Climate change: A challenge for our time

Interview with Petra Hielkema for Eurofi

SPEECH
DATE:
08 Sep 2021

What is the actual role and contribution of insurance undertakings regarding their ESG risk mitigation in the EU economy?

There is a growing urgency to tackle environmental, social and governance-related risks. As news of devastating natural catastrophes fills our screens and we see first-hand the impact on people and society, addressing the challenges of climate change is more pressing than ever.

The financial sector can act to contribute to climate change adaptation and mitigation. By considering environmental, social and governance (ESG) factors in their investment decisions, the financial sector can channel more investment to support the transition to a green economy.

Insurance companies – and occupational pension fund schemes – have a dual role. First, there is the ‘stewardship’ role. As large investors, insurers are well-placed to incentivise and engage with business to act and operate responsibly, ensuring sustainable long-term value creation. Insurers can choose to invest in greener initiatives, facilitating the gradual transition to a more sustainable and resilient economy.

Second, insurers can mitigate the risks of climate change by considering the impact of their own underwriting practices on the environment. In this way, insurers can increase market and citizens’ awareness and resilience to climate change.

The European Insurance and Occupational Pensions Authority (EIOPA) continues to work on a number of initiatives that will support the insurance and occupational sectors to foster a sustainable economy, as well as mitigation and adaptation to the risks of climate change.

What has been achieved so far in the insurance sector to embed sustainability in risk management and internal decision-making processes? How is the insurance sector contributing to the overall adaptation and mitigation of climate change related risk?

Natural catastrophes cause immense human and economic loss. This summer alone, there have been devastating floods, storms and forest fires across Europe and, given the growing frequency and intensity of natural catastrophes, climate-related losses are expected to grow.

It is important that insurers consider their own exposure to climate-change risk. While most insurers have some degree of exposure, only a minority assess climate change risk in the own risk and solvency assessment (ORSA) using scenario analysis. In its recent Opinion, EIOPA set out expectations on the supervision of the integration of climate change risk scenarios by insurers in their ORSA. In addition to integrating climate change risks into governance and risk-management systems, risks should also be assessed in the short and long term, using different climate change scenarios.

EIOPA also recently published a methodological paper outlining steps for integrating climate change in the underwriting risk capital charge of the Solvency II standard formula. The methodology supports the need to formalise an approach to re-assess and, where needed, recalibrate parameters for the natural catastrophe risk module of the Solvency II standard formula on a regular basis. The overarching goal is for the solvency capital requirements for natural catastrophe underwriting risk to reflect the expected impact of climate change to ensure the financial resilience of (re)insurers covering natural catastrophes.

As climate-related losses increase, there is the risk that gaps in insurance coverage will widen. In Europe, only 35% of climate-related losses are insured. There is also the risk that premiums become too expensive.

Ensuring the availability and affordability of insurance is also becoming more pressing. More than any other player in the financial sector, insurance companies play a vital role in building resilience, by encouraging and incentivising policyholders to take preventive measures. EIOPA has therefore been investigating how the insurance industry can reflect prevention measures in the design and pricing of products to incentivise policyholders to reduce risks. As outlined in a recent report, through risk-based pricing, contractual terms, and underwriting strategy (re)insurers should consider implementing measures for climate change adaptation and/or mitigation. EIOPA aims to incentivise (re)insurers' efforts in taking a forward-looking approach to covering risks arising from climate change.

Good data is key for insurers to make better-informed decisions. To promote awareness among stakeholders through a science-based approach, EIOPA has developed a pilot dashboard assessing the drivers of the natural catastrophe protection gap. The dashboard brings together data on economic and insured losses, vulnerabilities and exposure, as well as insurance coverage across the EU Member States. It will help in identifying regions at risk, the drivers of a climate-related insurance protection gap, as well as defining proactive prevention measures. It should also allow for evidence-based decision-making on measures to improve society's resilience against natural catastrophes at a time when losses to properties and businesses are likely to increase because of climate change.

What is the role of ESG disclosures in fostering sustainable investment? How do disclosures enable informed decision-making by stakeholders?

There is no doubt of the growing interest in sustainable investment – both from the industry and from consumers – and accurate information will enable informed decision-making.

As a first step, there needs to be a common understanding of what is meant by a sustainable investment. This is where the EU taxonomy is essential. It provides common definitions for those economic activities that can be considered environmentally sustainable.

Disclosures are the second step. According to a recent consultation by the European Commission on its renewed sustainable finance strategy, only 15% of respondents knew if their insurance or pension assets were invested in sustainable finance assets. Of those that did not know, most asked for more –

and more transparent – information about the environmental and social impact of their investments.

Disclosures will also help provide investors with information to make sustainable investment choices, as well as prevent greenwashing. Together with the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA), EIOPA has been working on regulatory technical standards setting out disclosure obligations for manufacturers of sustainable products under the Sustainable Finance Disclosure Regulation.

Together, the taxonomy and disclosures will help insurers and consumers identify where to invest for sustainable impact, how green their investment portfolios are, as well as empowering consumers to make informed decisions about the ESG profile of their investments.

Recent consultations have highlighted the challenges involved in achieving a disclosure that consumers can easily understand and also meets the different needs and requirements across all financial market participants. Nonetheless, given the importance of identifying key performance indicators for insurers' non-financial reporting regarding sustainability, EIOPA will continue to work closely with EBA and ESMA on this.

How to achieve an effective political and regulatory stability for financial institutions in the context of a permanently accelerating and fast evolving transition path?

Climate change – along with cyber risk and pandemics – is just one of a number of challenges faced by society. These threats are too big to be addressed by single entities alone and there needs to be dialogue between different stakeholders to strike a constructive balance and achieve shared solutions.

With all these challenges, as society evolves, the insurance sector must also adapt quickly, but it must do so in an orderly way.

Good supervision will help the sector evolve – in both the way it operates and products offered. With a pan-European supervisory role, EIOPA can help to ensure that regulation (and its changes) remains relevant, proportionate and consistently applied; and that there is a common approach to terminology, data collection and supervision.

Climate change is bringing with it many challenges, but it also brings with it opportunities in shaping how society adapts. Insurers and supervisors must work together to develop pragmatic approaches while ensuring policyholder protection. Here, EIOPA can bring together the supervisory community and industry, to share knowledge, build expertise and ensure good cooperation.

We are only at the start of the journey to much-needed change. EIOPA will continue to work closely with supervisors, industry, consumer groups and policymakers to bring about better outcomes for consumers, the sector and society.

LAST UPDATED ON:
8 Sep 2021