

SUSTAINABILITY RISKS IN INSURANCE



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Integrating sustainability considerations in risk management

Currently, integrating sustainability considerations in the risk management is one of the most challenging objectives of insurers. Sustainability considerations could affect the company's performance and value, especially in the long-run. Achieving this objective certainly requires significant adaptations to how insurers manage their risks and business. This is not an easy task.

Difficulties mainly arise because of the complexity of the nature and impact of sustainability risks. These can affect both assets and liabilities and can include the mitigation of the risks influencing the value and performance of the company (outside in) as well as the impact of the company's activity on sustainability issues (inside out). The latter, in turn, could affect the value of the company given their reputational consequences.

Most of these challenges obviously depend on the uncertainty about a clear classification of sustainable activities. The EU Taxonomy, together with the consequent enhanced transparency of financial entities and markets, is going to shed light on that, but more work is needed to complete the classification and to provide indications on how to apply the classification in practice. The level of alignment between what is classified as sustainable and its actual riskiness, in terms of expected losses for the insurers, also remains to be considered.

Sustainability risks, in general, do not materialize as specific risks, but affect the profile of other, more traditional risks. Climate risk, for example, affects market risk on the asset side via transitional risk, through the potential change in value of "brown" assets, as well as underwriting risk on the liability side, due to the increase of damages resulting from natural events. This implies a change in the approach and methodology used up to now to manage those risks.

It is a long journey, to approach with perseverance and balance.

The challenges on the identification of these risks add to the inherent difficulties to measure them. The historical data that are necessary to produce estimates are still lacking and, very often, estimates require a forward-looking approach. The measurement and management of sustainability risks, in general, do not follow the logic and metrics of traditional risks and sometimes build on factors that are not under the control of insurers, or are even unknown to them. This is the case, for example, of transitional risks, which depend on the modalities and pace of the public policy actions for a transition toward a sustainable world.

It is understandable that those challenges are limiting the insurers' capability to identify, measure and mitigate sustainability risks and to set a strategy and a governance to drive the business accordingly. The integration of sustainability considerations is a work

in progress and a lot of work remains to be done.

Climate risks are now the focus of attention and, in this context, transitional risks seem to be the most addressed. Organizational and governance safeguards within companies are heterogeneous and mainly dependent on the size of the insurers. The measurement of the specific effects of climate change on expected losses is still difficult. Pricing of relevant coverages relies mostly on the annual repricing in order to consider the long-term effects of climate risk.

As in the case of the introduction of the risk culture in the management of insurers, which the implementation of Solvency II has enhanced, the regulation itself could be a catalyst of the integration of sustainability considerations in risk management. Regulators and standard setters are working extensively in this field, even if at the moment this is mainly limited to environmental aspects and, among those, climate change considerations.

The work of EIOPA in relation to climate change, for example, spans from Pillar I aspects (e.g. NAT CAT capital charge), to risk management enhancement (e.g. scenario analysis in ORSA), from disclosure (e.g. KPI) to business considerations (e.g. "impact underwriting"). IAIS has also set an ambitious work plan. However, also in terms of regulations and standards, further work remains to be done.

What is important, I think, is that both regulators and the industry remain committed to sustainable objectives, but using risk based regulations and practices, supported by a proper cost-benefit analysis. They should openly cooperate to cross fertilize the knowledge of these risks, develop methodologies, collect relevant data to measure them, and enhance transparency in the market.

It is a long journey, to approach with perseverance and balance. We should avoid that the mitigation of sustainability risks leads to reducing the accessibility of coverages and increasing the protection gap, which in some regions is already too wide. This would limit the widely recognized contribution that insurance should make in the path toward a more sustainable world.



VICTORIA SAPORTA

Executive Committee Chair -
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Maintaining resilience: supervisory responses to climate change

The effects of climate change are already being observed across the globe and we can expect the risks will only increase further in the future. Every year new records are being broken, not only in climate terms, but also in economic terms. In 2021 worldwide insured losses from natural catastrophes exceeded USD 100 billion, continuing a trend of more than a 5% rise in losses seen in recent decades.

Insurers' business models are particularly impacted by climate change, both in their role as underwriters and investors. Members of the international insurance supervisory community, represented by the International Association of Insurance Supervisors (IAIS), are committed to urgently addressing climate risks. Insurers have a key role in climate change adaptation and risk mitigation.

Supervisory focus is on integrating climate risks into insurer governance and risk management frameworks

and public disclosure of material climate-related risks. We are currently conducting a gap analysis of our global insurance supervision standards to consider whether changes are needed to take account of growing climate risk, including whether further supporting material is needed to help supervisors apply these standards in practice. Additionally, this year we will add specific data on climate-related risks into our annual data collection for financial stability monitoring purposes to better understand how climate change impacts both the assets and liabilities of the insurance sector.

Importance of risk assessment and scenario analysis

Scenario analysis is a key tool for assessing climate risks to the insurance sector. It provides supervisors and firms with a framework by which they can assess the different climate pathways and the resilience of the sector.

Last September, we published such an exercise in a special report on climate, which assessed how insurance sector investments are exposed to climate risk. The report represents the first global, quantitative analysis on insurers' investment exposures and supervisors' views on climate-related risks and confirmed the benefits of an orderly transition towards internationally agreed climate targets.

Compared to an orderly transition, a disorderly transition, or a scenario whereby climate targets are not met at all, would have a two to six times greater adverse effect on sector-wide solvency.

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For example, under a "disorderly transition" scenario, results show an absolute drop in insurers' solvency ratio of more than 14%, increasing to almost 50% under a "too little, too late" scenario. Nevertheless, considering the solid overall solvency position of the global insurance sector, the sector as a whole appears to be able to absorb investment losses from all scenarios tested. However, more analysis will be needed, both to increase the scope of insurers' investments covered by the analysis and to extend the assessment to consider the physical risk impacts of climate change on insurers' liabilities.

We learnt many things from this exercise, as have many insurers that have undertaken similar exercises. In particular, the lack of a globally consistent framework for measuring climate risk-related financial information, the difficulties with translating climate change risks into financial risks and the long-term horizon over which climate impacts materialise all present challenges for our work.

Building on the lessons learnt from this analysis, the IAIS will continue to improve data availability and analytical tools for monitoring climate-related financial stability risks as well as to support the development and sharing of good supervisory practices among IAIS Members. For example, we have just finished a stocktake of our members' work on scenario analysis. This will help us identify where the IAIS can bring most value in developing guidance on supervisory practises. As we take this work forward, we will seek to learn from best practices; develop tools and further guidance; and, importantly, promote global consistency to help reduce market fragmentation. Our members, and the insurers they supervise, are at different stages of developing scenario analysis and this will be recognised in our work. We are collaborating with a range of partners, including other international bodies (BCBS, FSB, NGFS), and our implementation partners at the Sustainable Insurance Forum and the Access to Insurance Initiative.

Prudential supervision involves constant reassessment of risks to understand whether effective mitigants are place. New information and approaches to assessment of climate risk continue to emerge. As this work evolves, supervisors will focus on whether and how insurers are effectively embedding climate and other sustainability risks into their governance and risk management frameworks and public disclosure.



FAUSTO PARENTE

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Solvency II: leading the way in managing sustainability risks

Sustainability risks are of growing relevance for the investment and underwriting activities of insurers, as they can materialize, for example, through investment losses related to stranded assets, increased insured losses or reputational risks. In order to tackle climate change, insurers have set up important initiatives regarding their investment and underwriting activities, for example the Net-Zero Asset Owner Alliance and the Net-Zero Insurance Alliance, both focusing on the decarbonisation of economies to limit global warming.

EIOPA's work on sustainable finance reflects the important role of insurers as long-term investors and risk managers of a wide range of society's risks, ensuring that the prudential framework reflects sustainability risks in the areas of solvency, consumer protection and financial stability in an adequate and risk-based manner.

As a risk-based forward looking framework Solvency II is capable of managing climate risks alongside the other

risks faced by insurers. The tools used to measure and mitigate risks can for the most part also be applied to climate risks. For example, in 2021, the Solvency II framework has been adopted to include the prudential treatment of sustainability risks. The adopted amending regulations require the integration of sustainability risks in the risk management and governance of (re)insurance undertakings. Sustainability risks will need to be reflected in the investment and underwriting strategies of insurers and be monitored by the risk management as well as the actuarial function. As part of the prudent person principle, insurers will also need to take into account the potential long-term impact of their investment strategy and decisions on sustainability factors.

As sustainability risks, and climate change in particular, materialize in the insurers' investment and underwriting activities, further steps towards a more sustainability-related framework need to be taken. EIOPA welcomes the two additional mandates on sustainability risks proposed by the European Commission as part of the review of the Solvency II Directive.

Solvency II sets the pace when it comes to reflecting sustainability risks.

The first mandate requires EIOPA to explore by 2023 the potential for risk differentials related to assets or activities associated substantially with environmental and social objectives or harm to such objectives. The existence and quantification of sustainability-related risk differentials is part of an ongoing debate and has attracted a lot of interest among politicians, supervisors, industry experts, NGOs and academics. The continuous improvements in the sustainability-related data disclosures by firms, for example through the Non-Financial Reporting Directive in the EU, widespread carbon-pricing schemes like the EU's Emissions Trading System (EU ETS) and the increasing awareness of societies, firms and investors about sustainability risks, provide an increasing potential for climate-related risk differentials to become quantifiable. EIOPA will focus its analysis on specific asset classes that are substantially relevant for insurers' investment decisions and, based on available data, findings and exchanges with the other ESAs, conclude whether a dedicated prudential treatment

in Solvency II is justified. Given the expected increase in physical risk exposures due to climate change, EIOPA will also explore the potential for a dedicated prudential treatment of insurers' underwriting exposures related to climate change adaptation.

The second proposed mandate requires EIOPA to regularly re-assess the appropriateness of the scope and the calibration of parameters of the standard formula with regard to natural catastrophe risk, and if necessary, provide an opinion on potential changes to the prudential framework. Given the continuous and evolving impact of climate change on the frequency and intensity of natural catastrophes, a regular re-assessment of the capital requirements for natural catastrophe risk is an important step to integrate the latest considerations on climate change with regard to perils and countries affected, and thereby to ensure the solvency of the insurance sector against rising physical risk exposures.

Moreover, EIOPA published in 2021 an opinion to include climate scenario analysis in the ORSA. It is essential to assess climate risks both in the short term, and also in the long-term using forward-looking scenario analysis to inform strategic planning and business strategy adequately. Recently proposed amendments to the Solvency II Directive by the European Commission reflect these considerations and as a next step, EIOPA will publish application guidance to facilitate the implementation of materiality assessments and climate change scenarios in the ORSA.

The Solvency II framework has made important progress to address sustainability risks. However, as these risks continue to materialize in different ways, it is essential that Solvency II also continues to evolve to ensure that future sustainability risks challenges are appropriately captured.



DAVID ALTMAIER

Commissioner - Florida Office of Insurance Regulation

Managing and addressing climate and sustainability risks holistically

While the focus on ESG and sustainability initiatives in finance may appear, to some, to be a recent trend, these issues have long been a key focus for the insurance sector given its exposure to weather-related and other environmental risks. Addressing this challenge is a collaborative effort between insurers and insurance supervisors.

Insurance supervisors should take a holistic view to effectively address climate and related risks. The National Association of Insurance Commissioners (NAIC) and state insurance supervisors have been laying a proper foundation in the U.S. to address sustainability risks by focusing on three key areas:

- 1) climate financial risk analysis;
- 2) availability and affordability of insurance; and
- 3) stakeholder risk awareness and engagement.

The insurance sector faces potential risks both on the asset side of the balance sheet through their investments and on the liability side through the risks insurers underwrite.

As part of our insurance solvency regulatory framework, regulators collect information from insurers to monitor their exposure to both their underwriting and investment portfolios. This process includes forms such as the NAIC's Own Risk and Solvency Assessment (ORSA), which highlights insurer risk exposure and how it is managed; quarterly and annual insurer financial data, which includes critical information on insurer investments; and the Insurer Climate Risk Disclosure Data Survey, which helps supervisors assess and evaluate industry risks along with insurer actions to mitigate climate risk.

While analyzing insurers' financial risk and exposure is important in managing climate and sustainability risks, access to affordable insurance remains critical, especially as losses to consumers rise. Maintaining the vital balance between insurer solvency and reasonable rates can be challenging, particularly in certain areas that insurers view as presenting a greater risk of loss, such as flood zones. Through data collection, the NAIC has supported states' efforts to measure affordability and availability of residential coverage following extreme weather events.

Part of these holistic efforts include the promotion of mitigation and resiliency, especially in areas most vulnerable to climate risks. The NAIC provides education and outreach materials on numerous topics to promote mitigation across its membership and proactively conducts research to drive discussion and advance understanding of insurance issues among policymakers, regulators, and industry leaders.

and applied research to proactively address regulatory climate risk and resilience priorities.

The tools noted above will complement lessons being drawn from stress testing and scenario analysis. Efforts undertaken by individual jurisdictions and at the international level, such as the 2021 analysis and report by the International Association of Insurance Supervisors, are helpful in assessing the level of exposure insurers have to climate-impacted investments and how these exposures could affect insurer solvency and the financial system more broadly. The NAIC is in the process of planning a quantitative and qualitative climate scenario analysis on the asset side of domestic insurers.

In addition to potential risks, work to date in this area has highlighted a variety of opportunities for insurers. It has also flagged a need for greater consistency in measuring climate-risk-related financial information. To that end, the NAIC is reassessing its climate survey to maintain valuable historical information while better aligning it to the Financial Stability Board's Task Force for Climate-Related Financial Disclosure (TCFD).

Ultimately, our work continues to evolve. We are confident the holistic approach the states and the NAIC are taking will fortify the insurance sector and help ensure policyholders are better protected from the devastating costs of climate risks.

We look forward to continuing our discussions from the local to global level as we keep refining and strengthening our system and our industry.

Insurance supervisors should take a holistic view to effectively address climate and related risks.

Access to technology is imperative in this process, and to better inform the work in all these areas, the NAIC has an initiative underway to enhance the level of information received regarding potential and emerging risks by updating its Catastrophe Computer Modeling Handbook. We are also considering establishing a Catastrophe Model Center of Excellence to provide resources for state insurance supervisors, including access to modeling documentation; technical education and training;



STÉPHANE DEDEYAN

Chief Executive Officer
CNP Assurances

Climate-related stress tests: lessons learned by a life insurance company

The insurance sector is exposed to risks related to climate change through its investment activity, its insurance activity and its internal operations. They can take several forms:

- Physical risk, resulting from damage directly caused by meteorological and climate-related phenomena;
- Transition risk, resulting from the effects of a transition to a low-carbon economic model. It includes in particular regulatory, technological, social, market, liability and reputational risks.

Aware of the effects of climate change, CNP Assurances set up a climate risk committee in 2019. It brings together the risk department, the investment department, the actuarial department, the general secretariat and the CSR department, and was extended in 2021 to monitor the progress of the subsidiaries on the management of climate risks.

The ACPR organized in 2020 a climate stress test exercise dedicated to the French financial sector, in order to raise

awareness of vulnerabilities to climate change. CNP Assurances simulated the potential consequences of 3 scenarios:

- Efforts to comply with the Paris Agreement take place in an orderly manner between 2020 and 2050;
- Efforts to meet the Paris Agreement kick off sharply in 2030, reaching the targets in 2050;
- Efforts to meet the Paris Agreement kick off sharply in 2025 and targets are met quickly.

The impacts of the climate scenarios were assessed according to 3 metrics: the Solvency 2 balance sheet, the income statement and the valuation of the investment portfolio. For personal insurers such as CNP Assurances, the scenario of a sharp rise in temperatures leads to an increase in claims, caused by an increase in pollution and vector-borne diseases, which would impact:

- Death guarantees and work stoppage guarantees of protection and creditor insurance policies;
- Health care cost guarantees of protection insurance policies.

**Increase in claims
could be offset by a
wide mutualisation and
the decarbonization of
the portfolio.**

As regards CNP Assurances, the potential increase in claims induced by the occurrence of physical risk could be offset to a certain extent by an increase in the pricing of protection insurance and creditor insurance, wider pooling of risks and the development of private-public frameworks (like the French natural catastrophes regime). The use of behavioral studies (by measuring risk appetite and sensitivity to incentives of the consumer base) is also a leverage to mitigate climate-related risks.

During the annual renewal of its reinsurance cover, CNP Assurances is also exposed to various risks related to climate change: increase in the price of reinsurance and/or decrease in the capacity for reinsurance of climate-related perils, inadequacy between the duration of the cover of reinsurance - generally annual - and that of insurance coverage - sometimes multi-annual.

Regarding the insurance business, CNP Assurances could be impacted by various transition risks, in particular:

- changes in the savings behavior of our customers which would impact the net inflow of retirement savings;
- stricter environmental regulations which could disrupt the real estate market or household incomes and consequently impact the borrower insurance or mortgage surety business.

Regarding investment activity, in 2015 CNP Assurances adopted a low-carbon strategy in favor of the energy transition, then committed in 2019 to aiming for carbon neutrality of its investment portfolio by 2050 by adhering to the Net-Zero Asset Owner Alliance. In order to achieve carbon neutrality, CNP Assurances has set ambitious new targets for 2021 for 2025 in line with current scientific knowledge, in particular to reduce the carbon footprint by an additional 25% between 2019 and 2024 (scopes 1 and 2) of its directly held corporate equity and bond portfolio and an additional 10% between 2019 and 2024 of the carbon footprint (scopes 1 and 2) of its directly held real estate portfolio.

In order to limit the risk of stranded assets in its investment portfolio, in 2020 CNP Assurances adopted a plan to definitively phase out thermal coal : to this end, it has undertaken to achieve zero exposure to thermal coal in its investment portfolio by 2030 in the countries of the European Union and the OECD, and by 2040 in the rest of the world. These commitments were supplemented in 2021 by a policy governing its investments in unconventional oil and gas.

To go further, CNP Assurances finances an academic research program on emerging risks, created in January 2020 for a period of 5 years, the Chair of Excellence in Digital Insurance And Long-term risk (DIALog). One of the lines of research is dedicated to the study of future impacts related to the evolution of environmental factors in insurance. It will make it possible to carry out prospective reflection work aimed at understanding the major transformations underway while integrating the long-term dimension.

The expected results should improve the prospective vision, in particular the impacts of environmental risks on insurance claims and health (climate change, pollution, pandemic risk).



FRANCESCO MARTORANA

Group Chief Investment Officer -
Assicurazioni Generali S.p.A

Insurers as a force for good in achieving net-zero

More than ever, we know that public investment will not be sufficient to cover the investment required to complete the green transition, against the backdrop of the Paris Agreement, recently renewed at COP26.

Within the financial world, which is playing a leading role in redirecting private capital towards a more sustainable future, large insurers are making an increasingly decisive contribution.

Insurers play a double role: they have huge firepower in terms of financial assets to manage – European insurers manage over EUR €10 trillion of assets – and they have a deep knowledge of all the business sectors from the risk management point of view, being the enabler of most economic activities, enhancing their resilience and guarding them from potential failure.

Insurers are accelerating their reading of the climate challenge through the lenses of double materiality. Through the risks we incur, insurers must be able to measure and manage transition and physical risk on their assets. This remains a challenge as data and models are in a development phase. Insurers are confronted with the following

challenges: how to assess physical risk for a multinational? How to factor in transition risk for an energy company which committed to a significant transformation of its business model? Given that asset allocation is mainly represented by bonds, how to differentiate the risk for an issuer across its capital structure?

It is estimated that the EU needs c. €180bn in extra yearly investment over the next decade to meet the Paris targets. In the last few years, the Commission has taken important steps to ensure that institutional investors effectively play their role – for example, with the EU Taxonomy Regulation – and it is now more than ever the time for large private investors to start contributing to the sustainable recovery post-pandemic.

This is why Generali has committed to carry out up to € 9.5 bln in new green and sustainable investments by 2025 and has also launched an investment plan of €3.5 bln supporting the sustainable recovery in Europe, financing the most impacted sectors, such as SMEs, healthcare, education and sustainable housing via direct lending and private equity. These two commitments show, with the size of our assets, that we can provide a real and effective contribution to a green and sustainable economy.

as intermediate step to reach net-zero greenhouse gas emissions by 2050.

Given the relevance for insurers of fixed income portfolio with low turnover, we are convinced that engaging with companies is a more effective lever than the simple divestment, which can be more easily applicable to an equity portfolio. In addition, it can be more difficult for insurers to influence companies directly through voting – and engagement provides a tangible alternative to steer our investees towards a more sustainable path.

It is also worth mentioning the relevance of underwriting activities and the liability side. Generali pioneered the issuance of the first ever green catastrophe bond and is one of the founders of the Net-Zero Insurance Alliance. The Group is committed to increasing its share of insurance products with social and environmental value, which exceeded 23% of gross written premiums in 2020. The shift to a resilient, low-carbon economy will increase prosperity and will be a net driver of job creation. However, there will be transitional challenges for workers, communities, and countries while this shift is happening. A rapid green transition will have social consequences, and we believe that we must ensure an inclusive and just transition.

Implementing a just transition does not mean slowing the path to a low-carbon economy, but rather incorporating the social risks management related to workers and local communities into the insurance activities associated with implementing the strategies stemming from the Paris Agreement. If not managed, unemployment, community discontent and lack of labor skills could jeopardize the decarbonisation process. With this in mind, the transition must also include improving growth, generating net new jobs and reducing inequality.

Insurers are long term, liability-driven investors, which represents both opportunities and risks. We invest our assets according to a well-defined regulatory framework, which influences the way in which we integrate sustainability aspects in our strategy. In this sense, we welcome the proposed revision of Solvency 2, to ensure that sustainability risks are accounted for in the risk management framework of insurance companies.

The commitment to decarbonize the investment portfolio is crucial and must be linked to factual and measurable targets. In 2020, Generali joined the Net-Zero Asset Owner Alliance and has set out a target of decarbonizing its corporate investment portfolio by 25% by 2024, and to align its real estate portfolio to 1.5° pathway,



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Director Prudential Regulation
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With climate & sustainability risks, Solvency II does and should remain sensible

Solvency II possesses adequate tools, granularity and scope to embrace climate and sustainability issues at a sensible pace. With a demanding risk-based approach and structure the Solvency II prudential framework is robust and well equipped to address the multi-dimensions of climate and sustainability risks.

The three pillars of Solvency II, the micro and macro monitoring of risks, the quantitative and qualitative approaches, the forward looking stance and the economic valuations and calibration of the risks remain most valid and useful to monitor and supervise these new risks that are not so much new classes or categories as such but rather new drivers that modify the risk exposures of the different risks and perils already identified in the prudential framework. The attention drawn to these changes to embrace has been reinforced by Commission Delegated Regulation (EU) 2021/1256 amending Delegated Regulation (EU) 2015/35 as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings which shall apply from August 02, 2022. We

deem it more a reinforcement of the focus on these issues in the heat map than an innovative change. We rather acknowledge that the Solvency II regulation was no short of compelling (re)insurance undertakings to identify, analyse, assess, manage, monitor and report each and every risk they are facing as well as to investigate their trends and evolutions.

Physical and transitions risks can both be captured in the components of the solvency ratios computed in Solvency II pillar 1 quantitative requirements. Impacts can be tracked under both assets and liabilities.

On the assets side, with the help of the Non-Financial Reporting Directives and Regulations enhanced data reporting, sustainability information will flow in consistently across all stakeholders. The European Commission's proposal for a Corporate Sustainability Reporting Directive will fill the data gaps that exist by establishing a European sustainability reporting standard. This new framework aims at ensuring alignment of reporting requirements for companies with the overall legal framework for sustainable finance in the EU. Sufficient and standardised data is crucial. Notably requirements will be amended by extending the scope of reporting entities, introducing common reporting standards and clarifying the principle of "double materiality", where an entity considers how its activities affect sustainability and conversely how sustainability matters affect the entity and its performance. With these advancements, together with other stakeholders and investors, insurers will be able to better assess the overall performance and risks of their assets.

Solvency II possesses adequate tools and granularity to embrace climate & sustainability issues.

On the liability side, the amended Article 260 of the Commission Delegated Regulation (EU) 2021/1256 and Article 29 of the Commission Delegated Regulation (EU) 2015/35 require to take environmental developments for the calculation of the Best Estimate into account. Again, that adds to a focus that was already underlying the computations of best estimates and which was pertaining to the forward looking approach of the best estimate valua-

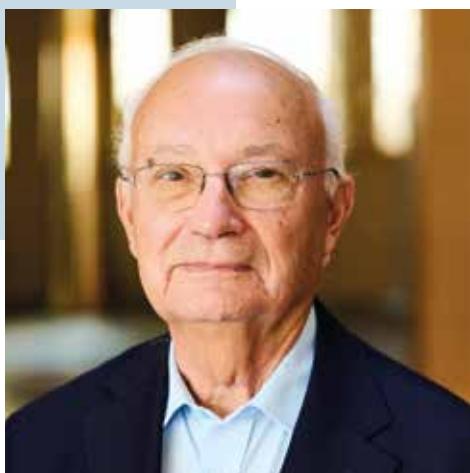
tions including the trends and evolutions of the risk drivers that could be assessed.

Generally, climate change issues are not particularly significant in the best estimate of reserves estimations. The insurance field most exposed to climate change is non-life. Yet, climate change does not play an important role here because the claims have already been occurred. In the estimation of the best estimate of premiums, climate change is taken into account via the evolution of future premium and future claims in the light of the trend insurers identify with historical data and other additional prospective insights.

Although best estimate methodological approaches allow to factor climate issues as just explained, we identify a weakness for the mid to long term trends in non-life due to the contract boundaries. We would support the introduction of equalization reserves to help contributing to climate change adaptation and playing an interesting role in maintaining an affordable and available insurance market.

With regards capital requirements under the capital requirement SCR measure, premium risk implicitly takes into account climate risks since the computation is using actual premiums as a key driver, the latter being directly impacted by adaptation measures. For natural catastrophe risks and as proposed by EIOPA regular reviews of the coefficients are foreseen every 3 to 5 years which will enable handling the impact of the climate change.

Under Pillar 2 the risk management is deeply rooted in the governance of (re) insurance undertakings and a steeper forward looking approach is undertaken with full going concern approaches that are enriched and challenged under adverse entity specifically suited stress scenarios. As risk experts, insurers are particularly well placed to inform about climate risk.



JEAN-JACQUES BONNAUD

Treasurer - Eurofi

Leveraging the insurance sector on the way toward a carbon free economy

In addition to the role of the Insurance sector on the financing of long-term investment needs of the economy notably those related to an unprecedented investment intensive transition required to address the general warming, the sector has also to respond to the increasing risks accompanying climate change, which will translate in a durable accumulation of catastrophes in the world.

The insurance sector, including of course reinsurance, is already addressing this problem. It has set up various types of responses adapted to the various geographical specificities of those risks as well as to the levels of compensation cost, which depend on the level of economic development. Indeed, economic development entails higher values of real estate and maintenance needs, higher wages, developed legal dispute culture... The cyclical inflation we are witnessing also compounds the challenge.

In France some studies on the projected increase in the cost of the climate change related disasters at the 2050 horizon, show that the « development

impact » on the cost could reach more than 50% of the anticipated increase of disasters' costs.

All things being equal, this means that on average the citizens will only be able to shoulder half of the additional charge, which corresponds to climate related claims.

All these evolutions will naturally confront the insurance and reinsurance companies to a need to increase their capital and trigger some important moves on the structures of the sector. But it is clear, as we can see it already, that the private sector will not be able to have the clients to accept certain increases on the cost of the premiums. Part of the surplus would thus eventually be supported by states, i.e., taxpayers.

Due to the impact on insurance costs of the level of development, climate related burden sharing mechanisms should be envisaged on a regional basis homogeneous economic development wise.

This should also help to consider that the impact on the theoretical pricing of the premiums which should be required from the insured clients, will be very dependent to the regional rhythm of climate change and its variability, e.g., in one region drought will concern agriculture as well as housing.

The same applies to marine submersion and storms and hurricanes and related damages, or to pandemics from which the western economies have recently felt the brutal effect on businesses losses and the costs of healthcare.

Public private partnerships appear unavoidable but they need to adapt to regional climate related risks.

Even before the current pandemic, some solutions have already been successfully experimented notably regarding pollution risks, terrorism, or natural catastrophes as well as agricultural disasters like hailstones.

In addition to professional pools or mutualisation mechanisms, for some of those risks the burden is shouldered by the state while the insurance sector provides both expertise and servicing, sometimes as it is the case for medical insurance the sector this provides an additional level of covertness.

The French natural catastrophe regime, created in 1983, shares the financial burden between public and private sectors. A specific tax on housing insurance premiums provides part of the financing to a public reinsurance company. The other part comes from the state. In addition, the insurance company will only afford part of the costs of reinsurance.

The likely increase of the costs of disasters in Europe and the fact that those threats have no national limits, should lead to a coordinated European long-term view in these issues. Perhaps it should lead to a European reinsurance facility addressing at least the risks arising in the less developed EU areas,

Similarly, in emerging economies in other regions in the world, although the reinsurance sector already operates and brings its expertise in evaluating the costs and managing the files, it will be more and more necessary to erase the excessive inequalities stemming from a probable lack of insurance and to address related social risks.

This should lead to a World Fund – a private public regional partnership supported by regional development banks, the World Bank or the IMF – which would give birth to a public global reinsurer.

The world will have the choice between massive social and migratory conflicts and solidarity on facing up the long-term unavoidable climate change.