An update on developments in the area of Sustainability and ESG issues relevant to the RMC

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Topics

1. The recent EIOPA consultation on use of climate change risk scenarios in the ORSA and the AAE's response to this consultation.
2. Topics coming out of the AAE Roundtable on sustainability and climate risks on 23 March 2021
3. The Sustainable Finance Disclosure Regulation
4. European Actuarial Climate Index

The recent EIOPA consultation on use of climate change risk scenarios in the ORSA and the AAE's response to this consultation.

https://www.eiopa.europa.eu/content/eiopa-consults-supervision-use-climate-change-scenarios-orsa_en?source=search

Other related material:

https://www.eiopa.europa.eu/content/irsg-advice-supervision-of-use-of-climate-change-risk-scenarios-orsa

https://actuary.eu/memos/aae-position-esg-actuarial-view/

EIOPA consultation / Overview

- The consultation is a follow-up to last year's Opinion on Sustainability within Solvency II, which recommended that (re)insurers consider climate risks beyond the one-year time horizon through the system of governance, risk-management system and their ORSA.
- The (re)insurance industry will be impacted by climate change-related physical and transition risks, EIOPA considers it essential to foster a forward-looking management of these risks and enhance supervisory convergence.
- The draft Opinion sets out EIOPA's expectations to national competent authorities on how to supervise the integration of climate change scenarios by insurers in their ORSA, applying a risk-based and proportionate approach.
- EIOPA expects to publish the final Opinion in the spring of 2021 together with a feedback statement on the consultation responses.

EIOPA consultation / Risk Analysis

- CAs should expect undertakings to assess the long-term risks of climate change using scenario analysis to inform the strategic planning and business strategy.
- The time horizon could be longer than the time horizons currently considered e.g. an order of magnitude of decades may be appropriate.
- The Opinion also provides practical guidance on the selection and implementation of scenarios.
- CAs should expect from undertakings a systematic improvement of the scope and sophistication of quantitative scenario analyses. This Opinion recognises that the approaches need to evolve over time, as new methodologies become available, insurance undertakings gain experience and EU regulation in the area of sustainable finance evolves.

AAE response / Agree

- It is important to foster a forward-looking management of climate change risk by insurance undertakings.
- 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. *A qualitative approach may be more appropriate here*.
- The long-term scenario analysis should at least distinguish two scenarios, where appropriate. *It is useful to distinguish between scenarios that are dominated by transition risks and those dominated by physical risks*.
- Competent authorities should encourage larger undertakings to disclose climate-related information. *Climate risk is acknowledged as a systemic risk. It is important that stakeholders can verify the consistency of the undertaking's current climate position, strategy and assumptions on the future development.*

AAE response / Room for improvement

Qualitative vs. quantitative analysis

- The individual undertaking should decide *when and if it is appropriate to include a quantitative analysis in the ORSA*, based on the outcome of qualitative analysis and (where relevant) responses to the industry-wide climate related stress tests.
  - Due to the many uncertainties related to forecasting over a longer time horizon it may be more appropriate to include *qualitative analyses which include expected mitigating actions per scenario rather than more detailed quantitative projections*.
  - Given the high level of uncertainty of the long term scenarios, the absolute numerical results of *individual long term scenarios should be considered with extreme caution*. The focus should rather be on sensitivities to scenarios and key assumptions.
- It is necessary to allow for an evolvement in climate change risk assessment.

AAE response / Room for improvement

Own risk assessment

- The ORSA is expected to support the risk management of an insurance undertaking on the business time horizon and includes a solvency measure. In this regard the focus should be on enhancing existing risk management processes and tools, and addressing any gaps that might currently exist, in order to allow for climate change.
- *We therefore recommend to focus less on quantitative scenarios and more on the continuous evolution of mitigating actions.*
- *Undertakings should have flexibility to determine what risks are relevant for them, which may include risks not reflected in these annexes.*

AAE response / Room for improvement

- We suggest that the CAs propose *a hierarchy of methods* in which undertakings can choose the step they want to start with based on their maturity in climate risk assessment and their exposure to climate risk.

- Rather than changing the time horizon of the ORSA, *the assessment of climate risk impact on the long term could be done through a Long Term Risk Assessment* (LTRA) and could feed into the ORSA. This could be performed less frequently than the ORSA (2 to 3 years frequency or less if a material change in conditions occurs) as it assesses a long term phenomenon. This should not result in excluding climate risk from the ORSA.

Topics coming out of the AAE Roundtable on sustainability and climate risks on 23 March 202

CO2 fluctuation since 800,000 BCE

it is the absolute level as well as the speed of increase

Is nuclear Energy green?

https://www.actuview.com/

AAE Roundtable. EC view on sustainability finance.

- EC has climate targets: 55% reduction in green house gas emission by 2030.
- There is planned annual investment of Euro 350B for Energy transition.
- There is need to harmonize criteria to identify sustainable investment more easily. This is aim of taxonomy regulation. There will be prepared Delegated Act – technical screening criteria.
- There is a need to integrate climate risk into prudential framework. KPIs need to be published by business.
- There should be sustainable risk into S2 – risk management policies, investments, renumeration policies of insurers.

AAE Roundtable. EC view on sustainability finance 2.

- **Actuarial Function should take consideration on sustainable risk for the purpose of insurers underwriting policies.**
- Sustainability risk should play a role in insurers ORSA. Insurers should sustainability impact of climate changes scenarios.
- Green risk factors can undermine S2 risk-based nature. Probably this is true. But taxonomy can give us more data in next years.
- There is challenge transfer climate risk into impact on insurance company.

AAE Roundtable. EIOPA view on sustainability finance 1.

- Actuarial community can support: **open mindness, open to future not being like the past**
- There will be rare events with non-linear effects. Be prepare looking into business models.
- There is a need to prepare Non-life contracts on longer term basis.
- Thare are public policy issues – what is good for insurer not necessary is good for society as whole.
- There should not be inconsistency between sustainability risk and standards of actuarial practice – e.g. selection and pricing risk.
- **Actuaries have skills on developing solutions – modelling, products.**

AAE Roundtable. EIOPA view on sustainability finance 2.

- 3 Eiopa priorities:
  1. Insurers should manage sustainability risk;
  2. Insurers and Pension Fund should reflect policyholders and pension members for sustainable investment;
  3. Insurers and Pension Fund should achieve sustainable investment.
- Eiopa issued methodology on including sustainable risk in nat-cat. And there is discussion – should be more often events or add new perils like wildfire.
- There is planned natural catastrophe dashboard.
- EIOPA in 2019 got conclusion – that evidence not justifying green supporting factor at this time.

AAE Roundtable. AAE view on sustainability finance.

- Risk is growing and perception of ESG risk is changing.
- AAE supports green deal.
- The same risk = the same capital. The same charges as for banking sector regarding market risk.
- WEF (world economic forum) issues risk report. 2008-1 social risk - pandemic; 2020-5 ESG risks – extreme weather, climate risk action failure; natural disaster; biodiversity loss, human made disaster.
- ESG in ORSA – how to solve the problem not to prescribe scenarios – principle-based approach focus on relevant risk for the company. And on other hands – comparability and consistency.
- There is a need for negative interest stress test.

Update on the Sustainable Finance Disclosure Regulation

https://www.eiopa.europa.eu/sites/default/files/publications/supervisory_statements/jc-2021-06-joint-esas-supervisory-statement-sfdr.pdf

Update on the Sustainable Finance Disclosure Regulation

- The Sustainable Finance Disclosure Regulation is intended to increase transparency on sustainability among financial institutions and market participants. The regulation consists of disclosure requirements on the organisational, service and product levels to standardise sustainability performance.
  - Sustainability risk policy (integration of sustainability risks into the investment decision-making process)
  - Principal Adverse Sustainability Impact (adverse effects on sustainability of the investment decision and/or in the investment advice)
  - Consistent alignment of the remuneration policies with the sustainability objectives
  - Product information related to sustainability for both environmental, social, and governance (ESG)-related products and non-ESG products.
- The deadline have moved back from 10 March 2021 to 1 January 2022 in order to allow time for market participant to gather information necessary and adjust their practices and also to prepare effective supervision.

European Actuarial Climate Index

European Actuarial Climate Index

- An index of extreme climate events has recently been introduced under the name European Extreme Events Climate Index (E3CI, www.ifabfoundation.org/e3ci/)
- The Board of AAE has decided to
  - set up a new working group on Sustainability and Climate Issues and
  - to end the work of the European Actuarial Climate Index Working Group.
- The Terms of Reference of this new working group will be published shortly. This working group will focus on making contributions in the fields of sustainability and climate issues. This could include work on extreme events climate indices, but no longer with the aim to develop and maintain such an index ourselves.

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