

Dirección General de Seguros y Fondos de Pensiones



ESG compliance in terms of Insurance sector:

Sustainability under Solvency II framework: the Spanish experience (by the DGSFP)

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- Sustainability is nothing new for the insurance sector.
- The insurance sector has always included NAT CAT risks as one of the risks it faces.
- The insurance sector is one step ahead of other sectors.
- Our legal framework (Solvency II) already includes NAT CAT risks.
- Undertakings must have enough own funds to cover, among others, NAT CAT risks. NAT CAT risks are already assessed in the standard formula for the calculation of Solvency Capital Requirements.
- NAT CAT risks are under review.

- DGSFP has created a new department for sustainability:
 - Solvency II
 - CSRD
 - CSDDD
 - Taxonomy
 - SFDR
 - ...
- DGSFP has included sustainability as one of the supervision priorities for the period 2023-2025.

- Supervisory procedures:
 - We have focused on the supervision of the specific requirements as regards to the integration of the sustainability risks in the governance in (re)insurance undertakings.
 - Areas of:
 - Underwriting
 - Reserving
 - Investments
 - Tasks of:
 - Risk management
 - Actuarial function
 - Remuneration policies
 - Prudent person principle
 - Articles 260, 269, 272, 275 and 275a of Delegated Regulation (EU) 2015/35
 - EIOPA: Opinion on the supervision of the use of climate change risk scenarios in ORSA
 - Modifications under Solvency II framework

- We have analysed more than 80% of the insurance market in Spain, both life and non-life.
- Questionnaires and meetings with all the undertakings.
- Results show a good degree of adaptation to the inclusion of sustainability risk in all the areas.
- Better performance:
 - Risk management task
 - Governance
 - Investments
 - ORSA
- More room from improvement:
 - Underwriting
 - Reserving
 - Actuarial function

- **System of governance**, Commission Delegated Regulation (EU) 2021/1256 of 21 April 2021 amending Delegated Regulation (EU) 2015/35 as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings:
 - (...) For that reason and to ensure that the system of governance is properly implemented and adhered to, it is necessary to clarify that **the system of governance of insurance and reinsurance undertakings and the assessment of those undertakings' overall solvency needs should reflect sustainability risks.**

- **Governance, good practices:**

- Department / area / Committee of sustainability: the undertaking must have a **sustainability governance structure**, consisting of a body (Committee/Commission/Department) with representation from all departments affected by sustainability and forums that involve the rest of the staff.
- Channels must be ensured to **guarantee communication between the different bodies**, both upwards to the governing bodies and downwards to all employees involved in their management. It is essential to convey sustainability as part of the company's culture.
- Mandatory **sustainability training** for all employees of the entity, as well as specific courses for the different areas with the greatest exposure to sustainability factors.
- Good practice requires clearly identifying the department **responsible for analysing and communicating regulatory changes** related to sustainability, and there must be a written procedure that determines how these changes are implemented.
- Likewise, it is considered appropriate to **keep all staff informed** of any relevant changes to ESG regulations through electronic means, such as the company's intranet.
- The sustainability area must be regularly considered within the **internal audit** plan.

- **Underwriting and reserving areas**, Commission Delegated Regulation (EU) 2021/1256 of 21 April 2021 amending Delegated Regulation (EU) 2015/35 as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings:
 - **actions to be taken** by the insurance or reinsurance undertaking to assess and manage the **risk of loss or of adverse change in the values of insurance and reinsurance liabilities**, resulting from inadequate pricing and provisioning assumptions due to internal or external factors, **including sustainability risks**.

- **Underwriting and reserving areas, good practices:**

- By including sustainability risk in the underwriting area, undertakings are analysing different risks in different **geographical zones** to assess the impact in premiums. It is desirable for undertakings to raise awareness and consider the micro (at the individual level) and macro (at the country/location level) **mitigating/adaptating factors** that can be taken and that can reduce the premium or avoid exclusions.
- Clearly define the **requirements** that the undertaking considers when **classifying a product as sustainable**.
- Specific **definition of vulnerable groups** and establish a rate that takes their vulnerability into account, applying reductions or discounts to the premiums.
- Include **sustainable guarantees** among products already sold (such as including the charging point and charging cables in the insurance for electric cars).
- In **claims management**, promote sustainable management and services (e.g. telematic appraisals, the use of spare parts instead of repairs with new parts).
- **Reserving** assessment.

- **Investments**, Commission Delegated Regulation (EU) 2021/1256 of 21 April 2021 amending Delegated Regulation (EU) 2015/35 as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings:
 - actions to be taken by the insurance or reinsurance undertaking to ensure that **sustainability risks relating to the investment portfolio are properly identified, assessed and managed.**;

- **Investments, good practices:**

- **Alignment with international agreements** (Net Zero, Paris Agreement...)
- **Knowledge:** whether through a provider or with their own information, the undertaking must have a high level of knowledge of the sustainability degree of the assets held in its portfolio (also for investment funds).
- The undertaking must have an **asset classification:** browns/greens/neutral... It will be considered good practice to analyse for the classification, not only the NACE code but also other elements such as transition plans or ratings.
- **Exclusions:** the undertaking must have a list of exclusions, covering highly polluting sectors and activities, controversial activities, and countries that violate human rights. The entity must have a roadmap to follow in cases where a pre-existing investment falls under one of the exclusions established.
- Undertakings should have an **ESG investment objective** within the portfolio.
- Good practice requires the creation of an engagement policy that defines the criteria to be followed by the entity in its **voting decisions**.
- Likewise, the undertaking must adopt measures aimed at ensuring its **stakeholders' commitment to sustainability**.

- **Prudent person principle**, Commission Delegated Regulation (EU) 2021/1256 of 21 April 2021 amending Delegated Regulation (EU) 2015/35 as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings:
 - 1. When **identifying, measuring, monitoring, managing, controlling, reporting and assessing risks arising from investments**, as referred to in the first subparagraph of Article 132(2) of Directive 2009/138/EC, **insurance and reinsurance undertakings shall take into account sustainability risks**.
 - 2. For the purpose of paragraph 1, insurance and reinsurance undertakings shall take into account the **potential long-term impact of their investment strategy and decisions on sustainability factors** and, where relevant, that strategy and those decisions of an insurance undertaking shall reflect the **sustainability preferences of its customers taken into account in the product approval process** referred to in Article 4 of Commission Delegated Regulation (EU) 2017/2358 (*).

- **Prudent person principle, good practices:**

- The implementation and monitoring of an **engagement policy** is considered good practice in compliance with the prudent person principle.
- Insurance undertakings must take sustainability risks into account when identifying, measuring, monitoring, managing, controlling, reporting, and assessing investment-related risks.
- They must consider the **potential long-term impact of their investment strategy** and decisions on sustainability factors.
- Where relevant, their strategy and decisions must reflect **consumer preferences**.

- **Actuarial function**, Commission Delegated Regulation (EU) 2021/1256 of 21 April 2021 amending Delegated Regulation (EU) 2015/35 as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings:
 - In coordinating the **calculation of the technical provisions**, the **actuarial function shall include all of the following tasks**:
 - the effect of inflation, legal risk, **sustainability risks**, change in the composition of the **undertaking's portfolio**, and of systems which adjust the premiums policyholders pay upwards or downwards depending on their claims history (**bonus-malus systems**) or similar systems, implemented in specific homogeneous risk groups;

- **Actuarial function, good practices:**

- **Participation** of the actuarial function in the development of the sustainability policy.
- The head of the actuarial function must be a **member of the sustainability body**.
- They must review and express their opinion on the **data quality** and information technology systems used to measure potential sustainability risks, as well as whether the **technical provisions** adequately capture these risks.
- The actuarial function's report must include its opinion on **how sustainability risks are included in the underwriting policy**, specifically on the appropriateness of **underwriting risk management, rates, modelling, and thresholds**.
- They must also conduct a review of the **adequacy of reinsurance**.

- **Remuneration policy**, Commission Delegated Regulation (EU) 2021/1256 of 21 April 2021 amending Delegated Regulation (EU) 2015/35 as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings:
 - **The remuneration policy shall include information on how it takes into account the integration of sustainability risks in the risk management system.'**

- **Remuneration policy, good practices:**

- Inclusion of **sustainability objectives** for the remuneration assessment. Sustainability factors must represent a specific percentage of remuneration.
- Without prejudice to the existence of cross-cutting objectives across all areas, **specific objectives** must be set for the different departments.
- Sustainability-related objectives must affect the **whole undertaking**, not only the entity's senior management.
- The degree of achievement of the objectives must be **based on detailed KPIs**.
- Remuneration policy must include short-, medium-, and long-term objectives.

- **Risk management & ORSA**, Commission Delegated Regulation (EU) 2021/1256 of 21 April 2021 amending Delegated Regulation (EU) 2015/35 as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings and EIOPA' opinion on the supervision of the use of climate change risk scenarios in ORSA:
 - The **risk management function** shall include all of the following tasks:
 - identifying and assessing emerging risks and sustainability risks.';
 - Undertakings must **integrate climate change risks in their system of governance, risk-management system and ORSA**, similar to all risks undertakings are or could be exposed to.
 - Undertakings must **assess climate change risk in the short term**.
 - Undertakings must **assess the long-term risks of climate change** using scenario analysis to inform the strategic planning and business strategy.
 - Undertakings should take a **broad view of climate change risk, including transition risk and physical risk**.

- **Risk management & ORSA**, Commission Delegated Regulation (EU) 2021/1256 of 21 April 2021 amending Delegated Regulation (EU) 2015/35 as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings and EIOPA' opinion on the supervision of the use of climate change risk scenarios in ORSA:
 - **Transition risks** are risks that arise from the transition to a low-carbon and climate-resilient economy. They include:
 - **Policy risks**, for example climate or energy efficiency requirements, carbon-pricing mechanisms which increase the price of fossil fuels, or policies to encourage sustainable land use.
 - **Legal risks**, for example the risk of litigation for failing to avoid or minimize adverse impacts on the climate or failing to adapt to climate change.
 - **Technology risks**, for example if a technology with a less damaging impact on the climate replaces a technology that is more damaging to the climate.
 - **Market sentiment risks**, for example if the choices of consumers and business customers shift towards products and services that are less damaging to the climate.
 - **Reputational risks**, for example the difficulty of attracting and retaining customers, employees, business partners and investors if a company has a reputation for damaging the climate.
 - **Physical risks** are risks that arise from the physical effects of climate change. They include:
 - **Acute physical risks**, which arise from particular events, especially weather-related events such as storms, floods, fires or heatwaves that may damage production facilities and disrupt value chains.
 - **Chronic physical risks**, which arise from longer-term changes in the climate, such as temperature changes, rising sea levels, reduced water availability, biodiversity loss and changes in land and soil productivity.

- **Risk management & ORSA:**

- Undertakings must identify material climate change risks for their business.
- Risks are considered to be material in the context of Solvency II where ignoring the risk could influence the decision-making or the judgement of the users of the information.
- Undertakings should identify the materiality of exposures to climate change risks through a combination of qualitative and quantitative analyses.
- In line with the Commission's Guidelines, undertakings should subject **material climate change risks** to **at least two long-term climate scenarios**, where appropriate:
 - a climate change risk scenario where the global temperature increase remains below 2°C, preferably no more than 1.5°C, in line with the EU commitments; and
 - a climate change risk scenario where the global temperature increase exceeds 2°C.
- Supervisors should expect undertakings to present and explain in the ORSA supervisory report the analysis of short and long-term climate change risks, including, among others, an overview of all material exposures to climate change risks, an explanation how the undertaking assessed the materiality and, where relevant, an explanation if the undertaking concluded that climate change risk is not material.

- **Risk management & ORSA, good practices:**
 - The **sustainability risk identification and assessment** process must:
 - Include a qualitative and quantitative approach.
 - Cover all material elements of assets and liabilities.
 - Consider risks other than those arising from climate change, including social risks.
 - Regarding **assets**, the following must be done:
 - Consider the main components of investments, including, where applicable, equities, corporate bonds, sovereign bonds, and others.
 - Consider the physical risk derived from real estate and real estate investments.
 - Regarding **liabilities**, the following must be done:
 - Analyse the impact of climate risks on the main lines of business, considering the geolocation of the portfolio.
 - In the life insurance business, perform a separate analysis for the portfolio exposed to longevity risk and mortality risk.
 - Consider the impact of rising temperatures on mortality, also incorporating indirect mortality.
 - Analyse the impact of transition risk, considering, for example, mortality associated with air pollution.
 - **Materiality analysis:** the materiality assessment should be based on clearly defined thresholds. It would be good practice to include details of this process and its outcome in the ORSA report using a materiality matrix.
 - The **CSRD's dual materiality** analysis should be linked to risk management and the ORSA results.

- **Risk management & ORSA, good practices:**

- **Scenarios:**

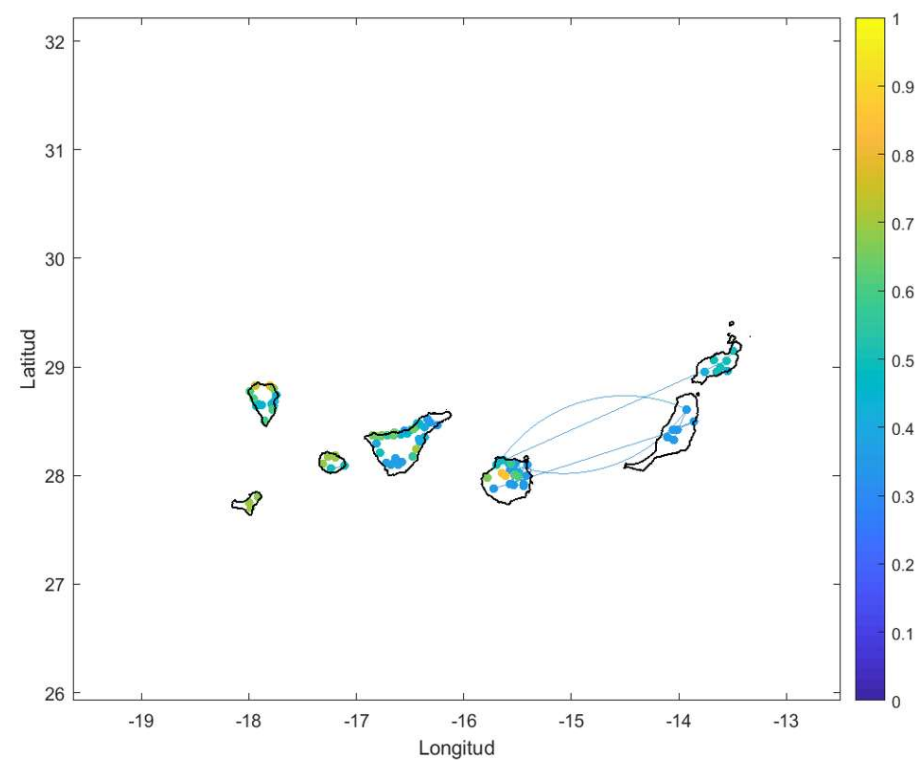
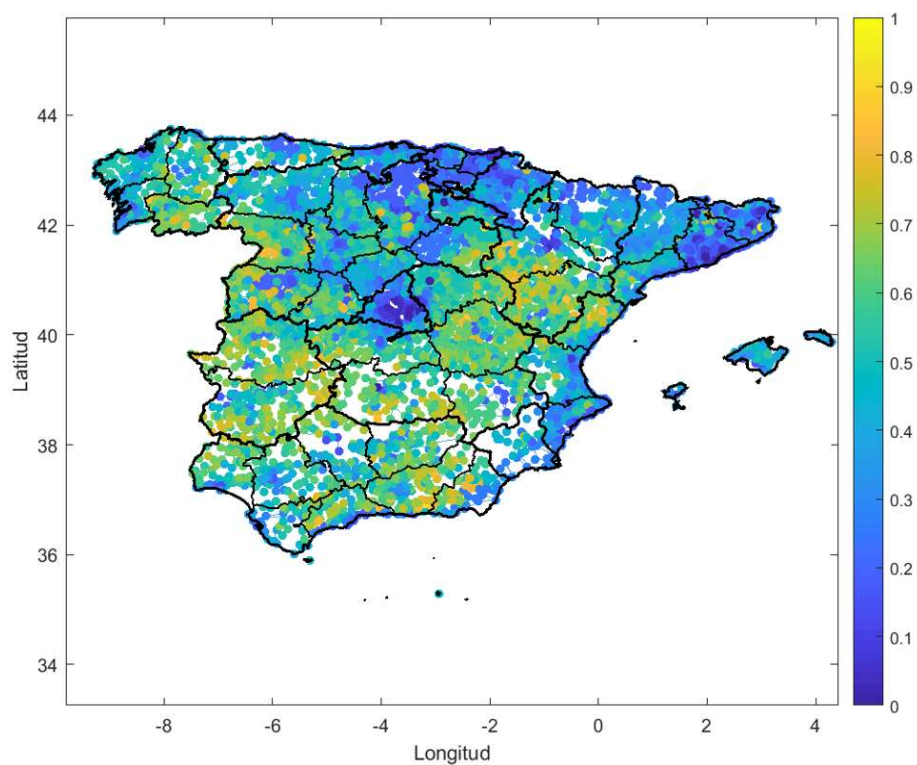
- In the absence of scenarios, the ORSA report should include a **justification for the non-materiality of its exposure to climate change risks**. It is also considered good practice to include this justification when it only covers part of the balance sheet or risk type (physical or transition).
 - All analyses **should include at least two scenarios** that meet the EIOPA Opinion criteria. These scenarios may be developed by the undertaking or by third parties. The analysis must include short-, medium-, and long-term impacts. The time horizon used must consider a long-term outlook of at least 15 years, in line with EIOPA's Application Guidance.
 - In cases where an external provider is used, both for data collection and for the analysis, **the entity must have sufficient knowledge of the information** provided.
 - The scenarios used in the ORSA must be **consistent with the CSRD** and the scenarios in the sustainability risk plans (the RTS are under development by EIOPA).
 - The ORSA report must clearly detail the process followed to calculate the impact on the entity's solvency based on these scenarios.

- **Protection gap:**

- Protection gap is one of the most important indicators to be followed.
- It is necessary to convey the culture of the importance of insurance.
- It is necessary to facilitate the access to insurance.
- Without insurance there is no coverage of ordinary risks or extraordinary risks.

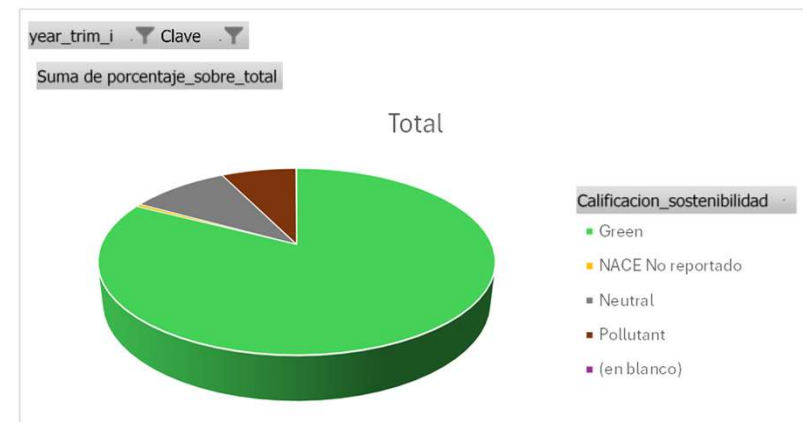
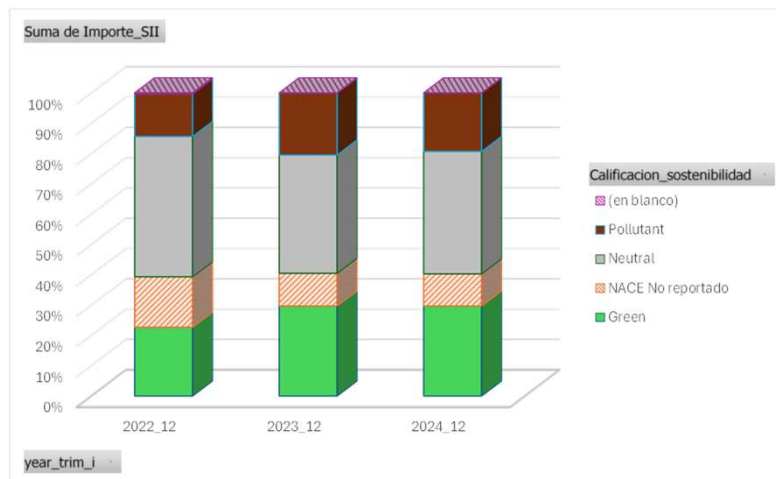
- **Protection gap:**

National coverage property: 82,8%



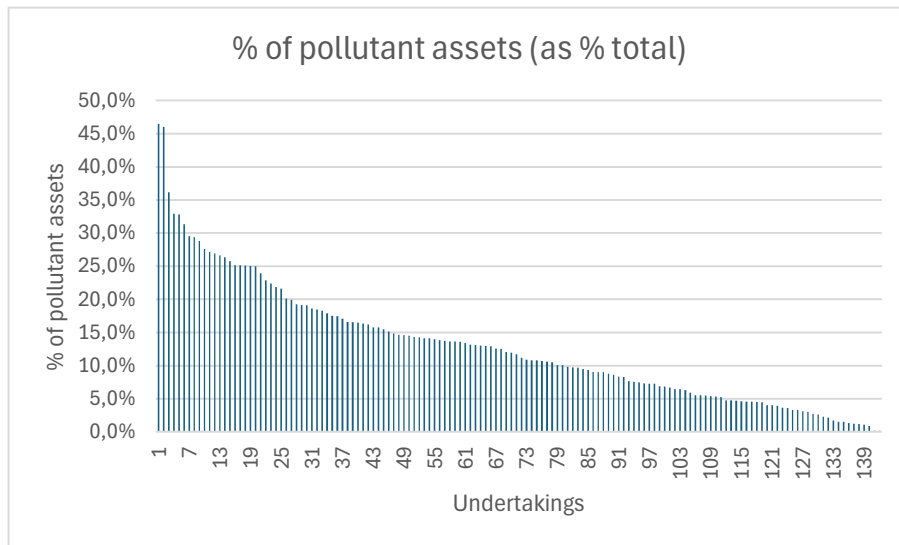
- **Transition risks:**

- Classification of assets: green, neutral, pollutant:
 - NACE codes
 - Battiston assessment
- General picture of % of assets pollutants/neutral/green that each undertaking has (or the whole sector).



• **Transition risks:**

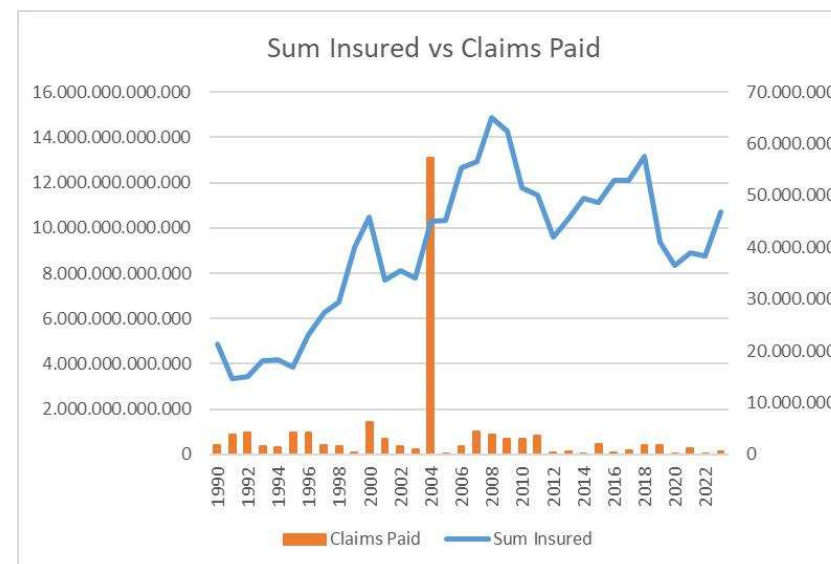
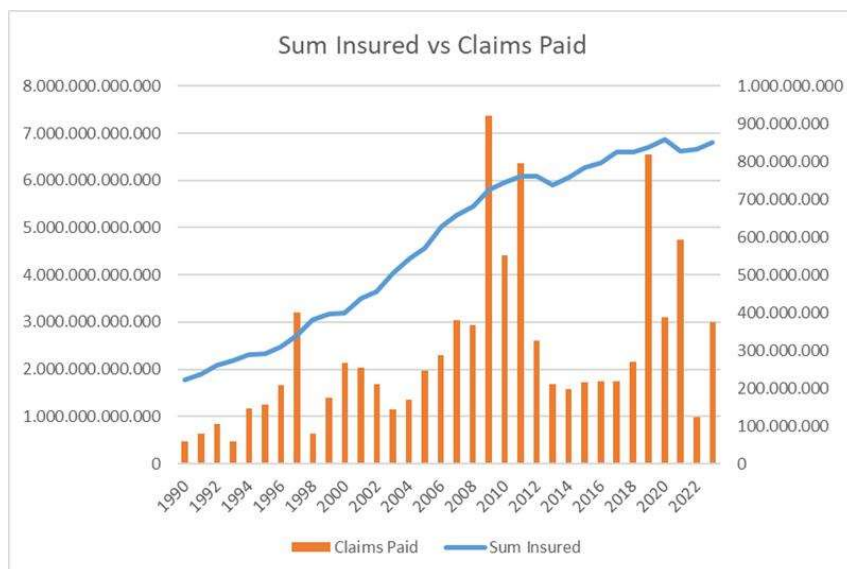
- We have the picture of the whole sector (% of pollutant/green/neutral assets for each undertaking)
- We can also analyse by NACE code, which ones are more important.
- We can assess by issuer if it is considered green/neutral/pollutant.



year_trim_i	2024_06	
Calificacion_sostenibilidad	Pollutant	
D35.1.1 - Production of electricity	2.853.538.775	
L68.2.0 - Renting and operating of own or leased real estate	2.640.662.195	
C29.1.0 - Manufacture of motor vehicles	2.453.032.868	
C19.2.0 - Manufacture of refined petroleum products	1.522.938.301	
H52.2.1 - Service activities incidental to land transportation	1.398.602.176	
C21.1.0 - Manufacture of basic pharmaceutical products	1.045.864.870	
C27.1.1 - Manufacture of electric motors, generators and trans	865.778.521	
D35.2.2 - Distribution of gaseous fuels through mains	793.583.072	
D35.1.3 - Distribution of electricity	702.323.944	
F41.1.0 - Development of building projects	658.741.342	
C30.3.0 - Manufacture of air and spacecraft and related machin	656.752.690	
D35.1.2 - Transmission of electricity	592.343.706	
L68.3.2 - Management of real estate on a fee or contract basis	558.940.476	
C26.5.1 - Manufacture of instruments and appliances for meas	518.673.308	
F42.1.1 - Construction of roads and motorways	454.464.797	
C26.6.0 - Manufacture of irradiation, electromedical and electr	405.413.825	
N77.1.1 - Renting and leasing of cars and light motor vehicles	390.310.404	
E36.0.0 - Water collection, treatment and supply	375.198.268	
H53.2.0 - Other postal and courier activities	296.204.745	
C32.5.0 - Manufacture of medical and dental instruments and s	273.793.558	
C15.1.2 - Manufacture of luggage, handbags and the like, saddl	266.724.461	
C20.4.2 - Manufacture of perfumes and toilet preparations	256.778.430	

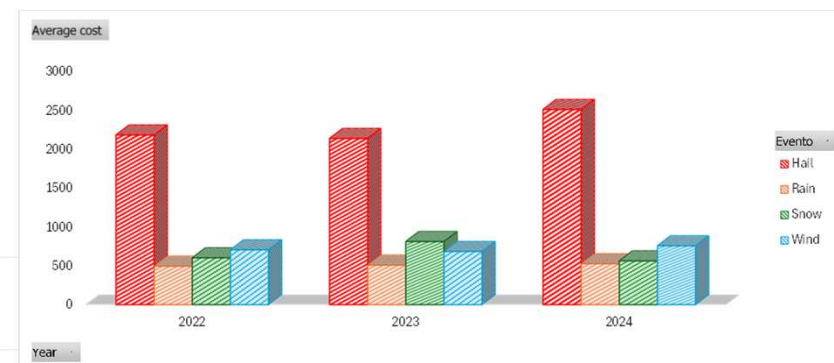
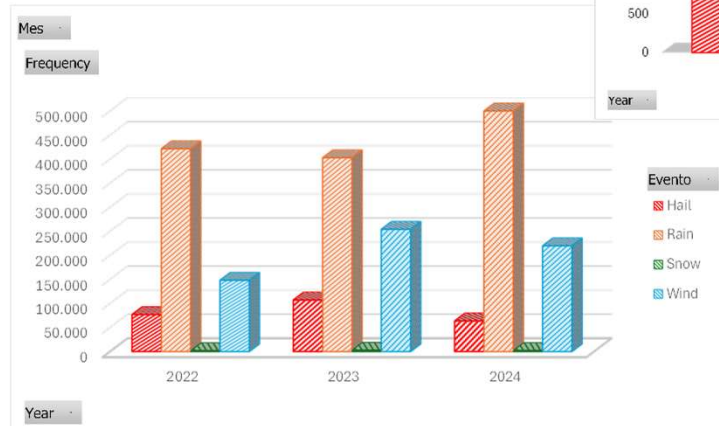
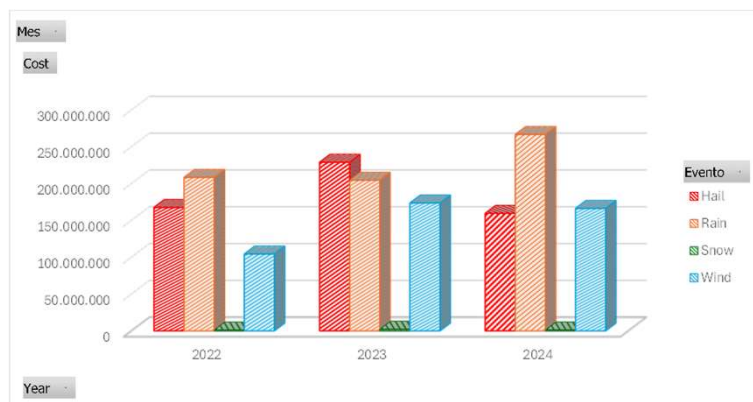
- **Physical risks, extraordinary events:**

- Claims paid due to extraordinary events in goods have increased during last years, but sum insured has a clear upward trend.
- Regarding personal damage the increase is not so relevant.



Physical risks, types of risk:

- Cost: wind and rain have increased their cost over last 2 years (+59% 2024 – 2022 and +28%, respectively).
- Frequency: wind and rain have suffered strong increases on their frequencies in 2024 compared with 2022 (+48% and +20%, respectively).
- Average cost: hail continues with the highest average cost, and it is increasing (+15% in 2 years).



• Physical risks, lines of business

• Cost:

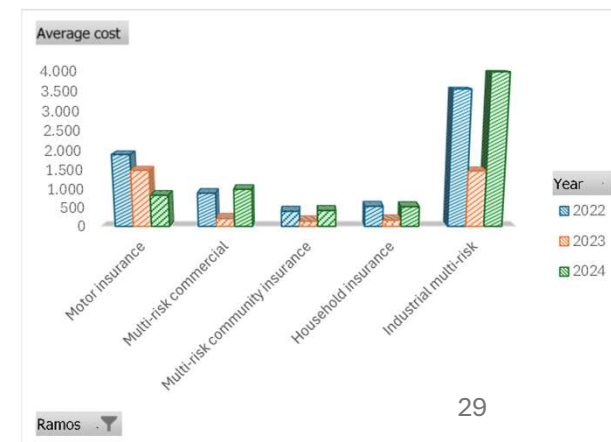
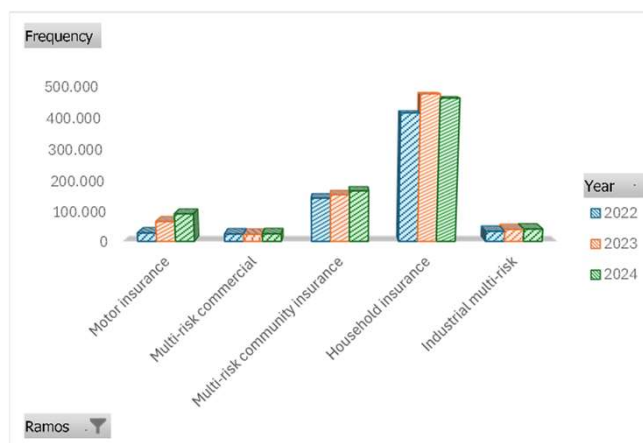
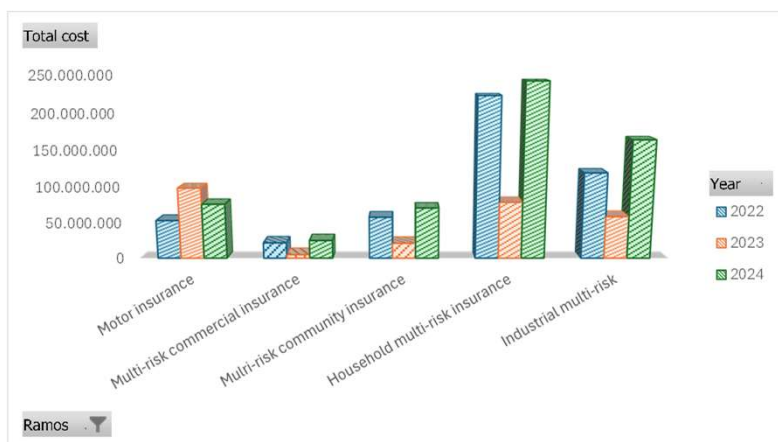
- All the lines of business have suffered cost increases.
- Household multi-risk and industrial are the ones with higher costs during last years (and with upwards trend +9% and +38% 2024 vs. 2022), although the highest increased has been in motor insurance.

• Frequency:

- All the lines of business have suffered an increase in their frequency.
- Although it has very reduced frequency, motor insurance line of business has increased 227% its frequency during the last 2 years.

• Average cost:

- Household multi risk is the line of business with higher cost and higher frequency: the average cost is very small.
- Industrial multi-risk: second highest cost with small frequency (although it has increased +23% in the last 2 years), resulting in high average cost (and increasing +12% in 2024 compared with 2022).

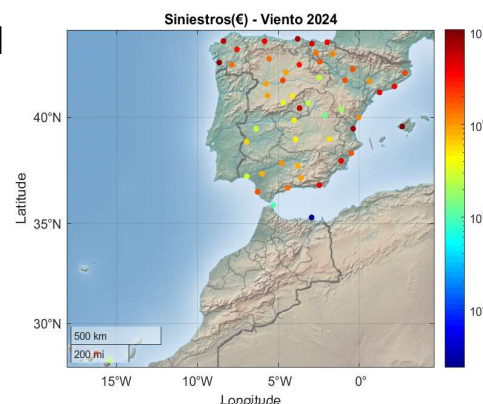


- Physical risks:
 - Geographical situation of Spain depending on NAT CAT risks:

Hail



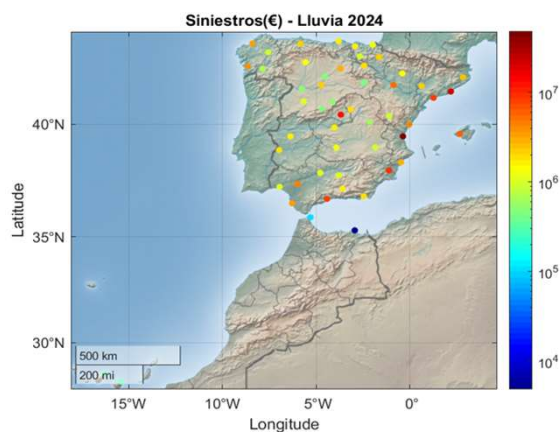
Wind



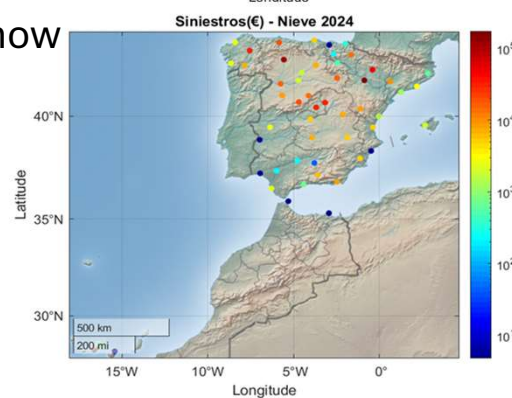
Total



Rain



Snow



Thank you!