

Consultation on an Opinion on Sustainability within Solvency II

Fields marked with * are mandatory.

Responding to this paper

EIOPA welcomes comments on its draft opinion on integrating sustainability in Solvency II.

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 **26 July 2019 23:59 hrs CET**.

Contributions not provided via the tool, sent to a different email address 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 template for comments. 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 and EIOPA's rules on public access to documents^[1].

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

* Confidentiality. Please indicate if you wish for your contribution to remain confidential.

- ☒ My comments can be published on EIOPA's website.
- ☐ My comments should remain confidential, i.e. should not be published on EIOPA's website.

☒ I accept your Terms

Rating

Question 1	    
Question 2	    

Data protection

Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published. They will only be used to request clarifications if necessary on the information supplied. EIOPA, as a European Authority, will process any personal data in line with Regulation 2018/1725. More information on data protection can be found at <https://eiopa.europa.eu/> under the heading 'Legal notice'.

Fields marked with * are mandatory

Information about the respondent

* Name of the organisation

Finance Watch

* Email

paul.fox@finance-watch.org

* Contact Name

Paul Fox

Challenges on integrating sustainability risks in prudential Pillar 1 requirements ("time horizon")

* Question 1:

Do you agree that no change in the time horizon for capital requirements would be required to integrate climate change considerations?

- ☒ Yes
- ☐ No
- ☐ n/a

* Please elaborate.

A first comment would be that there is a need to look beyond only climate change risks to environmental risks. Ecosystems and living organisms are experiencing a series of dramatic changes: pollution, ecosystem disruption and increased rate of extinctions. Our increasing impacts and depletion of our stock of Natural Capital are severely testing the ability of the Earth to provide for people's most basic needs. In 2009, the Stockholm Resilience Centre brought together 29 leading Earth-system scientists, who proposed a set of nine critical Earth-system processes with biophysical thresholds, or 'tipping points', called 'Planetary boundaries'. Crossing these thresholds could lead to irreversible environmental change, undermining the 'safe space for human development'. Four of them have already been crossed: biodiversity integrity, climate breakdown, land-system change and altered biogeochemical cycle. See ROCKSTRÖM et al, A safe operating space for humanity, Nature, 2009.

On the specific question of the time horizon for capital requirements needed to integrate environmental and climate change considerations, no change is necessarily needed. The rapid increase in uncertainty and risks linked to accelerating climate change and biodiversity loss do, however, call this into question and suggest it could be a subject for future review.

* Question 2:

Do you agree that insurers should consider sustainability risks, and in particular climate change risks, in a forward-looking manner?

- ☒ Yes
- ☐ No
- ☐ n/a

* If yes, how should this be incorporated into current or new requirements?

It is important for environmental and climate related risks to be considered in a forward-looking manner. While long-term investors have liabilities beyond 20-30 years, this does not mean that their time frames for investment are similarly long term. Undertakings do not yet appear to properly take into account long-term risks, including stranded assets, climate- and environmental-related risks.

Examples of why this is the case include that asset allocation decisions based on a historical view of risk, which generally prevents undertakings from taking into account systemic future events. As performance is generally evaluated on a quarterly basis it does not incentivise a proper consideration of medium- to long-term risks. It rather increases pressure to deliver short-term returns (furthermore, 2° Investing Initiative and the Generation Foundation identified four constraints on long-term analysis (beyond 3-5 years): a shortage of data from companies on their long-term plans, the high cost and low benefit of long-term analysis, a lack of standardised frameworks for long-term risk analysis, and a lack of demand from investors). Investment practice is also guided by measurement of short-term performance against peers, where risk is defined in relation to historic short-term volatility and divergence from a benchmark index — not by science-based analysis of physical risks. See SILVER, N., Blindness to risk: why institutional investors ignore the risk of stranded assets, Journal of Sustainable Finance & Investment, 7:1, 99-113, p.111.

* Question 3:

Do you agree that long-term scenario analysis in risk management, governance and ORSA should enable insurers to develop a forward-looking approach with regard to sustainability risks, and in particular climate change risks?

- ☒ Yes
- ☐ No

☒ n/a

* Please elaborate.

An essential part of this is ensuring that sufficient relevant data is sought out by undertakings and used in long-term scenario analysis. Governance disclosures should specify whether the company's approach to sustainability risks is consistent with IPCC (or other relevant, science-based, credible third-party) targets.

* Question 4:

What are your views on incorporating a standardised set of quantitative climate change scenarios in the ORSA, e.g. derived from the IPCC representative concentration pathways (RCP) - which are likely to evolve over time? Can you please elaborate on which scenarios you would use and which time span should be covered by such scenario analysis, specifying your approach for the valuation of assets, liabilities and your own solvency assessment (for standard formula and internal model users)?

A standardised scenario would be preferable from the point of view of allowing comparability between different approaches to the analysis of the scenario and monitoring how these approaches evolve. ". This scenario should be built around a set of parameters defined by a credible third-party (IPCC or other) and with a hard "floor" set by the regulators for each parameter that internal models cannot fall below.

Valuation of assets and liabilities

Valuation of assets

* Question 5:

Do you agree that the principles of valuation of assets of Solvency II allow for the consideration of sustainability factors?

- ☒ Yes
☐ No
☐ n/a

* Please elaborate.

Yes. However, any additional impetus that can be put on ensuring that sustainability factors are properly taken into account should be considered by EIOPA. It would be worth, for example, making explicit the already implicit requirement that the consideration of sustainability risk is in the best interest of policy holders and beneficiaries by integrating sustainability risk into the person prudent principle. The explicit requirement would be an important addition given that the financial impacts of climate change on investment portfolios might be significant.

* Question 6:

How in practice could the valuation of assets adequately (better) reflect sustainability risks?

ESG investing is often either considered to increase exposure to risk due to nature of the investments, or seen as a form of risk management and so leads to lower returns. Insurers are, however, uniquely placed to potentially consider taking a shared value business model perspective. See FSG, 'How Insurers Gain Competitive Advantage by Better Addressing Society's Needs', June 2017. As well as targeting investment opportunities to reduce protection gaps or target prevention, insurers can also avoid investments that are counter-productive. Insurers could put this into practice taking a stewardship role and pushing for better data availability on assets to help improve the reflection of sustainability risks in their valuation.

An additional issue for consideration is that some aspects of the Matching Adjustment mechanism, which is meant to encourage investment in long-term assets, work against sustainable investment, for example:

- The benefit of the MA is applied by reducing current technical reserves and solvency capital requirements instead of spreading this benefit over the lifetime of the asset. The use of what are, in effect, short-term capital incentives to promote long-term sustainable investment creates a confusing policy signal on sustainability.
- The MA is available for assets with fixed cashflows. Excluding investments with variable cashflows could harm investment in some categories of new sustainable infrastructure.
- The MA takes account of expected losses on assets via the "fundamental spread" but does not protect insurers against unexpected losses. This oversight needs addressing, given rising uncertainty linked to climate change.

Ideally, the rules would encourage long-term investing without resorting to short-term capital incentives, would accommodate a wider variety of sustainable long-term investment structures, and would provide some protection against unexpected losses as climate uncertainties increase.

* Question 7:

Should prudential disclosure requirements (e.g. Articles 263 and 296 of the Delegated Regulation) be amended to explicitly include sustainability considerations?

- ☒ Yes
☐ No
☐ n/a

* Please elaborate.

Given that the use of AVM might be particularly relevant to assets or liabilities that can be impacted by sustainability considerations, it would be important to explicitly include them under Article 263 of the Delegated Regulation.

The provisions of Article 296 of the Delegated Regulation could benefit from additional emphasis on assessing and describing levels of uncertainty that may be impacted by sustainability considerations.

* Question 8:

Should other enhancements / changes to the current regulations be envisaged regarding the consideration of sustainability factors in the valuation of assets?

- ☒ Yes
☐ No
☐ n/a

* Please elaborate.

In the context of comments made over the need to broaden the approach to sustainability to look at nature depletion and eco-systems as well as climate change impacts mentioned in the opinion, EIOPA could explore integrated valuation methodologies. Nature has an intrinsic value that cannot, and should not, be evaluated only through the lens of the benefit that mankind derives from it. As multiple and sometimes conflicting types of value co-exist (e.g. ecological, cultural, monetary) and their respective valuation methodologies (e.g. monetary, biophysical, sociocultural), an 'integrated valuation' framework could help integrate this range values that emerge at different levels (individual, community, national), by relying both on qualitative and quantitative information. Such a framework could be promoted as a way to answer the need to value nature, concerns over potential side-effects of monetary valuation and the limitations of relying solely on one method of valuation. See Finance Watch report 'Making Finance Serve Nature, May 2019'.

* Question 9:

Do you have additional views and evidence to be considered with regard to the exposure to physical risks?

The view on physical risks referred to in 7.4 and 7.5 of the EIOPA opinion should be broadened out to include risks arising from the impact of climatic, geologic events or widespread changes in ecosystem equilibria, such as soil quality or marine ecology. The Financial Stability Board has outlined that environmental risks can be event-driven ('acute') or longer-term in nature ('chronic'). See Cambridge Centre for Sustainable Finance, Environmental risk analysis by financial institutions: a review of global practice, Cambridge, UK: Cambridge Institute for Sustainability Leadership, 2016.

* Question 10:

Do you have additional views and evidence to be considered with regard to the exposure to transition risks?

A point to consider is that the 'market' as a whole seems to assume a very low probability that governments will successfully ban fossil fuels and strongly regulate nature-depletion, and may already have factored this risk in to prices to the extent considered appropriate. Whilst this possible perception of a low probability of effective regulation in the short term exists transition risk may be consistently underestimated. The rapid decline in the values of coal companies is one illustration of this. In other sectors, market views on transition risk may rest on assumptions that will likely change as a result of climate policy and emerging climate risk, for example by significantly shortening the time over which fixed assets of oil and gas companies are depreciated.

Valuation of liabilities

* Question 11:

Do you agree with the good practices EIOPA is suggesting for undertakings to apply for integrating sustainability in the valuation of liabilities?

- ☒ Yes
☐ No
☐ n/a

* Would you have further suggestions? Please elaborate.

EIOPA could consider ensuring that all of the good practices listed in 7.41 are used at a minimum (terminology under 7.40) when calculating their best estimate. It would be important to understand how EIOPA proposes to ensure that this minimum level of requirements is met.

* Question 12:

What is your view on adopting a forward-looking modelling approach in the calculation of the best estimate to assess climate change-related risks?

Please elaborate.

A forward-looking modelling approach would be a welcome addition to ensure that issues around historical loss data are addressed in a robust way.

However, given the evidence collected by EIOPA and outlined in 7.31, there is clearly a need to implement an approach that ensures the risks arising from the impact of climate change and nature depletion are properly taken into account.

Articles 2 and 29 of the Delegated Regulation are two areas from where issues could arise, when considered with Article 21 of the Delegated Regulation in the context of sustainability risks. Climate change and nature depletion risks are not likely to be properly taken into account through using historical loss data. In addition there may also currently be issues with the quality and availability of data to use for these risks. Here it would be useful to consider promoting a role for insurers to ensure that plans are put in address issues with lack of data, rather than using it as a default mechanism to resort to approximations to calculate the best estimate.

* Question 13:

What would you consider to be proportionate good practices for such a forward-looking modelling approach in the calculation of the best estimate?

Any decision on proportionality should be linked to cost-benefit analyses based on quantitative estimates and detail to justify the bases for these estimates.

* Question 14:

Do you agree that climate risks may affect the technical provision calculation for the life insurance?

- ☒ Yes
- ☐ No
- ☐ n/a

* Please elaborate.

Yes. Potentially already existing issues around under-reserving and under-capitalisation by insurers could be exacerbated by the impact of climate change and nature depletion. The ESRB has outlined concerns over potential underestimations of insurer's technical provisions. This is of particular relevance given that a large amount of insurers own funds that is made up of expected profits from future premiums- another element that could be impacted by climate and environment concerns. See ESRB, 'Macroprudential provisions, measures and instruments for insurance', November 2018.

As outlined by EIOPA in 7.42 life insurance may be both directly and indirectly impacted and so requires particular attention.

* Do you agree that the two main assumptions/areas where climate may impact the calculation of life technical provisions are the Economic Scenario Generators and the mortality rates? What about morbidity rates?

- ☒ Yes
- ☐ No
- ☐ n/a

* Please elaborate.

EIOPA should expand its view on the issues posed by climate risk and climatic events outlined in 7.42 to include the risks associated with nature depletion and eco-system disruption. This should be linked to the principle under 7.38 of the 'best science available', which EIOPA could help to qualify.

EIOPA should be encouraged to further consider these risks are included in life best estimates as indicated in 7.43. However, EIOPA should also clarify how this will be undertaken and what the responsibility and role of insurers would be in addressing difficulties in valuing liabilities.

Question 15:

Is climate change relevant for Economic Scenario Generators?

- ☒ Yes
- ☐ No
- ☐ n/a

* If yes, how could climate change be included in Economic Scenario Generators?

A key point is that Economic Scenario Generators may be extremely useful, but their use may significantly impacted by regulatory regimes that companies fall under. EIOPA would need to ensure here that ESG are used to help provide projections for longer time horizons, than what may currently often be 1 -5 years.

EIOPA should also look into how far there is a reliance by insurers on the same third-party provided Economic Scenario Generators.

* Question 16:

Is the impact of climate change relevant on the mortality rates?

- ☒ Yes
- ☐ No
- ☐ n/a

- * If yes, how could climate change be included in mortality rates?

There appear to be a number of examples of efforts under way by actuaries to update their mortality tables for the impact of climate change. See 'Climate Change for Actuaries: An Introduction' by the Climate Change Working Party, IAEW, 25 March 2019 and 'Climate Change and Mortality', International Actuarial Association, November 2017. New data and scenarios arising from these initiatives should be incorporated into prudential models.

Investment and underwriting practices

Investment practices

- * Question 17:

Do you identify other relevant practices to include sustainability risks in (re)insurers' investment strategy and decisions?

ESG investing is often either considered to increase exposure to risk due to nature of the investments, or seen as a form of risk management and so leads to lower returns. Insurers are, however, uniquely placed to potentially consider taking a shared value business model perspective. See FSG, 'How Insurers Gain Competitive Advantage by Better Addressing Society's Needs', June 2017. As well as targeting investment opportunities to reduce protection gaps or target prevention, insurers can also avoid investments that are counter-productive. Insurers could put this into practice taking a stewardship role and pushing for better data availability on assets to help improve the reflection of sustainability risks in their valuation. It would help potentially move more insurers from being reactive to proactive in the face of developments linked to sustainability risks.

- * Question 18:

Do you have any further views on the analysis of returns on sustainable assets?

-

- * Question 19:

To what extent do you align your investment strategy and decisions with your underwriting practice and decisions in respect of sustainability risks?

-

- * Question 20:

Which good practices do you identify to deal with transition and physical risks in (re)insurers asset portfolios?

ESG investing is often either considered to increase exposure to risk due to nature of the investments, or seen as a form of risk management and so leads to lower returns. Insurers are, however, uniquely placed to potentially consider taking a shared value business model perspective. See FSG, 'How Insurers Gain Competitive Advantage by Better Addressing Society's Needs', June 2017. As well as targeting investment opportunities to reduce protection gaps or target prevention, insurers can also avoid investments that are counter-productive. Insurers could put this into practice taking a stewardship role and pushing for better data availability on assets to help improve the reflection of sustainability risks in their valuation. It would help potentially move more insurers from being reactive to proactive in the face of developments linked to sustainability risks.

Underwriting practices

* Question 21:

Do you consider "impact underwriting" as described in the opinion to be a relevant way to take into account sustainability in underwriting policy?

- ☒ Yes
☐ No
☐ n/a

* Please elaborate.

An understanding of impact underwriting that ensures both products with a positive ESG impact are created, as underlined in 8.38, should also be complemented with identifying where products have a negative ESG impact to then be able to take action accordingly.

* Question 22:

(a) Do you explicitly consider risk mitigation and adaption strategies addressing climate change in your products?

- ☐ Yes
☐ No
☒ n/a

* Please elaborate.

-

* (b) What would be the main benefits/obstacles of the generalisation of such a practice?

-

* (c) Which measures would you recommend to assess the risk mitigating effect of such underwriting?

-

*

Question 23:

Do you identify other good practices than those described above?

- ☐ Yes
☐ No
☒ n/a

* Please describe.

-

* Question 24:

What are your views on climate change potentially widening the protection gap for natural catastrophe (re) insurance?

As outlined in the opinion there are serious issues related to financial stability and potential concentrations of risk arising from natural catastrophe (re)insurance. Potential issues arising from the impacts of climate change may not only increase the protection gap, but also increase financial stability risks. In cases of public – private reinsurance pools for natural catastrophes, the potential consequences of risk transfer to states should be carefully considered. As mentioned in previous responses exploring a shared value business model could allow insurers to help reduce the protection gap, including through mitigation and adaptation.

* Question 25:

Do you have evidence on Solvency II impacting the insurance protection gap (e.g. for natural catastrophe risks) in light of climate change?

Please elaborate.

-

Capital requirements

Market risk

* Question 26:

(a) Do you support the views on the treatment of sustainability risks in the market risk module?

- ☒ Yes
☐ No
☐ n/a

* Please elaborate.

EIOPAs approaches in 9.12, 9.13, 9.16 and 9.17 reflect positive avenues to pursue.

* (b) Do you have further evidence which should be considered?

- ☐ Yes
☒ No
☐ n/a

* Please elaborate.

-

* Question 27: Property risk

Do you have additional views and evidence to be considered with regard to the integration of sustainability risks in property risk?

- ☒ Yes
☐ No
☐ n/a

* Please elaborate

There are serious issues and concerns over the use of capital charging approaches and the way in which they steer insurers' asset allocation decisions – both generally and for sustainability purposes. These concerns are ultimately that regulation based on risk weighting and internal modelling is overly complex and prone to manipulation to be able to properly achieve its objectives.

* Question 28: Equity risk

(a) Do you have comments on the analysis of risk differentials for listed equity?

- ☒ Yes
☐ No
☐ n/a

* Please elaborate.

EIOPA should carefully investigate concerns raised that certain risk charges in Solvency II are not properly calibrated and discourage investment in equities, listed and unlisted, and unrated debt. There may be evidence to suggest that insurers have scaled back their engagement in equities and that private equity funds are able to outbid the public markets for assets. We recognise that this could be attributable, at least in part, to different drivers such as perceived excessive valuation levels in listed equities and the ability of private equity funds to take on high levels of very low cost debt. However, if EIOPA can establish that there is genuine evidence of an imbalance in Solvency II that penalises equities and discourages insurers from investing in the real economy then it should be addressed.

* (b) Do you have additional views and evidence to be considered with regard to the integration of sustainability risks in listed equity risk capital charges?

- ☒ Yes
☐ No
☐ n/a

* Please elaborate.

Please see input under question 28 (a).

*

(c) Do you have additional views and evidence to be considered with regard to the integration of sustainability risks in unlisted equity risk capital charges?

- ☒ Yes
☐ No
☐ n/a

* Please elaborate.

Please see input under question 28 (a).

* (d) Which data sources or research conducted would be relevant to consider for unlisted equity risk capital charges?

-

* Question 29: Spread risk

(a) Do you have additional views and evidence to be considered with regard to the integration of sustainability risks in spread risk capital charges?

- ☐ Yes
☒ No
☐ n/a

* Please elaborate.

-

* (b) Which data sources or research conducted would be relevant to consider for the integration of sustainability risks in spread risk capital charges?

-

* (c) What are your views on the methodology for a green bond index?

-

* (d) Do you have additional views and evidence to be considered with regard to the integration of sustainability risks in unrated debt capital charges?

-

* (e) Which data sources or research conducted would be relevant to consider for the integration of sustainability risks in unrated debt capital charges?

-

* Question 30:

Do you agree that climate change should be captured in a forward-looking manner in the ORSA for market

risk especially by incorporating a quantitative approach based on a standardised set of climate change scenarios?

- ☒ Yes
☐ No
☐ n/a

* If yes, which scenarios/tools could be used for quantitative assessments and which time span would you apply?

-

Natural catastrophe underwriting risk

* Question 31:

Do you agree that regular recalibration of the parameters for the natural catastrophe risk module of the standard formula will allow to capture climate related developments, including the impact of climate change?

- ☐ Yes
☐ No
☒ n/a

* Please elaborate.

-

* Question 32:

Would you advise changing the design of the natural catastrophe risk module of the standard formula to capture climate related developments, including the impact of climate change?

- ☐ Yes
☐ No
☒ n/a

* Question 33:

Do you agree that climate change should be captured in a forward-looking manner in the ORSA for natural catastrophe underwriting risk especially by incorporating a quantitative approach based on a standardised set of climate change scenarios?

- ☒ Yes
☐ No
☐ n/a

* If yes, which scenarios/tools could be used for quantitative assessments and which time span would apply?

-

* Question 34:

How do you take into account the long term view of climate-related developments, including the impact of climate change for the management of your natural catastrophe risks?

-

Internal models

* Question 35:

Do you agree the rules relating to internal model design and calibrations do not prevent internal model undertakings from accounting for sustainability factors, with particular regard to the climate risk that existing insurance and reinsurance obligations are exposed to?

- ☒ Yes
☐ No
☐ n/a

* Please elaborate.

Yes, but there are serious reservations over the use of internal models that should enter into consideration here. The ESRB has identified a need for better monitoring and assessment of internal models, which could help give a view on any possible good or bad current practices arising from the use of internal models in this area. See ESRB, 'Macroprudential provisions, measures and instruments for insurance', November 2018.

Ultimately the use of internal models is, however, not an appropriate instrument of prudential regulation. The only acceptable model should be a standardised approach that allows at least a minimum level of comparability, rather than attempting to standardise some minimal elements around internal models.

* Question 36:

Could you provide further explanation/examples on how sustainability factors, with particular regard to the climate-change risks are taken into account in your internal model?

-

Contact

Pamela.Schuermans@eiopa.europa.eu