUFI action plan



2020: Incubate.
Consolidate policy in reports, draft technical
standards, discussion papers and draft
opinions.



From 2021: Enact.
Develop guidance and implement
supervision, step-by-step

CURRENT EIOPA ACTIVITIES MAPPED TO EU COM STRATEGY

EU renewed sustainable finance + climate adaptation strategies

- Prepare for collection of climate-related insurance **loss data**
- EIOPA **nat cat protection gap dashboard**
- Promote prevention and climate change adaptation through **'impact underwriting'**
- Contribute to **EU taxonomy** (insurer = user as well as eligible economic activity)
- Integrate climate change risk into **risk assessment** (Solvency II and IDD, delegated regulation, IORP II), incl. through capital requirements, scenario analysis in ORSA
- Financial stability tools and methodologies: methodological framework for **stress testing, sensitivity analysis** to climate-related transition risk
- Prudential and corporate **disclosure** (SFDR disclosure, NFRD, SII), **eco-labelling**

EU recovery and resilience plan

- **Shared resilience solutions**: opportunity for improved risk assessment, prevention, product innovation and risk transfer solutions between public and private sector
- Opportunities for **innovation and digitalization** for sustainable finance
- **Macro-financial** implications of nat cat protection gap

Global engagement

- Contribute to international standard-setting: member of **Sustainable Insurance Forum (SIF)**, **Network for Greening the Financial System (NGFS)** and **International Association of Insurance Supervisors (IAIS)**

SOME RECENT DELIVERABLES AND CURRENT WORK

➤ to identify risks:

- Consultation on amendments to the SII **supervisory reporting** and disclosure requirements (ESG risks to investments) (consultation till 17 October)
- Advice on regulatory technical standards for **disclosure** under the Sustainable Finance Disclosure Regulation and **reporting of sustainability KPIs** under the Taxonomy Regulation
- Pilot **dashboard** on the nat cat insurance protection gap
- Climate change **physical risk sensitivity analysis** (following earlier transition risk sensitivity analysis)

➤ to ensure appropriate product design/ regulatory treatment



- Methodological paper for integrating climate change in **nat cat underwriting risk** in SII standard formula
- Report on **non-life underwriting and pricing** in light of climate change ('Impact Underwriting')
- Analysis of **exclusions of coverage** for business interruption damage resulting from pandemic; analysis on **insurability of 'NDBI' risks** in the context of pandemic

➤ to monitor and manage risks

- Opinion on the supervision of the use of **scenario analysis** for climate change related risks in ORSA
- Methodological principles for insurance climate risk **stress testing**
- **Shared resilience solutions** in the context of pandemic risk

OUTLOOK – AREAS OF INCREASED ATTENTION

Based on EIOPA's work so far, and taking into account external developments and COM strategy

- **Implementation of supervision of ESG risks:**
 - Requirement for integrating sustainability risks in governance of (re)insurers becomes applicable from August 2022
 - Application guidance for ORSA scenario analysis on climate risk
- **Attention to greenwashing and conduct risk**– importance of relevant disclosure, implementation of ESG preference in product design and distribution
- **Regulatory treatment of ESG related aspects in solvency requirements for assets and liabilities**
 - 'Risk differentials'
 - Measures for climate adaptation in non-life ('impact underwriting')
- **Climate stress testing**

Financial stability dashboard includes ESG risks	Oct. '21
Methodological paper on potential inclusion of climate change in the natural catastrophe standard formula	July '21
Report on-life underwriting and pricing in light of climate change	July '21
Advice on RTS on the content, methodologies and presentation of disclosures under the EU Regulation on sustainability-related disclosures in the financial services sector	Feb. '21
Final Report with draft Regulatory Technical Standards (RTS) on product-related taxonomy disclosures	Oct. '21
Advice on KPI for environmentally sustainable activities by insurers or pension funds under Article 8 of the taxonomy regulation	Feb. '21
Contribution to SIF application paper on the supervision of climate-related risks in the insurance sector	June 2021
Opinion on the supervision of the use of climate change risk scenarios in ORSA	March '21
Thematic article on climate change, catastrophes and the macro-economic benefits for insurance	July '21
Prudent Person Rule chapter of the IORPs' Supervisory Handbook includes some good practices on the supervision of IORPs incorporating ESG factors in their investment policy (not publicly available)	March '21
Staff paper on measures to improve the insurability of business interruption risk in light of pandemics	Feb. '21
Issues paper on shared resilience solutions for pandemics	July '20
Pilot dashboard on insurance protection gap for natural catastrophes	Dec. '20
Report on the sensitivity analysis of climate-change related transition risks	Dec. '20
Thematic article on the EU sustainable finance taxonomy from the perspective of the (re)insurance sector	July '20
Second discussion paper on methodological principles of insurance stress testing	June '20
IORP stress test report addresses IORPs' ESG and greenhouse gas exposures	Dec. '19
Advice to EC on potential undue short-term pressures from financial markets	Dec. '19
Thematic article on climate Risk Assessment of the sovereign bond portfolio of European insurers	Dec. '19
Thematic article on impact of Green Bond Policies on Insurers: Evidence from the European Equity Market	June '19
Opinion on sustainability within Solvency II	Sept. '19
Discussion paper on protection gap for natural catastrophe risks	Sept. '19
Opinion on the supervision of the management of ESG risks faced by IORPs	June '19
Technical advice to EC on the integration of sustainability risks and factors in Solvency II and in the Insurance Distribution Directive	April '19
Analysis on climate-related exposures in insurers' investment portfolios	Dec. '18

Annex – Insurance nat cat protection gaps

INSURANCE PROTECTION GAP – POLICY AREAS

- Currently, only 35% of the total losses caused by extreme weather and climate-related events across Europe are insured (EIOPA, 2019 Staff discussion paper: Protection gap for natural catastrophes). This is likely to worsen due to climate change. Practical insurance example: Increasing global property premiums by 33-41% until 2040, ... share of catastrophe risk will rise to around 28–31% from an estimated 20% in 2020 (SwissRe sigma 4/2021)
- Increasing the insurance penetration is not sufficient as due to the increasing frequency/intensity of some events, some risks might become uninsurable. It is therefore key to understand the current insurance protection gap, identify where it comes from and take appropriate policy measures to secure financial stability and protect policyholders.



- Areas of work of relevance for addressing protection gaps
 1. **Risk assessment: How big is the gap, where does the gap come from? EIOPA’s nat cat insurance protection dashboard**
 2. **Prevention: Can insurance contribute to reducing losses? EIOPA’s work on climate change adaptation through ‘impact underwriting’**
 3. **Product design and governance: analysis on exclusions from insurance coverage.**
 4. **Risk transfer: What is the role for public and private initiatives? EIOPA’s framework for ‘Shared resilience solutions’**
 5. **Supervision: promote risk assessment, product adequacy, and oversight**

1. NAT CAT INSURANCE PROTECTION GAP DASHBOARD

EIOPA published in Dec. 2020 a [pilot dashboard on insurance protection gap for natural catastrophes](#)

This is the first pilot dashboard which depicts the insurance protection gap for natural catastrophes in Europe.

The aim is to represent the drivers of a climate-related insurance protection gap in order to identify measures that will help in decreasing society's losses in the event of natural catastrophes. Key drivers: hazard, exposure, vulnerability and insurance coverage.



- **Some issues emerged:**

Access to relevant data (loss data, hazard data, vulnerability data...)

- **Future steps**

Finalise dashboard in 2022 using data collection (currently taking place). Start country diagnostic with COM.

2. PROMOTE CLIMATE CHANGE ADAPTATION THROUGH INSURANCE - IMPACT UNDERWRITING (1/2)

EIOPA published its [final report on non-life underwriting and pricing in light of climate change in July 2021](#)

- It highlights the challenges associated with short-term non-life contracts and annual re-pricing in the context of climate change; and it identifies how insurers could contribute to climate change mitigation and adaptation by the concept of ‘impact underwriting’

Definition of climate change-related adaptation measures (i.e. risk reduction measures)

- (Structural) measures that are implemented by the policyholder ex-ante to a loss, which reduce the policyholder’s exposure to climate-related hazards through lowering i) the probability that a loss occurs and/or ii) lowering the severity of a loss.

Future steps: EIOPA’s work will continue to identify

- How climate change-related adaptation measures are included in product design and underwriting pricing, and
- How risk reducing effects of these adaptation measures are reflected in the corresponding Pillar I treatment?
- Pilot exercise in 2021 with insurance companies to collect good practices on impact underwriting and study the prudential Pillar 1 treatment (technical provisions, solvency capital requirements)

NON-LIFE INSURANCE PRODUCTS THAT PROMOTE ADAPTATION MEASURES ARE PRODUCTS THAT ...

APPENDIX A: CLASSIFICATION OF CLIMATE-RELATED HAZARDS⁶⁶⁹

	Temperature-related	Wind-related	Water-related	Solid mass-related
Chronic	Changing temperature (air, freshwater, marine water)	Changing wind patterns	Changing precipitation patterns and types (rain, hail, snow/ice)	Coastal erosion
	Heat stress		Precipitation or hydrological variability	Soil degradation
	Temperature variability		Ocean acidification	Soil erosion
	Permafrost thawing		Saline intrusion	Solifluction
			Sea level rise	
Acute	Heat wave	Cyclone, hurricane, typhoon	Drought	Avalanche
	Cold wave/frost	Storm (including blizzards, dust and sandstorms)	Heavy precipitation (rain, hail, snow/ice)	Landslide
	Wildfire	Tornado	Flood (coastal, fluvial, pluvial, ground water)	Subsidence
			Glacial lake outburst	

- i. Offer coverage for climate-related perils
- ii. Include climate change-related adaptation measures that lower the policyholder's exposure to climate-related perils
- iii. Set incentives for policyholders to take up adaptation measures, e.g. through reduced premiums or deductibles

Examples:

- Premium discounts for storm coverage w.r.t. houses meeting IBHS fortified standards (Travelers)
- Premium discounts for flood coverage w.r.t. houses with flood resilience measures (FloodRe)

Source: EU COM Climate Delegated Act,

04.06.2020

3. EIOPA WORK ON EXCLUSIONS FROM MASS SCALE EVENTS (PANDEMICS, CLIMATE CHANGE,...)

Current approach

- Since the onset of the COVID-19 crisis, EIOPA has been looking into issues relating to exclusion in insurance contracts.
- **Some issues emerged :**
 - Heterogeneous landscape in relation to pandemic exclusions across the EU
 - Lack of clarity in terms & conditions, with few cases where NCA intervention or Court cases took place to address ambiguous and vague clauses.
- EIOPA issued in July 2021 a questionnaire to NCAs to collect information on the exclusion related issues as well as actions taken by NCAs and/or industry as well as on the court cases (if any) since the onset of the pandemic.
- Considering similarities in terms of nat-cat exclusions and pandemics exclusions this work may be expanded to cover NAT CAT exclusions.

Future work

- As part of the Union Wide Strategic Supervisory Priorities (USSP), EIOPA and NCAs will do further work the treatment of exclusions in the POG context.
- In particular, pending Members' approval, EIOPA aims at launching a thematic review aimed at understanding at how exclusions are treated within the product design and POG process – i.e., how are exclusions reconciled with demands and needs – this is expected to cover pandemic exclusions as well as NAT CAT exclusions (tbc).
- EIOPA will also launch a demand side assessment in Q1 2022 to understand issues which consumers face when NAT-CAT events materialize. This will include: whether they were cover under the general umbrella policy, if not whether they thought they were covered, if yes whether the paid out was as expected.
- The study will also look at why consumers are not buying add-on NAT-CAT coverage, if available

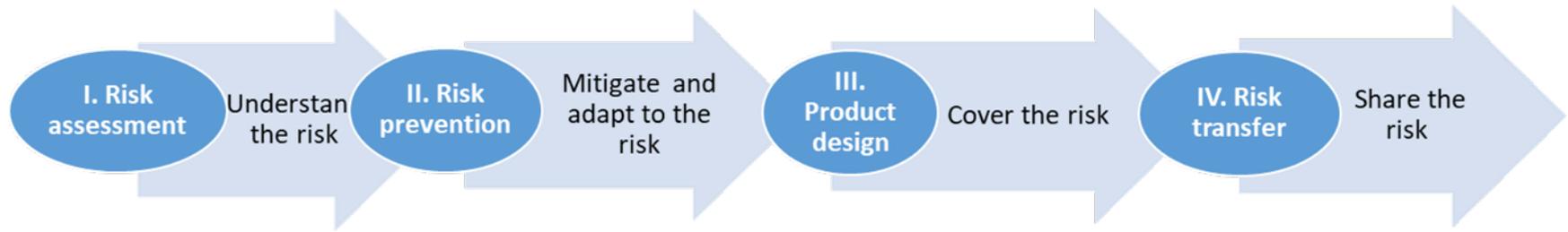
3. ROLE OF PUBLIC AND PRIVATE INITIATIVES FOR SYSTEMIC RISKS INCL. CLIMATE CHANGE: SHARED RESILIENCE SOLUTIONS

Context for developing the SRS: Covid-19 pandemic

- traditional insurance solutions are not sufficient to cover losses
 - The Covid-19 pandemic event is **global**, resulting in limited options for diversifying risk geographically, across sectors or lines of business
 - The pandemic affects the **both sides of (re)insurers' balance sheets**: increase in claims and asset risk
 - There is a **market failure in providing insurance** for non-damage business interruption (**NDBI**),
- There is a need to pursue **institutional as well as insurance (product)-related solutions**, involving public and private actors, to limit the cost of disorderly adjustments



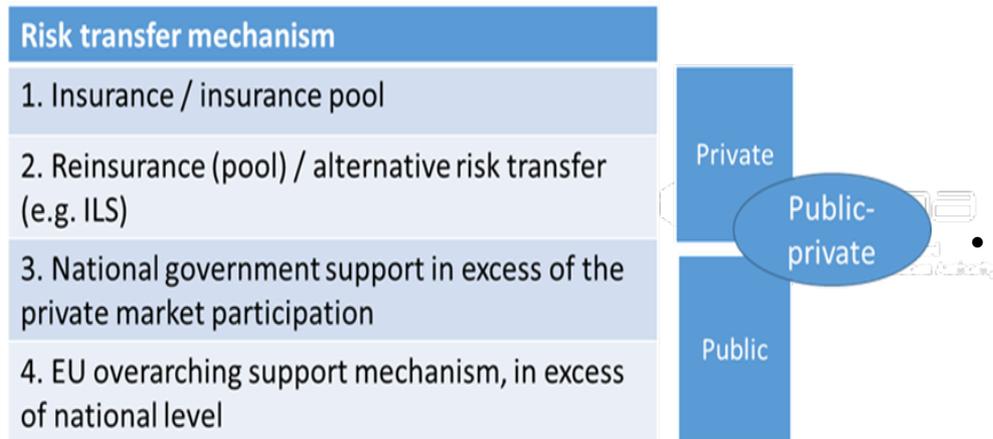
SRS: BUILDING BLOCKS AND FOUR PRINCIPLES



1. Requires the sharing of costs and responsibilities across the relevant parts of the private and public sector in a meaningful manner (“**skin in the game**”).
2. An efficient shared resilience solution will require an element of **central coordination** across public and private entities.
3. Any solution involving public and private sector would be conditional upon implementing efficient and effective **prevention and adaptation** measures.
4. A shared resilience solution can only insure against a **portion of the economic costs**.

See: Issues Paper on Shared Resilience Solutions, July 2020 www.eiopa.europa.eu/content/issues-paper-resilience-solutions-pandemics_en

RISK TRANSFER MECHANISMS AT NATIONAL AND EUROPEAN LEVEL



- SRS should integrally form part of national and European recovery frameworks and should contribute to making the EU's economy and society more sustainable
- SRS can be explored for other systemic or “black swan” /mass scale catastrophe events: cyber risk, climate change or future health emergencies

See: Staff paper on measures to improve the insurability of business interruption risk in light of pandemics

APPLYING THE SRS IN THE CONTEXT OF CLIMATE CHANGE

Risk assessment:

Identify the drivers of a protection gap against climate risk:

[EIOPA pilot dashboard on insurance protection gap for natural catastrophes](#)

Risk prevention and product design:

Promote risk-based adaptation measures in insurance products ('impact underwriting'):

[Report on-life underwriting and pricing in light of climate change](#)

Risk transfer:

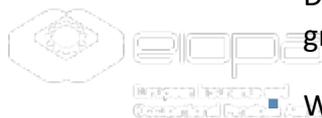
Address the potential systemic impact across Europe where a lack of coverage is combined with high exposures compared to the size of the economy and public revenues as well as high levels of public debt.

[Discussion paper on protection gap for natural catastrophe risks](#)

[Thematic article on climate change, catastrophes and the macro-economic benefits for insurance](#)

OVERSIGHT

- **EIOPA supervisory handbook (NCA only)**
- Recommendations to supervisory approach for the assessment of (re)insurers' governance and risk management framework to deal with climate change related risks, including on
 - ✓ business model and strategy
 - ✓ governance and risk appetite
 - ✓ risk management
 - ✓ the prudent person principle for investment
- **OVS approach climate change risk analysis**
- In 2021-2022, EIOPA will use Colleges of Supervisors (i.e. meetings with NCAs to discuss on supervisory issues of international groups), to
 - Discuss on the climate-change risk for the specific groups, based on high level materiality assessment;
 - When possible, analyse ORSA report to identify points of improvement.
- EIOPA intends to support the implementation of the ORSA guidance with the aim to improve the quality of the existing climate-related reporting in the ORSA



**Save-the-date –
EIOPA 5th sustainable finance roundtable on 7 December 2021**

THANK YOU!

For more information visit:
<https://www.eiopa.europa.eu>