

ORSA

## FEEDBACK STATEMENT

on comments received on the draft Opinion on  
the supervision of the use of climate change  
risk scenarios in ORSA

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**eiopa**

European Insurance and  
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## **Introduction**

EIOPA conducted a public consultation on the draft Opinion on the supervision of the use of climate change risk scenarios in ORSA, which ran from 5 October 2020 until 5 January 2021. EIOPA received 24 stakeholder responses to the public consultation, of which 17 public and 7 confidential responses.

EIOPA would like to thank all stakeholders for their responses to the public consultation. The input received provided important guidance for EIOPA to finalise the Opinion. All comments submitted were given careful consideration by EIOPA.

This feedback statement summarises the main responses received and how EIOPA addressed them in the Opinion. The non-confidential individual responses received and EIOPA's feedback on these responses are published in a separate document.

## **Objective of the Opinion**

The Opinion is addressed to the national competent authorities on the basis of Article 29(1)(a) of the EIOPA Regulation and aims to enhance supervisory convergence. The Opinion sets out supervisory expectations on the integration of the use of climate change scenarios by insurance undertakings in their ORSA.

Given that undertakings will be impacted by climate change-related physical and transition risks, EIOPA believes it is important to encourage a forward-looking management of these risks, also in the long term. Currently, only a small minority of undertakings assess climate change risk using scenario analysis in the ORSA. Moreover, where undertakings perform a quantitative analysis of climate change risk, most assessments take a short-term perspective.

Solvency II already requires undertakings to consider in their ORSA all risks they face in the short and long term and to which they are or could be exposed. In that respect, the Opinion is not imposing additional requirements, but only confirming and clarifying existing EU legislation.

## **Main responses received and how EIOPA addressed them**

Stakeholders almost unanimously supported the importance of a forward-looking management of climate change risk by insurance undertakings. Nearly all stakeholders also supported the gradual approach taken in the Opinion that quantitative scenario analyses of undertakings should be expected to evolve over time, considering that methods are advancing and insurers need to gain experience.

### Long-term time horizon

Almost three quarters of stakeholders agreed that insurers in their ORSA should not only consider climate change risk in the short term, but also in the long term to inform strategic planning and business strategies. A number of respondents emphasised the importance of aligning the time horizon of the climate change risk assessment with the strategic planning horizon. However, as other respondents pointed out, long-term developments beyond the planning horizon may influence current strategic planning. That is also true for non-life undertakings, even where they capture climate change induced trends in physical underwriting risks by annual re-pricing.

More than half of respondents indicated that the explanation what constitutes long-term should be made more specific. To enhance the description of the meaning of long-term, an illustrative example was included of the length of short-medium- and long-term time horizons that tend to be considered from a climate change perspective (paragraph 3.3). This further explanation is not meant to prevent undertakings from choosing the appropriate length of the time horizon for the long-term scenario analysis, taking into account their material exposures.

Stakeholders commented that uncertainty increases with the time horizon, as recognised in the Opinion, suggesting that the analysis may become meaningless. In EIOPA's view, uncertainty is inherent in risk management, not a reason not to assess and take into account the risks. Long-term analysis using 'what if' scenarios constitutes a trusted and mainstream tool to explore and to take into account future uncertainty in strategic decision-making.

### Minimum of two long-term scenarios

The majority of stakeholders agreed 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. An important argument provided by stakeholders was that a minimum two scenarios would be needed to take into account the uncertainty with regard to the long-term impact of climate change.

Undertakings may also consider another combination of these two long-term temperature scenarios more appropriate and, in order to implement them, develop

their own scenarios and/or build on existing ones, which was already specified in the draft opinion. It was clarified in the Opinion that the long-term analysis using a minimum of two scenarios should only be conducted in the event of material climate change risk exposures (paragraph 3.20, see also below).

#### Disclosure of climate-related information and consistency with ORSA

More than two thirds of respondents were of the view that the 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. To reflect the view and arguments provided by stakeholders, the main benefits of such disclosure were included in the Opinion (paragraph 3.28). Although respondents generally agreed that information provided in the non-public ORSA and public disclosures should be consistent, it was emphasised that both have different objectives, which was clarified in the Opinion (paragraph 3.30)

#### 'Own' risk assessment and proportionality

Stakeholders emphasised that ORSA should remain an 'own' risk assessment with sufficient flexibility to assess material climate change risks in a way that is proportional to the size of those risks, also emphasising the appropriateness of qualitative approaches to long-term scenario analysis. Over two thirds of respondents indicated that the draft Opinion does not strike the right balance between setting common expectations and allowing undertakings to do their own risk assessment. Moreover, the same share of respondents answered that the expectations do not achieve a proportionate approach to climate change risk analysis in ORSA, fitting small-, medium- and large-sized undertakings

EIOPA does not tend to issue opinions for every individual risk that undertakings may have to consider in their ORSA. However, a justification for setting supervisory expectations on climate change-related risks is that few undertakings are now considering these risks in the ORSA, including from a long-term perspective. Moreover, EIOPA does not share the view that undertakings should be given flexibility to take into account climate change risk outside of the ORSA. Solvency II requires undertakings to consider in their ORSA all risks they face in the short and long term and to which they are or could be exposed. Still, a number of amendments were made to the Opinion to address the justified concerns with regard to flexibility, materiality and proportionality:

- The Opinion clarifies that insurers in their ORSA first have to conduct a materiality assessment to identify material climate change risk exposures and, subsequently, subject the material exposures to a risk assessment (paragraph 3.1). In the event that climate change risk is deemed not to be material then exposures also do not have to be subjected to at least two long-term climate scenarios (paragraph 3.20). In such circumstances, competent authorities should expect undertakings to explain in the ORSA supervisory report why they judge climate change risk not to be material.

- The Opinion emphasises flexibility for insurers in conducting long-term scenario analysis by clarifying that long-term scenarios, or the assessment of the impact of those scenarios, do not have to be updated every year, given the long-term nature of the assessments. At the same time, undertakings can partially update the long-term scenario analysis, as new material exposures are identified or new methods or data become available (paragraph 3.22 and 3.24).
- The Opinion emphasises a risk-based and proportionate approach to the speed of evolution as well as the scope and granularity of quantitative scenario analysis (paragraph 3.25 and 3.27).
- The Opinion stresses that balance sheet calculations in long-term scenario analysis require a lower level of precision, given the 'what if' nature of long-term climate scenarios (paragraph 3.22-23). Moreover, it is clarified that insurers without any prior experience, can start analysing long-term climate scenarios in a largely qualitative way (paragraph 3.27).

#### Analysis of costs and benefits

More than half of respondents did not agree that Annex 2 provides a balanced view of the costs and benefits of the draft Opinion. Many stakeholders indicated that the analysis of costs and benefits was very high-level and did not provide a quantification. Respondents also expressed the view that the costs may exceed the benefits because of the expectations being overly prescriptive and not allowing sufficient flexibility to assess material climate change risks in a way that is proportional to the size of those risks. Annex 2 was amended to recognise that the costs of developing and implementing the necessary tools for climate change scenario analysis are not directly estimated and are difficult to quantify. Moreover, EIOPA trusts that the modifications made to the Opinion in terms of flexibility, materiality and proportionality will contribute to stakeholders having a more favourable view of the costs they originally reckoned with.

#### Examples of physical and transition risks

Nearly all respondents considered that the examples in Annex 3 and Annex 4 cover the main transition and physical risks to which undertakings may be exposed. The main part of the Opinion was amended in order to clarify that the examples should not be interpreted as an exhaustive list of transition and physical risks (paragraph 3.7). A number of stakeholders suggested to remove the examples on pandemic risks because, in their view, there is no established link with climate change. However, scientific research shows growing evidence that outbreaks of epidemic diseases may become more frequent as climate continues to change.<sup>1</sup>

#### Guidance for integrating climate change risk scenario in ORSA

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<sup>1</sup> See UNEP, UNEP Frontiers 2016 Report: Emerging Issues of Environmental Concern, United Nations Environment Programme, 2016, Nairobi.

Nearly all respondents provided comments and suggestions on the guidance for developing and including climate change risk scenarios in ORSA in Annex 5 of the Opinion. EIOPA considers to further elaborate on the guidance in the coming years, seeing the advantages of developing and providing optional guidance for companies regarding climate scenario design and specifications using concrete case studies. This would also contribute to lowering implementation costs for insurance undertakings, in particular small- and mid-sized ones, and to enhancing the comparability of reported information.

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