Response to EIOPA Public Consultation on a draft opinion on sustainability within Solvency II

Introduction

The Federation of European Risk Management Associations (FERMA) represents the interests of more than 4800 risk and insurance managers through its 21 national risk management member associations in 20 European countries. With a membership composed of 37% of European captive insurance users, FERMA is the only representative organisation in Brussels of the smallest type of insurance entities regulated under Solvency II.

At a time when regulators require from financial institutions an increasing control over the risk appetite and the insurance market is more and more challenged to cover for increasing extreme climate-related risks such as hurricanes, storms, floods or wildfire, captive insurance companies are ever more considered as an attractive alternative risk management solution by private and public organisations.

FERMA welcomes EIOPA's invitation to comment on its draft opinion on sustainability within Solvency II.

General comments

FERMA supports the consideration of sustainability risks by insurers in order to stimulate greener business practices. It shares the views of EIOPA that sustainability should be considered as part of the risk management framework and business planning of an insurer when it decides on the evolution of its investment/client portfolio mix.

However, FERMA stresses that taking into account sustainability should not go beyond the primary and foremost objective of any insurance supervisory regime which is to ensure that (re)insurance companies are able to pay all their debts, and especially the liabilities from insurance contracts (i.e. expected claims and associated expenses).

Solvency II already allows insurers to efficiently deal with the sustainability risks be it through the market or catastrophic risk sub-modules for instance. Capturing these risks should not require additional complex methodologies beyond balanced and specific adjustments.

As such, FERMA is concerned by the introduction of specific stress scenarios on sustainability for small and less complex insurers like captives, especially with regard to the ORSA, which is tailored to the own risk and solvency of the insurance undertaking and should not be prescriptive with standard scenarios to test.

FERMA believes that any new measure should apply the principle of proportionality in order to ensure that:

- ✓ Solvency II requirements are practically applied according to the nature, size and complexity of the regulated company;
- ✓ Regulatory actions and requirements are commensurate to their final objective.

Captive (re)insurance companies are first and foremost a risk management tool for their parent and group entities. As such, they benefit from sustainability risks management from two main stakeholders:

1) Most of captives' sustainability risks are addressed by their parent or sister companies. The sustainability exposure to physical and transition risks from climate change of the group they belong to is already included in the global risk management framework, the captive risk tolerance limits and pricing, and its investment policies of their parent company.

2) When captive (re)insurance companies (re)insure or (retro)cede risks from or to the (re)insurance market, the third-party risk carriers they are dealing with already take into account sustainability risks in their pricing, underwriting and investment strategy.

This is part of the multinational company's good corporate governance, duty of care towards its investors and stakeholders and enterprise risk management strategy that is generally disclosed in the published annual reports.

Forward looking standardised scenarios in the ORSA (Questions 3 and 4)

For small and less complex insurers like captives, EIOPA's proposals for a forward-looking approach with regard to sustainability risks and the incorporation of a standardised set of quantitative scenarios in the ORSA seems overly prescriptive and disproportionate.

The very nature of the ORSA is to be tailored to the specific situation of the insurer. It is highly likely that standardised scenarios will struggle to match the diversity of insurance business models.

Capital requirements (Question 27)

FERMA shares EIOPA's views that the current design of Solvency II capital requirements should:
- remain risk-based and on a 1-year time horizon;
- remain neutral to different types of risks and not impose sustainable investment incentives;
- not introduce a separate risk module for sustainability risks as they already materialise through existing risk categories.

Future evolution of climate change is undoubtedly a long-term trend and will be factored into the SCR by the regular recalibration of volatility factor for relevant line of business.

Captive (re) insurance undertakings are almost exclusively involved in the coverage of non-life, industrial or commercial risks. Coverage of third-party risks is generally not a major part of a captive business and therefore the sustainability requirements should be appropriately adjusted to ensure proportionality.

Valuation of assets (Questions 5 and 6)

FERMA believes that it is crucial to bear in mind that captive (re)insurance undertakings are not institutional investors and as such do not bear the same level of stranded assets risk because of transition risks. There would consequently be no value from both a regulatory or operational perspective to consider new valuation techniques based on sustainability applicable to captives.

The current Solvency II framework can easily and efficiently address most of the sustainability risks through existing valuation methodologies. For instance, the credit rating of investments being not sustainable is likely to be lower and will be adequately reflected in the valuation of Solvency II assets.

The impact on assets valuation is already factored into the "market value" of those assets at any point in time by the market. Additional stress will pose a significant administrative burden for small and less complex (re)insurance companies.

Underwriting (Question 22)

FERMA believes that within the concept of "impact underwriting", it is important to consider the underwriting concentration of captive (re)insurance companies, i.e. the fact that their strategic objective is to (re)insure only risks arising from their group's activities. As such, they heavily rely on the sustainability profile of their group's activities and should not be negatively impacted beyond the requirement of additional capital, if and where required.

To enforce the proportionality principle, specific provisions should be applied for the underwriting policy, including the possibility for an exemption from new sustainability rules.

Conclusion

FERMA supports the initiative of EIOPA for ensuring that insurance undertakings operating under Solvency II take into account sustainability within their respective solvency calculation models.

Captive (re)insurance companies are first and foremost a risk management tool for their parent and group entities and already benefit from sustainability risks management performed by the fronting insurers, possibly reinsurers and/or the captive's parent group. Nevertheless, the captive can also have its own sustainability investment policy.

Therefore, FERMA calls on EIOPA to consider captive industry as a special regulated category that should be given the benefit of proportionality and non-complex solvency modelling.

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