Cover Letter on the Report on the Prudential treatment of sustainability risks in Solvency II

Mr John Berrigan
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Per email only

Subject: Report on the Prudential treatment of sustainability risks in Solvency II

Dear Mr Berrigan,

Article 304a of the Solvency II Directive mandates EIOPA to assess the potential for a dedicated prudential treatment of assets or activities associated substantially with environmental or social objectives, or harm to such objectives, and to assess the impact of proposed amendments on insurance and reinsurance undertakings in the European Union.

In response to this mandate, EIOPA followed a step-by-step approach. The first outcome of EIOPA's work under this mandate was a discussion paper published in 2022, outlining the scope, methodologies, and data sources for the analysis. The second outcome was a consultation paper published in 2023, which presented findings and policy implications based on public feedback on the discussion paper, as well as input from the work of the Platform on Sustainable Finance and exchanges with the European Banking Authority (EBA). EIOPA has also consulted with the European Systemic Risk Board (ESRB) regarding EIOPA's findings and policy implications.

EIOPA's analysis focused on Equity, Spread, Non-Life underwriting, Social, and Property risks.

EIOPA's approach was based on a risk- and evidence-based methodology, encompassing both a detailed backward-looking analysis from a 99.5% Value at Risk (VaR) perspective to understand historical risk exposures across these categories, and a forward-looking analysis to validate its findings.

Regarding policy recommendations, EIOPA proposes to implement a targeted capital surcharge specifically for fossil fuel-related corporate bonds and equity investments. A supplementary capital requirement on fossil fuel-related assets emerges as a comprehensive approach, providing a robust mechanism to better align capital requirements with their risk exposures. While expert judgment is necessary to address empirical uncertainties and ensure shock factors remain within reasonable bounds, this option represents a pragmatic approach for enhancing financial resilience of the insurance sector.

For categories such as Property, Non-Life underwriting risks, and Social risks, EIOPA recommends further analysis be conducted at a later stage, when more data becomes available. The report presents in a transparent manner the analysis performed, the conclusions reached as well as the technical limitations identified during EIOPA's analysis.

EIOPA would also like to bring to your attention the range of views within the Board of Supervisors (BoS) during the discussion and approval process of this document. While some Members expressed full support for the proposed measures, others expressed concerns about the methodology and data set used in the analysis. Other Members supported the analysis but raised concerns in relation to wider considerations which are deemed relevant for the decision.

Such wider considerations raised by Members should be taken into account when assessing the potential introduction of a dedicated capital surcharge on fossil fuel-related stocks and corporate bonds in the Solvency II framework:

- If adopted by the European Commission, only the insurance sector would be subject to a dedicated capital charge on fossil fuel assets, without a corresponding treatment on the banking side.
- While the additional capital requirement for insurers may have a minimal impact on the market, there are concerns that it could potentially hinder the transition if it imposes financial burdens that affect insurers' ability to support the broader economy.
- Given the relatively low materiality of fossil fuel exposures among insurers, the complexity and modelling costs associated with implementing these measures may outweigh the benefits.
- Currently, there is insufficient evidence that credit rating agencies effectively incorporate sustainability considerations into their rating methodologies, raising concerns about potential double counting of capital charges if these methodologies evolve in the future.

EIOPA believes it is crucial to be transparent about these limitations while emphasizing that our recommendations are grounded in the most robust data and methodologies available. EIOPA is confident that these measures will contribute to maintaining the Solvency II

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framework fit for purpose and adequately reflecting sustainability risks, safeguarding the protection of European policyholders in the long term.

Yours sincerely,

[signed]

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Chairperson of EIOPA

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