

IRSG

INSURANCE AND REINSURANCE STAKEHOLDER GROUP

Advice on methodology on the potential
inclusion of climate change in the nat cat
standard formula

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ADVICE ON METHODOLOGY ON THE POTENTIAL INCLUSION OF CLIMATE CHANGE IN THE NAT CAT STANDARD FORMULA

The IRSG supports EIOPA's work to assess the impact of climate change and reflect this in the natural catastrophe risk submodule.

The group backs more explicit definitions of perils to ensure that all risks are captured, and none are double-counted. Specific perils should be mapped to terms used to avoid confusion. It is also vital to be aware of different side effects, like consequences of droughts for business lines other than agricultural insurance. Secondary perils, occurring following significant events, and other specific risks, such as volcanic eruption and marine submersion, should also be on monitored in case of increased importance.

The calibration of the standard formula must remain up to date, and its scope should reflect the material risks to which European insurers could be exposed. However, it is worth recognising the limitations of the standard model and materiality of the risks. In our opinion, subject to a materiality assessment, the standard formula could and should be expanded by including new perils or wider scope of existing perils only where scientific data supports it. To this end, EIOPA should develop materiality thresholds which are applied consistently across all markets.

EIOPA's proposal to undertake regular assessment of the nat cat parameters, e.g. every 3-5 years, should ensure that the future evolution of nat cat risks including the impact of climate change is appropriately captured in the nat cat submodule. The assessment should ensure that recalibrations are only undertaken where material changes have occurred to avoid unjustified volatility in the parameters.

If the reassessment process identifies the need for recalibration, this should be undertaken through a standardised, transparent, and documented process concerning the data used and the methods applied. If changes are proposed to be made to SF parameters, supporting calibration documentation, covering derivation and selecting parameters should be made publicly available. This will enable improved insurer understanding of the parameters and put insurers in a better position to assess the SF's potential gaps and appropriateness. Also, in case of expert judgement, appropriate documentation should be made, particularly where recommendations deviate significantly from the input data.

Representatives of model vendors, academics, and insurance and reinsurance companies can all provide valuable insights into the process. We fully agree that nat cat models should employ forward-looking climate change scenarios. However, there is no need to limit the scope of models to be used for nat cat risk management at this stage. Regarding the impact of climate change, a

consensus about the selected climate change scenario(s) and time horizon(s) is vital where it is to be included in the forward-looking models.

Our knowledge of potential climate changes and their outcome for the insurance industry is limited. That is why insurance regulators and supervisors should avoid any parameters in SF that lower transparency. The IRSG does not support adding a loading factor to the parameters that capture climate change at this level. This type of approach should be avoided since it increases complexity; it is very challenging to implement, and potentially creates double counting. This argumentation can be echoed in the case of reevaluating the correlation matrices to include climate change. In the opinion of the IRSG, this will only lead to significantly increased complexity and spurious accuracy.

Finally, the IRSG considers that EIOPA should take adaptation and prevention measures into account when assessing weather-related risks. However, at the same time, it is essential to differentiate the impact of those measures (i.e., wildfires and droughts).