Position Paper

Response to EIOPA call for evidence for an opinion on sustainability within Solvency II

Our reference:	ECO-LTI-19-050		
Referring to:	Call for evidence for an opinion on sustainability within SII		
Related documents:			
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Pages:	12	Transparency Register ID no.:	33213703459-54

1. Definitions

Sustainability risks

Sustainability risks are operationalised via the concepts of environmental, social and governance risks. Sustainability risks could affect both the investments and the liabilities of insurance and reinsurance undertakings. Currently the assessment of environmental factors, in particular climate change, is most advanced in theory and practice.

Climate risks will be the main, though not exclusive, focus of call for evidence.

Environmental, social and governance (ESG) factors

[Reference is made to the European Commission proposal "on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341", in Article 2(o) "sustainable investments".]

- Environmental: factors that contribute to an environmental objective. Such objectives include climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, waste prevention and recycling, pollution prevention and control and protection of healthy ecosystems. [See Article 5, Commission Proposal for a Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment, COM(2018) 353 final.]
- Social: factors that contribute to a social objective, and in particular to tackling inequality, an investment fostering social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities;

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- Governance: factors that contribute to good governance practices, and in particular companies with sound management structures, employee relations, remuneration of relevant staff and tax compliance;

Physical risks

Risks arising from increased damage and losses from physical phenomena associated with both climate trends (e.g. changing weather patterns, sea level rise) and events (e.g. natural disasters, extreme weather). Climate trends and shocks could pose economic disruptions affecting insurers, the economy, and the wider financial system. At the macro-economic level, losses from physical risks may affect resource availability and economic productivity across sectors, the profitability of firms and individual assets, pose supply chain disruptions, and ultimately impact insurance market demand. Losses arising from physical risks, especially when uninsured, may have cascading impacts across the financial system, including on investment companies and banks.

Transition risks

While the transition to a low-carbon economy may create opportunities, it may also create risks (e.g. credit, liquidity) and/or significantly constrain economic growth, especially in the case of too sudden or too late policy changes. Transition risks are arising from disruptions and shifts associated with the transition to a low-carbon economy, which may affect the value of assets or the costs of doing business for firms. Those risks may be motivated by policy changes, market dynamics, technological innovation or reputational factors (see figure below). Key examples of transition risks include wrong assessments of climate-induced risks and opportunities and policy changes and regulatory reforms which affect carbon-intensive sectors, including energy, transport and industry. Policy and regulatory measures may affect specific classes of financial assets (such as real estate portfolios), in addition to those affecting capital markets.

Liability risks

These pertain to risks that industries, companies and possibly individuals may be held liable for contributing to climate change or climate change-related events, or fail to disclose the climate impact of their operations.

*Q1. Do you agree with these **definitions**? If not, please provide the definitions you usually use when defining climate change related-risks, from existing legislation or of other sources you refer to?*

Insurance Europe generally agrees with the definitions. However, Insurance Europe suggests a clarification of the definition of sustainability risk to highlight that they must be financially relevant risks with a potential negative impact on the value of the asset/investment.

The insurance sector notes that a clear distinction should be drawn between:

- ESG as financial risk and opportunities
- ESG as risk to the general stakeholders, related to environment and society at large

In this respect, a number of companies already work in line with UN Guiding Principles on Business and Human rights, OECD MNE guidelines and national business recommendations. These all state that risks to the general stakeholders should be considered.

With respect to physical risks, Insurance Europe stresses that they encompass a wider range of risks than the sole environmental risks. In addition, uninsured risks should be taken out of scope of the definition of physical risks.

Regarding liability risks, as in TCFD work, they should be included in transitional risks. Considering this category separately creates unnecessary complexity.

*Q2. What types of **gaps and barriers** (information, data, scenarios), if any, are currently complicating the identification and assessment of climate change risks?*

Corporate disclosure is still in its infancy for climate change. This impairs data availability and quality (e.g. for data indicated in Q3) which is key to reliably deal with climate change risks. A series of gaps and barriers that complicate the identification and assessment of climate change risks on a company-wide scale also includes the lack of:

- clear definitions and rules for the classification of sustainable activities
- quantitative data on company strategies (especially regarding transition risk)
- data quality and comparability (with significant differences between different data providers)
- mature identification and valuation models; related methods are not yet stabilized: the choice of data necessary for valuation depends on the chosen method, which could consequently evolve with the progresses made in methodologies
- valid scenarios and knowledge on expectations for future technological development and demand.

Focusing on the potential impacts on the underwriting side (i.e. potential impact on claims, risk pricing and premium income), another barrier to solid risk identification and assessment is the limited availability of scientific studies that project the effects of climate change risks in the future while taking into account the response of the entire insurance market to these changed risk trends, ie for NatCat risk.

For climate scenarios and climate model projections guided by those scenarios, the IPCC's Radiative Concentration Pathways (RCP) could be used as the guiding GHG scenarios. This would qualify as a suitable framework to use given that these are the relevant scenarios for the official climate policy process.

*Q3. What types of **data inputs** do you use to inform your analysis of climate-related risks (for both assets and liabilities)?*

The insurance sector informs its analysis of climate-related risks based on the loss history and underwriting experience for the insurance operations, and the analysis of the underlying fundamentals for investments. Specifically, the following data inputs are usually used:

- company-specific quantitative data, policies and strategies sector-specific data, eg energy diagnostics are used in the real estate field. When there are prescribed norms for some activities, the data linked to these norms are usually used.
- internal data on loss history and underwriting experience for the insurance operations
- external metrics and policy tools related to a number of initiatives (eg referring to TPI and CDP data, RCP scenarios). Carbon footprint data, information on energy mix, decarbonization strategies, climate targets, green patents are often used across industries.
- geospatial and infrastructure information at asset level for operators/investees to run physical risk scenarios

In general, it is key that the analysis of climate-related risks builds on qualitative scenarios, ie to consider options and responses to future developments under uncertainty. This approach is coherent with the fact that the identification of climate change impacts is hard to disentangle from the effects of several other factors that will change and collectively challenge the insurance business in the future. This is also in line with the IPCC perspective that climate change is interlinked with many factors, partly influencing or even aggravating each other.

2. Assets and sustainability risks

2.1. Identification of the assets subject to sustainability risk

Climate change can pose risks as well as bring opportunities for investments.

Climate change impacts on environmental system (oceans, marine environment, coastal zones, freshwater systems, ecosystems of forests, soils) as well as on society (human health, agriculture, energy, transport, tourism, climate migration…). Climate change will affect the frequency and severity of certain extreme weather- and climate-related events, such as droughts, heat waves and heavy precipitation events [See European Environment Agency, Climate change, impacts and vulnerability in Europe 2016. An indicator-based report. EEA Report No 1/2017.].

This may in turn induce changes in consumer expectations, the development of new technologies dealing with climate change, adaptations in policies and regulation enabling the transition towards a lower carbon economy and may drive changes in investment behaviour.

*Q4. Which **impacts of climate change or the transition to a low-carbon economy** do you consider to pose the greatest risks **on investments for insurers**? Which would create opportunities? Which other impacts of climate change should we consider? Please specify.*

Oceans, marine environment

Major risk	Major opportunity
Minor risk	Minor opportunity
No risk	No opportunity

Please comment:

Coastal zones

Major risk	Major opportunity
Minor risk	Minor opportunity
No risk	No opportunity

Please comment:

Freshwater systems

Major risk	Major opportunity
Minor risk	Minor opportunity
No risk	No opportunity

Please comment:

Ecosystems (forests, soils)

Major risk	Major opportunity
Minor risk	Minor opportunity
No risk	No opportunity

Please comment:

Human health

Major risk	Major opportunity
Minor risk	Minor opportunity
No risk	No opportunity

Please comment:

Agriculture

Major risk	Major opportunity
Minor risk	Minor opportunity
No risk	No opportunity

Please comment:

Energy

Major risk	Major opportunity
Minor risk	Minor opportunity
No risk	No opportunity

Please comment:

Transport

Major risk	Major opportunity
Minor risk	Minor opportunity
No risk	No opportunity

Please comment:

Tourism

Major risk	Major opportunity
Minor risk	Minor opportunity
No risk	No opportunity

Please comment:

Climate migration

Major risk	Major opportunity
Minor risk	Minor opportunity
No risk	No opportunity

Please comment:

Other, please specify:

The above division does not always meet the investors' analysis which looks at the individual activities within the analysis of the specific issuers. Even if climate change will affect various industries differently, investors will diversify at geographical and industry levels as a means to eliminate idiosyncratic risks.

The sector also notes that ESG factors, and climate change in particular, can be risks or opportunities according to the governance of the investee, more than its activities.

In addition, insurers will be exposed to significant political risk associated to the future challenges related to the transition to a low-carbon economy.

*Q5. With regard to **drivers of investment behaviour**, please specify if they represent a risk or an opportunity of investment for insurers, as well as their importance. Do you think that additional drivers need to be considered? If yes, please specify.*

Changes in consumer expectations

Major risk	Major opportunity
Minor risk	Minor opportunity
No risk	No opportunity

Please comment:

New technologies

Major risk	Major opportunity
Minor risk	Minor opportunity
No risk	No opportunity

Please comment:

Policies and regulations enabling the transition towards a lower carbon economy

Major risk	Major opportunity
Minor risk	Minor opportunity
No risk	No opportunity

Please comment:

Other, please specify:

Physical risk

*Q6. Which **drivers of physical risk** do you consider have the greatest impact on assets **in the geographical areas where you invest**? Are there geographical differences between the markets in which you invest? If yes, please specify.*

Transition risk

*Q7. Which **drivers of transition risk** do you consider have the greatest impact on assets **in the geographical areas where you invest**? Are there geographical differences between the markets in which you invest? If yes, please specify.*

Green/brown assets

*Q8. Do you consider that **green assets need to be distinguished from other assets** in order to implement an efficient asset allocation regarding climate change impacts? If yes, which **criteria** do you consider relevant for **classifying assets as "green"**?*

No, there is no need for a binary green/brown approach as a precondition for insurers adopting efficient asset allocations with regards to climate change.

The only necessary work is the one focused on the EU taxonomy on sustainability, namely on the identification of E, S and G factors. Once the E factor is clarified in a consistent and comparable way, all investors will be better positioned to assess their asset allocations against climate change objectives. In this respect, the insurance sector stresses that:

- **The ESG factors need to be considered together and on a case by base approach** to enable investors to deal best with risks and be efficient in their societal role. This will avoid instances where, on the one hand, a "green" asset has negative social impacts and, on the other hand, a "brown" asset has positive social impacts. This is even more crucial for activities which are hard to categorise. Despite appearances, even coal-related activities might be challenging to categorize in some cases, eg there is no real alternative for metallurgical coal necessary for steel production.
- The taxonomy approach currently discussed by European policymakers will provide a classification of sustainable activities. However, **the framework is not designed as a risk-based framework and is therefore not to be used as a prudential tool to identify assets that have a higher/lower exposure to physical, transition and sustainability risks**. In terms of classification, the industry notes that the current taxonomy would only be fit for purpose for the application in the green bond universe or in project finance where a given economic activity is financed, e.g. a wind park, a solar park or public transport. With respect to the financing of entire companies or even conglomerates, the approach of the taxonomy might not be fit for purpose. Due to shifts in activities and strategy in the regular course of business or as a result of mergers and acquisitions the footprint of a company could materially change.

It remains key that Solvency II remains modern and risk-based and avoids imposing investment limits. Solvency II should measure the risks that insurers are exposed to when investing; only if there is proof that E, S, G factors can have an impact on the risk profile of an investment, these should be reflected in the framework.

There is no need for a green/brown definition, and definitely not a need for EIOPA to develop a definition for the insurance sector. Any definitions in the area of E, S, G should be envisaged at European or even international level.

*Q9. Do you consider that **brown assets need to be distinguished from other assets** in order to implement an efficient asset allocation regarding climate change impacts? If yes, which **criteria** do you consider relevant for classifying assets as "brown"?*

See answer to question 8.

2.2. Impact of sustainability risks, with particular regard to climate risks on valuation of assets and on market risks

*Q10. What are the **transition risks** that you consider most relevant to have an impact **on asset valuation**?*

- *Change in investors' expectations and preferences*
- *Policy changes*
- *Technological trends*
- *Reputational factors*
- *Demand for more transparency*
- *Rise in the cost of energy or CO2*
- *Change in consumers' preferences*

Other, please specify:

*Q11. What trends or events caused by climate change, potentially leading to **physical risks on assets** do you consider most relevant to have an impact on asset valuation?*

- *Climate trends*
  - *temperature rise*
  - *changing/extreme weather patterns*
  - *sea level rise*
  - *higher CO2 concentrations*
  - *higher global emissions (other than CO2)*
  - *trends on biodiversity/animal migration*
  - *displacement - climate immigration*

- *Climate change-related (extreme) weather events*
  - *windstorms*
  - *flood*
  - *hail*
  - *heat waves*
  - *drought*
  - *subsidence, landslides*
  - *freeze, snowfalls, avalanches*

Please specify.

*Q12. **How do sustainability risks affect the valuation of financial assets** in investment portfolios over the short, medium and long term?*

*Q13. **How do transition and physical risks affect the valuation of financial assets** in investment portfolios, over the short, medium, and long term?*

*Q14. Which are, in your view, **the types of assets whose valuation is most subject to transition risks**? Do you consider unrated bonds and loans, unlisted equity and real estate to be affected? What about other assets?*

*Q15. Can **sustainable investments** be viewed as good investment opportunities? In particular, should sustainable investments be subject to similar **targets and measures of expected return** as other investments? If not, please provide examples of investment targets and measures of expected return for sustainable investments.*

Sustainable investments can be good investment opportunities, depending on the meaning of "good". Sustainable investments can be good investment both in terms of their return to investors and in terms of their impact on the environment or society. In general, the attractiveness of any investment depends on a series of factors in the investment decision process, including risk-return profile, matching of assets and liabilities, overall investment strategy and capital requirements. ESG factors and risks are not enough on their own to consider a sustainable investment as a good investment opportunity.

With respect to the expected return, sustainable investments should be subject to the same targets and measures of expected return as other investments. It is to be noted that some assets are considered as sustainable with respect to the environment but the activity underlying the asset could be not profitable without subsidies.

*Q16. Can you provide evidence on how the **carbon footprint** is taken into account **in the pricing of an asset**? Would other methods also be relevant for the pricing of an asset? Please elaborate and distinguish asset classes where possible.*

*Q17. Can you provide **evidence that green assets or brown assets have a significantly different risk profile** than other assets? Please elaborate.*
No.

There is no clear evidence of differences between green assets or brown assets at aggregate level. If green or brown assets are exposed to different risks than other assets of the same asset class, these risks should be taken in account. In general, all financially material risks should be recognized in the investment process. Therefore, if risks are similar, green or brown assets should not be treated differently.

*Q18. Do you have evidence that **green assets**, or assets with a lower **exposure to physical and transition risks**, have a different **market risk profile** than other assets? If yes, please elaborate on the evidence and on how market risk structures differ. Please identify the relevant assets/asset classes.*
No.

There is no clear evidence of differences at aggregate level. Green assets are not necessarily less exposed to physical and transition risks then other assets.

*Q19. Do you have evidence that **brown assets**, or assets with a higher **exposure to physical and transition risks**, have a different **market risk profile** than other assets? If yes, please elaborate on the evidence and on how market risk structures differ. Please identify the relevant assets/asset classes.*
No.

There is no clear evidence that brown assets contain higher market risk than other assets.

Q20. Do you have evidence demonstrating that either assets that are considered green or have a lower exposure to physical and transition risks, or assets that are considered brown or that have a higher exposure to physical and transition risks, are correlated in a significantly different manner than those correlations provided in the

standard formula in Solvency II*? If yes, please elaborate on the evidence and on how correlations differ. Please distinguish between asset classes.*
No.

There is no clear evidence of differences in correlation between green assets or brown assets.

There is not enough data and thus no statistical evidence on correlations between green and brown assets on the one hand and standard formula asset classes on the other hand. If asset classes in the standard formula framework should be refined with respect to the **exposures to physical, transition and sustainability risks**, the best way forward would be to build up a pan-European data base, or at least to initiate a research project assigned to an independent institution such as a European Supervisory Authority, to validate correlation and risk parameters of specific asset classes, which might not necessarily coincide with the currently available definitions of green and brown investments.

In addition, the insurance sector stresses that the classification of assets should be based on their specific exposure to physical and transition risks. In certain cases, the so called "green" assets may also be exposed to physical risks to a great extent (e.g. offshore wind power). Therefore, it is key to look at the risk **exposure of the specific assets.**

2.3 Practices for asset allocation
Q21. Please rank the following ***investment criteria*** *according to importance on a scale from 1 (highest importance) to 7 (lowest importance):*

	Please rank from 1 - 7
*Profit expectation in short term	
*Profit expectation in medium term	
*Profit expectation in long term	
*Matching assets and liabilities	
*Level of market risk associated with assets (including climate risks)	
*Risk-return profile	
*ESG factors (risks and opportunities)	

Other, please specify:

Q22. When deciding on ***asset allocation****, which information do you mostly take into account (modelling of expected returns, of expected cash-flows, ratings of the assets…). Is the approach different for sustainable investments? if yes, please elaborate.*

The question is not relevant because insurers' approach to investing is not different for sustainable investments compared to any other investments. Insurers have a duty of diligence and care for their policyholders, and this duty applied to all types of assets they invest in.

The investment assessment is multifactorial. The matching of assets and liabilities, the risk-return profile and the level of market risk are among the key factors that are taken into account when deciding on the asset allocation. Sustainability is also increasingly becoming relevant in the asset allocation policies of insurers.

*Q23. Which strategy do you pursue in reducing sustainability risks in your investments? Do you consider the **strategy of exclusion/ investment decrease** in any economic sector/ geographical area appropriate to reduce the potential sustainability risks? Please elaborate.*

Exclusion can be an appropriate strategy to mitigate some risks. However, it is to be noted that exclusions are often related to ethics consideration rather than financial risks. Certain sectors, such as controversial weapons are excluded under most investment policies. Similarly, companies are often excluded from insurers' investments because they do not follow in international norms.

In addition, the insurance sector notes that engagement practices can be a suitable approach for risk mitigation and support transition. Engagement allows for a good knowledge of investees and a better risk management. However, it needs to be considered that effectiveness of engagement depends on the portfolio types, generally being more effective and manageable in equity portfolios than in bond portfolios.

Another factor to consider is that the overall effectiveness of engagement policies conducted by small and medium sized companies can be ambiguous and it can be very costly, especially when is outsources. Engagement should be aligned with the requirements of the Directive (EU) 2017/828 (shareholder rights Directive).

*Q24. Please choose the (combination of) **key sustainability (ESG) factors** which you pursue in investing in sustainable assets (only one answer).*

- *Environment (including climate change) factors*
- *Social factors*
- *Governance factors*
- *Environment (including climate change) + Social factors*
- *Environment (including climate change) + Governance factors*
- *Social + Governance factors*
- *Environment (including climate change) + Social + Governance factors*

3. Liabilities and sustainability risks: risk identification and impacts

EIOPA identified the following Lines of Business as subject to climate risks, in accordance with Annex I of the Solvency II Delegated Regulation:

Insurance:
LoB 4. Motor vehicle liability insurance
LoB 5. Other Motor insurance
LoB 6. Marine, aviation and transport insurance
LoB 7. Fire and other damage to property insurance
LoB 8. General liability insurance
LoB 12. Miscellaneous financial loss insurance (bad weather)

Reinsurance:
Proportional non-life reinsurance to the LoB mentioned above:
Proportional reinsurance motor vehicle liability
Proportional reinsurance Other Motor
Proportional reinsurance Marine, aviation and transport insurance
Proportional reinsurance Fire and other damage to property insurance
Proportional reinsurance General liability insurance
Proportional reinsurance Miscellaneous financial loss insurance (bad weather)

Non-proportional non-life reinsurance:
LoB 27. Non-proportional Marine, aviation and transport reinsurance

LoB 28. Non-proportional property reinsurance
Non-proportional reinsurance for LoBs 5-7, 9-12

*Q25. Do you consider that **other lines of business** than those outlined above are materially exposed to physical and transition risks? If so, please list them and outline the particular climate-change related exposures of those LoBs.*

Insurance is directly affected by climate change, made apparent by the expected increase in claims expenditure, as a result of the industry's pivotal role in the compensation of the financial losses incurred by insured households, farmers, energy providers etc.

Physical and transition risks, and climate change more generally will have a direct impact on claims across a significant number of the industry's business lines.

LoBs covering damages from **natural hazards** are the most exposed to climate change.

Physical risks
*Q26. Which key **physical risk factors** do you consider to impact most on underwriting **in the geographical areas where you operate**? Are there geographical differences between the markets in which you operate?*

- *Climate trends*
  - *temperature rise*
  - *changing/extreme weather patterns*
  - *sea level rise*
  - *higher CO2 concentrations*
  - *higher global emissions (other than CO2)*
  - *trends on biodiversity/animal migration*
  - *displacement - climate immigration*

- *Climate change-related (extreme) weather events*
  - *windstorms*
  - *flood*
  - *hail*
  - *heat waves*
  - *drought*
  - *subsidence, landslides*
  - *freeze, snowfalls, avalanches*

General comment:

Please specify.

*Q27. **How do physical risks** – including an increasing frequency and severity of extreme weather events – **affect your organisation's underwriting business performance**, in terms of market demand, claims burden, or other factors? Please explain how, over what timeframes and across which business lines. If you do not consider that physical risks affect your underwriting business performance, please explain why.*

Transition risks

*Q28. What are the key **transition risk factors** that you anticipate to potentially impact most on **underwriting markets** in the geographical areas where you operate?*

*Q29. **How do transition risks** – including economic, social, technological, regulatory or policy factors stemming from climate change – **affect your organisation's underwriting business performance**, in terms of market demand, claims burden, or other factors? Please explain how, over what timeframe and across which business lines. If you do not consider that transition risks affect your underwriting business performance, please explain why.*

Liability risks

*Q30. **Does your organisation consider that it may be exposed to liability risks stemming from climate change**, either now or in the future? For example, unintended exposure to climate risks through professional and corporate indemnity policies. If yes, what steps might your firm take to monitor, reduce, or mitigate these risks? If no, please explain.*

Sustainability risks

*Q31. **How do sustainability risks**, other than induced by climate change (incl. other environmental, social and governance risks) **affect your undertaking's underwriting business performance**?*