Stress tests and ORSAs are good for climate risk management

Interview with Petra Hielkema, Chair of EIOPA, conducted by Chris Cundy, Insurance ERM

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Speaking very broadly, insurers have three areas of focus on sustainability and climate: their underwriting; their investments; and their operations. Do all these areas need oversight from insurance supervisors?

If you look at it from a risk perspective, there are sustainability risks in underwriting, investment and, generally, in governance, finance and risk management. So I think there is a role for supervisors in all three pillars.

As for all risks, our role is to assess the materiality of the risks to the undertaking, its policyholders and the market. Here climate risks are no different from any other risks: the physical and transition risks will materialise through 'traditional risks', such as increased insurance risk or depreciation of asset values.

That is why it is important EIOPA looks across all areas in its work: the calibration of the risks; the design, distribution and prudential treatment of products; and the integration of sustainability risks in the governance and risk management framework of insurers.

One of EIOPA's goals is to "integrate ESG risks in the prudential framework of insurers". Do you view the ORSA as the best place for ESG risks to be managed? Which aspects of ESG/sustainability might need to be put into other parts of Solvency II?

Clearly there is a role for pillar 3 - reporting and transparency - in dealing with the risk.

The ORSA has a very important role because it's the best way for an insurer to
assess its own risk and has the ability to fit the risk profile of the company. We are still very much in the process of developing how we deal with this risk, and in the ORSA there is a lot more room for that.

Should you also look at pillar 1 capital requirements? I don't think we are there yet, but the European Commission's Solvency II proposal includes asking for EIOPA's advice on risk differentials for sustainability. So there's interest at the political level as to whether that's possible.

Where we are now, the ORSA combined with sensitivity analysis and stress tests are the best way forward.

EIOPA has previously stated "brown" or "green" capital charges on assets should not be used for political objectives, but based on the actual risks. Now EIOPA has been tasked with researching this by the Commission, how are you ensuring this question will be given a fair trial? And will EIOPA be looking at all asset classes?

We said in the past that we saw no evidence of differences in risk characteristics that will make a differential prudential treatment appropriate. We will not move away from that. I see the need to incentivise a move towards more sustainable activity, but I do not think capital requirements are there to incentivise - but to address risks.

Over 2022-23 we will assess the evidence as more data becomes available. For sure we cannot do all the assets by June 2023, so we will have to look at a broad spectrum and find appropriate asset samples for a first analysis. That could be property, but we haven't made a pick yet.

EIOPA will shortly begin an exercise examining the concept of impact underwriting (the idea that insurers can incentivise policyholders to mitigate and adapt to climate risks). What is happening, and what are you hoping to achieve?

Starting in December and running to March, we will work with a group of volunteering insurers to see what it takes to do impact underwriting: how do you do it? What is good practice? What are the obstacles - including the regulatory obstacles?

At the same time, we want to see what new products could be developed, and
perform a behavioural analysis on the consumer side to understand why people are not buying certain products. We saw with the flooding in Europe this year that only 30% of consumers took the cover that was available.

One of the fears about a changing climate is the emergence of larger protection gaps. Do you see EIOPA playing a larger role in helping to close these?

There is a greater opportunity to align risk assessment and risk prevention initiatives between the public and private sector – and EIOPA can support the technical part of the discussion.

The private sector can play a bigger role than it has now, but we should not jump straight to public-private partnerships; it should be a step-by-step process. First we need to identify the gaps; our natcat dashboard will be very helpful and we will be updating that.

Then we need to know the drivers of the gaps. Is there a proper risk assessment? Is it supported by information, preferably open-source? And is there sensible risk prevention that we can have, including adaptation measures?

Once we have that, we can turn to product design, and ask if that's happening in the market or not. You may reach a point where the private solutions are exhausted and you need to talk further.

In 2022, the Commission wants to have climate resilience dialogues and that's an area where we can contribute as a regulator and from a technical perspective.

EIOPA has been developing a climate stress testing framework. When can we expect an EU-wide stress test to focus on climate?

We have to do a market-wide stress test every three years and the one we're doing right now is on Covid-19 and the low-yield environment. The results will be out in December. There is a request from the Commission for a climate stress test, and the chances are we will be doing climate-related stresses on the pensions side next year.

From the pragmatic side, we have just had an insurance stress test and we will be doing the pensions side next year, so it won't happen in 2022. The question is
are we going to wait three years until 2024, or do it in 2023? I tend to say we will not wait, and do it in 2023, but there is no formal proposal or agreement on that.

We have been doing quite a lot in this area already: we had natcat risk in the stress test three years ago and since then we have done sensitivity analysis.

Climate is one of the issues being discussed under the EU-US Dialogue, and at the International Association of Insurance Supervisors (IAIS) and Sustainable Insurance Forum (SIF). Do you have any expectations of a "minimum" standard of climate risk management and reporting that can be agreed internationally?

We are supportive of the work done by the NGFS (Network for Greening the Financial System) and the SIF. Both have been helpful in developing scenarios. IAIS is also creating a group, and at the EU-US Dialogue we have two new workstreams on climate: on disclosures and resilience. We are willing to share where we are and push the topic.

Any minimum is helpful. For a start, having global standards on disclosures and reporting, making them as harmonised as we can, will be very helpful. I think we are sometimes a frontrunner in Europe and I'm happy with any catching up that happens globally. Let's hope COP26 will bring more steps at a global level.

How will EIOPA help consumers make informed choices on the sustainability of the insurance products? How will you help prevent "greenwashing"?

EIOPA in itself cannot prevent greenwashing. But we can monitor and provide tools.

It starts with transparency on which products are sustainable and which are not.

We have contributed to the Sustainable Finance Disclosure Regulation and the Taxonomy Regulation. We have also defined that if insurers claim a product is green, it should not only say [that it's green] because it is taxonomy aligned, but we would also like to see a "do no harm" statement to include the rest of the portfolio.

The example I give is that if 5% or 10% of the portfolio is taxonomy-aligned, the total portfolio can still be more harmful because the rest is so polluting.
Another step is to standardise disclosures. Currently much of the disclosure is serving several audiences, and overall the documents can be too complex for consumers.

There is also appropriate product design. We have provided advice to the Commission on how you integrate sustainability in product oversight and in governance requirements. It's indirect, but it's a tool to assess whether it's happening in the market.

Can you monitor or oversee greenwashing? You can if you have enough data. But disclosures and product design is a good start.

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