Comments on the draft Delegated Acts regarding technical screening criteria for the Taxonomy Regulation

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Contact person:	RAB secretariat	E-mail:	international@insuranceeurope.eu
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Introduction

Insurance Europe's Reinsurance Advisory Board (RAB) welcomes the opportunity to provide comments as part of the EC consultation on the technical screening criteria for the Taxonomy Regulation. The RAB comments focus on Annex II, regarding the criteria for reinsurance as an activity that substantially contributes to climate change adaptation.

In the general context of the Regulation, it appears that the proposed criteria are limited to the coverage of risks stemming from climate-related perils set out in Appendix A ceded by the insurer to the reinsurer. In this respect, the RAB would like to point out that:

- The classification of climate-related hazards in Appendix A should not be considered an exhaustive list. The list should be reviewed periodically to ensure it is updated with all relevant weather-related perils and considers the occurrence of potential new hazards.
- Lines of business and segments not directly in the scope of climate-related perils (eg life and health) could also be classified as "environmentally sustainable" provided they substantially contribute to climate change adaptation or cover sustainability-related risks.
- Beyond non-life and reinsurance activities, more insurance-related activities could also be considered sustainable under the EU environmental taxonomy, based on their capacity to provide adaptation to climate change risks. For example, catastrophe bonds and related classes, such as insurance-linked securities (ILS) could automatically be considered eligible activities under the taxonomy. By channelling capacity from capital markets, ILS enable the capacity of the (re)insurance market to cover more risks, thereby contributing to climate change adaptation.

General comments

- The **RAB fully supports the European Green Deal's objectives** and welcomes the recognition of the sustainable nature of reinsurance activities.
- As European reinsurers, we would like to highlight that our **business model is international in nature**. Therefore, the majority of our cedants and stakeholders will not be European, adhering to their own regulatory and data protection frameworks. As reinsurers, we are therefore reliant on our cedants and intermediaries who are closer to the risks to gather the information necessary to undertake an internal assessment on the screening criteria. From our clients' perspectives as non-European partners not falling under the EU taxonomy regime, they may find it difficult to provide us with the necessary assessments.
- The RAB is of the view that it will be extremely **difficult for reinsurance activity to meet all of the criteria for taxonomy alignment**, primarily because some are at the level of the individual original

insurance contracts, others at the level of the reinsurer. The RAB believes that if the underlying insurance activity is taxonomy-aligned, then by extension reinsurance of that activity should also be deemed taxonomy-aligned, as reinsurance is often an enabling/facilitating financial instrument.

- In the current taxonomy, it remains unclear how to deal with a significant part of reinsurers' business, namely **treaty business**. In treaty business, reinsurance companies reinsure large portfolios in which the underlying contracts might not be known at sufficient granularity by the reinsurer. Nevertheless, a significant part of those portfolios might in fact qualify as green, according to the proposed taxonomy. The RAB would therefore welcome a practical solution for appropriately considering such treaty business within the taxonomy, ie in the form of a look-through approach.
- The role of **reinsurance brokers** is not reflected sufficiently in the criteria yet. The criteria are written under the assumption that all reinsurance is transacted as direct, bilateral arrangements between cedant and reinsurer. In practice, in some lines of business or certain markets, reinsurers often have little or no direct contact with their cedants, ie insurer clients. Therefore, reinsurers will not be able to evidence all criteria by default.
- For the reinsurance criteria to be feasible it is key that individual activities mentioned currently as different criteria, ie engagement in product development and provision of data, should themselves qualify as sustainable activities.
- The RAB would recommend the wording "weather-related risks". In reinsurance for non-life natural catastrophe business, the annually renewed reinsurance covers pertain to weather-related hazards and associated risks. Climate change is a risk of change for non-life natcat risk and its impact is hard to isolate from that of other risk drivers.
- Moreover, the RAB would like to emphasise that by channelling capacity from capital markets, ILS enable the capacity of the (re)insurance market to cover more risks, which may then be used to insuring climate change adaptation measures as well as some of the effects of climate change. Furthermore, the buffers and reserve funds thereby released might be geared towards financing climate change adaptation measures. Beyond insurance and reinsurance, this would be a good opportunity for the European Commission to take ILS into account in Annex II to the draft Delegated Act on climate change adaptation as another layer after insurance and reinsurance.

Comments on the five proposed criteria

1. Leadership in modelling and pricing of climate risks

<u>*RAB proposal for criterion 1*</u>

1. Leadership in modelling ~~and pricing~~ of weather-related ~~climate~~ risks in view of climate change:
(a) the reinsurance activity uses ~~state-of-the-art~~ modelling techniques that:
(i) are used to properly reflect in the premium level the exposure, hazard and vulnerability to climate-related ~~change risks~~ <u>perils</u> as well as actions taken by the policyholder of the insurer to protect the insured asset or activity against those risks, where such information is provided by the insurer to the reinsurer;
(ii) *~~do not~~* only rely on historical trends <u>in a sound way</u>;
(iii) integrate forward-looking scenarios <u>in strategic planning</u>;
(b) the reinsurer discloses publicly <u>a summary of</u> how the risks stemming from climate-related perils are considered in the reinsurance activity.

- The RAB would recommend the following wording for point (a):
  - Subpoint (i): "Leadership in modelling ~~and pricing~~ of weather-related risks in view of climate change". There is no isolated modelling and pricing of "climate change risks". Instead, climate change influences the calibration of individual model parameters, such as event frequency or precipitation rates. Climate change attribution theory is a developing research field.

Therefore, it is often impossible or not sensible to isolate the impact of climate change on these model parameters.

- Subpoint (ii): "historical trends in a sound way". The inclusion of this wording is key as historical trends are important and should therefore not be neglected. They include the past and observed impact of climate change to date, as well as other important aspects not related to climate change, such as loss cost inflation.
- Subpoint (iii): "integrate forward-looking scenarios in strategic planning". For non-life natcat business, risk management and pricing builds on assessing the risk for the duration of the reinsurance cover, ie, not for future periods normally projected on the basis of climate scenarios. In the context of climate change, the challenge in terms of a forward-looking approach is not to infer the current level of hazard activity and risk just by averaging over past decades. More appropriately, trends and more sophisticated scientific climate modelling should be used to estimate the hazard activity level and risk. This is particularly challenging for tail risk. For this reason, it is not adequate to integrate forward-looking scenarios to assess today's risk via natcat modelling. Instead, analyses based on forward-looking scenarios are useful for learning about potential challenges related to business planning and strategy.

- In general, consistency of time horizons needs to be better accounted for. In line with the above, forward-looking scenarios should be embedded to the extent they are relevant for the cover provided, ie, the projection period should be aligned with the coverage period. Long-term impacts from climate change may not be relevant for a one-year natcat risk cover, even if the cover obviously protects against impacts from climate change during the coming year.
- For point (b), the RAB notes that the link between public disclosure and the sustainability of the reinsurer's activities is not clear. Practically, such prospective disclosure requirements seem difficult to implement (on a transactional basis). Either they could be limited to such high-level information as would ultimately not provide any benefit to the public beyond what is already required in regulatory disclosure requirements. Or, if it is expected to provide details on pricing assumptions/approaches to the public, there could be an anti-trust issue. The RAB would ask for this criterion to be reconsidered.
- Finally, ILS use state-of-the-art modelling techniques: adequate structuring and proper pricing of ILS require modelling of the weather-related risks from the ground-up. This, in addition to vulnerability and exposure of assets, determines the pay-out matrices and thereby the risk-return profile of the instruments. For that matter, in compliance with the requirements, ILS properly model weather-related risks, inherently make projections and not mere extrapolation of historical trends (since these are longer term assets) and need to project forward-looking scenarios for pricing purposes.

2. Supporting development and supply of enabling non-life reinsurance products

RAB proposal for criterion 2

2. Supporting development and supply of enabling non-life reinsurance products:

(a) the reinsurance activity's underlying products cover risks stemming from climate-~~related~~ affected perils ~~and reward, in a risk-based manner, preventive actions taken by the insurer's policyholders, including lower premiums where a policyholder has invested in adaptation measures~~;

(b) the reinsurance activity complies with one or more of the following criteria:

(i) where desired by the insurer, the reinsurer engages with the insurer, either directly or via a reinsurance intermediary, during the development of the underlying product by:

- discussing possible reinsurance solutions that the reinsurer is willing to offer in relation to that product. The final product is brought to market using one of the reinsurance solutions that were discussed with the reinsurer during the product development phase;
- providing data or other technical advice enabling the insurer to price the coverage for risks stemming from climate-related perils ~~as well as risk-based rewards for preventive actions taken by the insurer's policyholders~~;

~~(ii) the insurer would likely reduce or discontinue its coverage under the underlying product without the reinsurance agreement or a comparable reinsurance agreement in place;~~
(iii) the reinsurer provides, as part of the business relationship with the insurer or the reinsurance intermediary, data or other technical advice or both enabling the insurer to offer coverage of risks stemming from climate-related perils ~~and the coverage allows for risk based rewards for preventive actions taken by the insurer's policyholders.~~

- The criterion 2) is generally adequate, except where it links the recognition of the reinsurance activity to the direct insurers' policyholders' behaviour. The latter ignores the substance of the reinsurance activity and may impede the criterion to operate.
- The RAB proposes to use the wording "risk stemming from climate-change-affected perils" instead of "risk stemming from climate-related perils". We assume here that the intention is to include all perils that are affected by the changing climate, not only the ones that originate from a changing climate (as this would be none).
- Reinsurance pricing takes account of the insurer's loss history and intended portfolio changes. The pricing reflects preventive measures, subject to their effectiveness with respect to the reduction of past losses. In practice, the weight of future/intended preventive measures in the pricing of the transaction should be limited if effectiveness is uncertain.
- If the product pricing is risk-based, the reinsurance price already provides cost transparency, thereby setting incentives for preventive actions even if the product itself does not have explicit preventive components. The basic idea of risk-based pricing of (re)insurance products is that the client is motivated by the very price signal to reduce its risk. So, first and foremost, risk-commensurate pricing is the most important means whereby the product provider motivates the client to reduce the risk. The RAB proposes that this should be reflected in the requirements more clearly. See also comment under 3 below.
- Criterion (2.(b)(ii)) that the insurer would likely reduce or discontinue its coverage without the reinsurance agreement should be reconsidered. It is not within the remit of the reinsurer to provide evidence about the insurer's rationale for seeking reinsurance cover. This may include a number of different reasons which are not all related to the specific underlying product, but also generally the insurer's risk profile and solvency situation.

3. Innovative reinsurance coverage solutions

RAB proposal for criterion 3

3. Innovative reinsurance coverage solutions:
(a) reinsurance products sold under the reinsurance activity offer coverage for risks stemming from climate-related perils, especially in cases where the demands and needs of the insurer's clients, based on the underlying products, require so. ~~Such insurance products appropriately reflect risk-based rewards for preventive actions taken by the insurer's policyholders~~;
(b) depending on the demands and needs of the individual customers of the insurer, reinsurance products may include specific risk transfer solutions which may include protection against business interruption, contingent business interruption, other non-physical damage-related loss factors, cascading effects and interdependencies of hazards (secondary perils), cascading impacts of interacting natural and technological hazards or critical infrastructure failures.

- As above, criterion 3) is generally adequate, except when it links the recognition of the reinsurance activity to the direct insurers' policyholders' behaviour. The latter ignores the substances of the reinsurance activity and may impede the criterion to operate.
- Traditional reinsurance pricing is by design risk-based and, by that token, includes a price signal which considers prevention and/or protection measures. On the face of it, the obligation to have an explicit

"risk reward mechanism" in place at cedant level appears a little problematic and, more importantly, either incompatible with the pooling of some risks or not in line with actuarial pricing techniques.

- The addition "where the demands and needs of the insurer's clients, based on the underlying products, require so" unnecessarily restricts the range of activities to be considered, since the coverage as such already represents an activity that should qualify. Therefore, there may be a range of reasons for the insurer to acquire such cover.
- The RAB would like to stress that ILS help expand the (re)insurance market by providing additional capacity to insurance products geared towards providing financial protection from weather-related risks. ILS products go a step further in bringing innovation and cutting-edge technology to the field. In addition, transformation of a (re)insurance agreement into an investible security provides a sustainable alternative source of capacity to the (re)insurance market, while providing an attractive investment product for institutional investors.

4. Data-sharing

RAB proposal for criterion 4

4. Data-sharing:

(a) with due regard to Regulation (EU) 2016/679, a significant share of loss data related to the reinsurer's activity is made available, ~~free of charge~~, to relevant external parties, including public authorities or scientists. The parties declare to use the data for the purposes of enhancing adaptation to climate change by the society in a region, country or internationally and the reinsurer provides the data aggregated at a level of granularity ~~sufficient for~~ consistent with the use ~~declared~~made by the respective external parties and compatible with the protection of business secrecy and applicable law;

(b) where the reinsurer is not yet sharing such data with an external party for the aforementioned purpose, it has declared the intention to make its data available ~~, free of charge,~~ to interested relevant external parties and has indicated under which conditions such data can be shared;

(c) that declaration of intention to share available data is easily accessible, ~~including on the reinsurer's website~~, for relevant external parties.

- The RAB acknowledges the importance of well-organised data-sharing, but some adjustments are needed to avoid unnecessary legal uncertainty and ensure the criterion is workable in practice.
- Many RAB members already support data-sharing by joining a number of initiatives. For example, some reinsurers provide their support to OASIS, an open-source platform for developing, deploying and executing catastrophe models. Open data standards are also part of the OASIS initiative. In addition, reinsurers share a significant amount of data with regulators and public authorities.
- A data-sharing criterion must duly consider data availability, data ownership considerations and cost-benefit considerations. Reinsurers cannot support any externally declared use of data with a given granularity level if data is simply not available at the required level of detail. Reinsurers can also not disclose data at individual cedant or even group cedant level. The current wording does not seem to take these aspects into account.
- Finally, the RAB is concerned about the requirement to disclose the declaration of intention on firms' websites. This may create a material information security risk and expose firms to cyber attacks, eg in the form of denial of services.
- In the case of ILS, being a capital market instrument, the parameters of pricing, loss assessment and settlement are made available as a regulatory requirement. Given the nature of index-based products, transparency is even more inherent.

5. High level of service in post-disaster situation

RAB proposal for criterion 5

5. High level of service in post-disaster situation:

Claims under the reinsurance activity, both ongoing and those from large-scale loss events resulting from risks stemming from climate-related perils, are processed in accordance with high handling standards for claims and in timely fashion in line with applicable law and there has been no failure to do so in the context of recent large-scale loss events. Where appropriate, the reinsurer supports the insurer or the reinsurance intermediary in assessing the claims from the underlying product. ~~Information as regards procedures on additional measures by the reinsurer in case of large-scale loss events is publicly available.~~

- Most reinsurers already provide a high-level of services in post-disaster situations and will likely be able to fulfil this criterion. The relevance of the criterion is not yet clear, nor is the extent to which it is expected that these services can be evidenced if a company is challenged on its qualification as environmentally sustainable.
- Should the EC decide to keep this, a negatively designed criterion would be better, meaning that if there are/have been actual unjustified problems with claims-handling in a large-loss event, the classification might be withdrawn
- The criterion "information as regards procedures on additional measures by the reinsurer in case of large-scale loss events is publicly available" should be removed as Solvency II already provides for adequate regular and ad-hoc public disclosure.
- ILS products bring innovation and timely settlement to the field, and can, in the case of disasters leading to humanitarian crises, prompt mobilisation of capital and fast settlement of claims, which are key to successful disaster risk management. In addition, the knowledge and data shared before, during and after such events, from a macro-perspective, as covered by ILS products, contribute to greater understanding and better future management of such events.

Insurance Europe's Reinsurance Advisory Board (RAB) is a specialist representative body for the European reinsurance industry. It is represented at chief executive officer (CEO) level by the seven largest European reinsurance firms: Gen Re, Hannover Re, Lloyd's, Munich Re, PartnerRe, SCOR and Swiss Re, with Insurance Europe providing the secretariat. Through its member bodies, the RAB represents around 60% of total worldwide reinsurance premium income. The RAB promotes a stable, innovative and competitive market environment. It further promotes a regulatory and trading framework that facilitates global risk transfer through reinsurance and other insurance-linked capital solutions.