6 – SYSTEMIC RISK

Overarching recommendations

> The European Commission should renew and link the mandates of the European Supervisory Agencies to enable a co-ordinated approach to climate-related financial risk.

> The European Commission should create a taxonomy of unsustainable economic activities and the European Central Bank should conduct climate stress testing at European level.

> The European Central Bank should green European monetary policy, and with the European Supervisory Authorities should ensure that banks and insurance firms are incentivised to manage climate risk, including through a risk-based differentiated capital requirement framework.

This year a health crisis cascaded to create systemic social, economic and financial impacts. Sustainability risks could create equally powerful impacts in the future and must be managed.

In 2020 we are seeing an economic crisis unfold around the world that has been driven by second and third order effects of an initial health crisis. The COVID-19 pandemic arose as a result of cross-infection from animals to humans, something that has become increasingly likely due to increased cross-species exposure as a result of biodiversity depletion and industrial scale animal farming.[222]

In recent years a consensus has emerged among financial regulators and central banks that climate change is a threat to financial stability both due to physical risks and transition risks.[223] Transition risks are associated with the uncertain financial impacts that could result from a rapid net-zero transition and are commonly understood as relating to stranded assets. Physical risks arise from

[222] CarbonBrief (2020) **Q&A: Could climate change and biodiversity loss raise the risk of pandemics?**

[223] NGFS (2018) **NGFS First Progress Report**

the interaction of climate-related hazards with the vulnerability of exposure to human and natural systems.[224] Further financial risk arises from the second and third order effects that may occur as a result of climate impacts.

Launching the finance agenda of the UN's COP26 climate summit, Mark Carney and Christine Lagarde urged companies, financial institutions and central banks to accelerate climate risk assessment and disclosure.[225] Pressure to change is not just coming from regulators and policymakers. An increasing number of investors and activists are also demanding change from financial institutions.[226]

Link the sustainability mandates of the European Supervisory Agencies

The European Green Deal Communication did not address the need for a joined-up approach to climate-related financial risk. However, the European Green Deal is only one of the two main ambitions relevant to the EU's economic agenda. The other is *An Economy that Works for People,* which relates to the Economic and Monetary Union, the Banking Union and the Capital Markets Union.[227] These address the governance of financial services and focus on the integration of EU economies, development of capital markets and the supervision of banks. It is important that management of systemic climate-related financial risk does not fall between the cracks of these two policy frameworks.

The European Supervisory Agencies have recently created action plans on sustainable finance [228] but responsibilities are split between them, and there is no common strategy or formal co-ordination process for addressing climate risk (an example of such a coordination process is the cross-regulator taskforce on climate risk disclosures[229] that was created in the United Kingdom in 2019). However, the European Central Bank, European Banking Authority and European Insurance and Occupational Pensions Authority are all members of the international Central Banks and Financial Supervisors' Network for Greening the Financial System.

[224] Bank for International Settlements and Banque de France (2020) **The Green Swan: Central banking and financial stability in the age of climate change**

[225] Financial Times (2020) **Carney and Lagarde press for business action on climate change**

[226] Financial Times (2020) **Energy's stranded assets are a cause of financial stability concern**

[227] European Commission (2020) **Adjusted Work Programme 2020**

[228] ESMA (2020) Strategy on Sustainable Finance; EBA (2020) **EBA Action plan on sustainable finance**; EIOPA (2020) **Sustainable finance**

[229] UK financial regulators (2019) **Joint Statement on Climate Change**

E3G

The Agencies are already working together on issues related to sustainability, e.g. in publishing the Joint Consultation Paper on ESG disclosures Standards for Financial Market Participants in April 2020.[230] This paper sets out proposed disclosure metrics for financial firms which should ideally be aligned with the taxonomy (see recommendation in Chapter 2). In order to add this level of oversight to existing supervisory responsibilities it is likely that the European Supervisory Agencies will require new budgets and resources in order to build the required internal skills and capability.

In January 2020 the Bank for International Settlements and the Banque de France called for five Cs to address financial stability risk – contribute to coordination to combat climate change – in other words, increased coordination among central banks, regulators and supervisors as well as other players such as government, the private sector and civil society.[231]

The European Commission should renew and link the mandates of the European Supervisory Agencies, enabling financial regulators and supervisors at EU and national levels to prioritise sustainable finance.

> The European Supervisory Agencies should play a stronger and more urgent role in identifying and reporting on the risks that sustainability factors pose to financial stability and the need to address environmental harmful investments.

> In order to facilitate increased action around sustainability by the European Supervisory agencies their budgets and resources should be appropriately strengthened, so that they are able to develop the skills and capability required for their new responsibilities.

> The Joint Committee and the European Systemic Risk Board could develop a common EU methodology for environmental scenario analysis, which could later evolve into climate and environment stress testing.

[230] European Banking Authority (2020), **Joint Consultation Paper on ESG Disclosures by Financial Markets Participants**

[231] Bank for International Settlements and Banque de France (2020) **The Green Swan: Central banking and financial stability in the age of climate change**

> The European Commission should ensure that both its agendas related to economic development including the European Green Deal and An Economy that Works for People are used to advance sustainable finance.

Identifying unsustainable economic activities and avoiding stranded assets

The first aim of the Sustainable Finance Action Plan was to re-orient capital flows towards sustainable investment, but so far there have not been any European policy measures with a specific goal to move finance out of unsustainable investments.[232] This is the case despite the European Systemic Risk Board indicating in 2016 that reducing carbon emissions requires economies to reduce their carbon intensity, which "implies a shift away from fossil-fuel energy and related physical capital".[233]

Info: Climate-related financial risks related to stranded assets

The transition to climate neutrality creates a risk of stranded assets. These are fossil fuel assets that are no longer profitable due to policy changes, reputational impacts, technological breakthroughs and shifts in market preferences and social norms. This can lead to unanticipated asset write-downs, devaluations or conversion to liabilities.

Globally, current policies are on a path to 2.8 to 3.2°C of warming[234] while the majority of equity and bond indices (e.g. S&P 500, MSCI World) are on a 5°C warming path.[235]Companies with stranded assets could face large losses, triggering financial instability across the financial system – from the banks that lend to them, the insurers that underwrite them and the asset

[232] European Commission (2018) **Action Plan: Financing Sustainable Growth**

[233] European Systemic Risk Board (2016) **Too late, too sudden: Transition to a low-carbon economy and systemic risk**

[234] Climate Action Tracker (2020) **Temperatures**

[235] WWF (2018) **European Asset Owners: Climate Alignment of Public Equity and Corporate Bond Portfolios;** Mirova (2019) **Estimating Portfolio Coherence with Climate Scenarios**

managers that invest in them.[236] Estimates of the value and scope of stranded assets vary depending on the models and assumptions used. Carbon Tracker estimated the amount at $1.6 trillion and IRENA at $18 trillion.[237]

Coal is at high risk of stranded assets since 81% of European coal-fired power generation is already uncompetitive compared to new renewables and storage, while 100% will be uncompetitive in 2025.[238] Countries in Western Europe are implementing coal phase-outs and power utilities are taking steps to decommission these uncompetitive assets. However, several Central and Eastern European countries are planning to keep coal in their energy mix, locking consumers into high electricity prices and exposing state owned utilities and tax payers to the cost of stranded assets.[239] The eight most coal-exposed financial institutions provided financing of €14.8 billion to European coal corporations from November 2018 to December 2019.[240]

There is a growing consensus that unabated oil and gas use is not compatible with the Paris Agreement.[241] Stranded assets in the oil and gas sector are already taking form. Oil and gas company BP had an asset write-down of up to 17.5 billion in June 2020 due to COVID-19 and the shift away from fossil fuels.[242] Since then, BP has elaborated a strategy to become net-zero by 2050 and cut oil and gas production by at least 40% by 2030.[243] Some Western European countries have started debates about the future of oil and gas.[244]

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[236] Financial Times (2020) **Energy's stranded assets are a cause of financial stability concern**

[237] Carbon Tracker (2020) **Mind The Gap: the $1.6 trillion energy transition risk** and IRENA (2017) **Stranded assets and renewables: How the energy transition affects the value of energy reserves, buildings and capital stock**

[238] Rocky Mountain Institute, Sierra Club and Carbon Tracker (2020) **How to Retire Early: Making Accelerated Coal Phaseout Feasible and Just**

[239] E3G (2020) **The Just Transition Fund: 4 Benchmarks for Success**

[240] Europe Beyond Coal Campaign (2020) **Fool's gold: The financial institutions risking our renewable energy future with coal**

[241] E3G (2020) **Financial risks for gas investments in Europe**

[242] Forbes (2020) **BP's Big Writedown: A Harbinger For A Declining Industry Or Of A Struggling Company?**

[243] BP (2020) **From International Oil Company to Integrated Energy Company: BP sets out strategy for decade of delivery towards net zero ambition**

[244] E3G (2020) **The Just Transition Fund: 4 Benchmarks for Success**

The Network of Central Banks and Supervisors for Greening the Financial System has identified an unsustainable taxonomy as an important step to identifying the assets that will be impacted by the Paris Agreement.[245] The European Central Bank has voiced support for the development of an 'unsustainable' taxonomy from a prudential perspective.[246]

The Consultation for the Renewed Sustainable Finance Strategy raised the possibility that the European Commission could make moves towards developing an 'unsustainable' taxonomy and a 'transition' taxonomy. The lack of a science-based definition of sustainable economic activities has led to substantial greenwashing and has slowed down efforts to increase sustainable investment. It is now time to take steps to address this gap by creating a taxonomy of unsustainable activities.

The existing taxonomy of sustainable activities[247] should facilitate efforts to increase sustainable investment based on objective assessment in line with science. However, at this point there is still a risk that the thresholds defining which gas projects fall within the scope of the taxonomy could be amended. This would pose a risk of stranded assets, since gas investments are not aligned with a 1.5°C trajectory. It is important that the assessment methodology remains objective and aligned with the Paris Agreement.

Investment into climate transition is urgently needed. It is not clear whether a new taxonomy is needed or whether Europe should first seek to work with other jurisdictions which have already been carrying out related work, e.g. Japan and Canada, through the International Platform on Sustainable Finance. The underlying principles for work to define transition finance should be: i) objectivity and science-based assessment, ii) alignment with the Paris Agreement including alignment of transition activities with sectoral pathways to climate neutrality by 2050.

[245] NGFS (2019) **A call for action: Climate change as a source of financial risk**

[246] European Central Bank (2020) **Eurosystem reply to the European Commission's public consultations on the Renewed Sustainable Finance Strategy and the revision of the NonFinancial Reporting Directive**

[247] European Parliament and Council of the EU (2020) **Taxonomy Regulation**

E3G

The European Commission should broaden the taxonomy's scope in 2022 to include unsustainable activities

> The European Commission should take steps to create a taxonomy of unsustainable economic activities in 2022 with a view to complete by the end of the year, following review of the Taxonomy Regulation. These activities should be identified based on objective science-based assessment and in light of the Paris Agreement.

> The Taxonomy Delegated Acts should ensure that the taxonomy remains science-based and that it is not affected by political considerations that could result in stranded asset risk.

> The European Commission should seek to work with other jurisdictions to define transition activities, while maintaining the principles of i) objectivity and science-based assessment, ii) alignment with the Paris Agreement including alignment of transition activities with sectoral pathways to climate neutrality by 2050.

Integrating sustainability in credit ratings

Credit rating agencies influence the sustainability and stability of the financial system through their services, which means that the suitability of their assessment methodologies is of vital importance.[248] Research done by the European Securities and Markets Authority indicates that there is a lack of consistency in the extent to which Environmental, Social and Governance factors are considered within credit ratings across asset classes.[249] The research also indicates that there is an insufficient level of transparency about methodologies used.[250]

Credit rating agencies are becoming increasingly active in looking at climate change impacts and their fiscal and economic consequences.[251] While short-term impacts on credit from climate change are minimal, research indicates that rating agencies are starting to assess sustainability risks over longer time horizons. For example, 717 corporates had a credit rating downgrade attributed

[248] HLEG (2018) **Final Report 2018 by the High-Level Expert Group on Sustainable Finance**

[249] ESMA (2019) **ESMA advises on credit rating sustainability issues and sets disclosure requirements**

[250] ESMA (2019) **ESMA advises on credit rating sustainability issues and sets disclosure requirements**

[251] Inside Climate News (2019) **Climate Change Becomes an Issue for Ratings Agencies**

to long-term climate and environmental factors by S&P Global Ratings between mid-2015 and mid-2017.[252]

In the Sustainable Finance Action Plan the European Commission proposed to explore amending the Credit Rating Agency Regulation to mandate credit rating agencies to integrate sustainability factors into their assessments. The Credit Rating Agency Regulation requires credit rating agencies to consider all factors that are material for the probability of default of the issuer or financial instrument when issuing or changing a credit rating or rating outlook.[253]

The European Securities and Markets Authority adopted guidelines on disclosure requirements for credit ratings and rating outlooks which will become applicable as of April 2020, and proposed that the European Commission assesses whether there are sufficient regulatory safeguards in place for other products that will meet the demand for pure sustainability assessments.[254] According to the guidelines, credit rating agencies should disclose cases where Environmental, Social or Governance factors are key drivers behind a change to a credit rating or rating outlook.

The European Commission should require credit rating agencies to integrate sustainability risks into their assessments.

> The EU should revise the Credit Rating Agency Regulation in 2021 to require that credit rating agencies integrate sustainability risks, including and second and third order impacts, into their assessments and disclose their methodologies for doing so.

> Credit rating agencies should conduct Environment, Social and Governance risk assessments using forward-looking scenarios and stress testing and should where possible use longer time horizons (e.g. 10 years or more), during which these risks are more likely to materialise.

[252] S&P Global (2017) **How Environmental And Climate Risks And Opportunities Factor Into Global Corporate Ratings**

[253] European Parliament and the Council (2009) **Credit Rating Agency Regulation**

[254] ESMA (2019) **Final Report: Guidelines on Disclosure Requirements Applicable to Credit Ratings**

Integrating sustainability into monetary policy

In light of the COVID-19 pandemic, the European Central Bank signalled that it was 'ready to do whatever it takes' and unveiled packages of a total €1.1 trillion of quantitative easing to stimulate the eurozone economy.[255] These measures were aimed at ensuring that all sectors of the economy could benefit from supportive financing conditions that enable them to absorb the COVID-19 shock. Between mid-March and mid-May 2020, the European Central Bank purchased corporate bonds worth €30 billion, from which €7.6 billion went into fossil fuels.[256] At the same time, the Bank has calculated that it is currently holding around 20% of the eligible green corporate bond universe.[257]

So far, the European Central Bank has not communicated a policy to avoid supporting high carbon industries whereas there have been discussions on only targeting viable businesses, which would include many in high carbon sectors. The widely supported 'market neutrality' principle means implicit support for fossil fuel sectors, but even conservative central banks are starting to recognise that monetary policy must play a role in the fight against climate change.[258]

The Bank is in the process of reviewing its monetary policy strategy, and has extended the review from the end of 2020 to mid-2021.[259] The review presents an opportunity to assess whether the European Central Bank should be more proactive in greening its asset purchases, or in adjusting the conditions of its refinancing operations, including the collateral framework, to take risks related to climate change into consideration. [260]

[255] European Central Bank (2020) **Improving funding conditions for the real economy during the COVID-19 crisis: the ECB's collateral easing measures**

[256] Greenpeace (2020) **ECB injects over €7 billion into fossil fuels since start of COVID-19 crisis**

[257] European Central Bank (2020) **Never waste a crisis: COVID-19, climate change and monetary policy**

[258] Deutsche Bundesbank (2020) **Monetary policy must play a role in the climate fight**

[259] European Central Bank (2020) **ECB extends review of its monetary policy strategy until mid-2021**

[260] European Central Bank (2020) **Never waste a crisis: COVID-19, climate change and monetary policy**

Address sustainability risks in monetary policy, including supporting the European Central Bank to green its asset purchases

> The European Central Bank should align its asset purchasing programmes and collateral frameworks with the Paris Agreement to support the low carbon transition and should publicly disclose the alignment of its operations.

> The European Central Bank should guarantee that as part of crisis response measures it will keep purchasing bonds issued by the European Investment Bank and national and regional public banks to a certain volume, in order to support redistribution of capital to the East and South of Europe and in order to ramp up investment in a net-zero and resilient economy.

> The European Central Bank should align refinancing operations to the banking sector with the Paris Agreement to encourage more sustainable bank lending.

Stress-testing Europe's economy against climate-related financial risk

The European Central Bank is an active member of the Network of Central Banks and Supervisors for Greening the Financial System, which published a report in June 2020 in which it recommends that central banks assess the implications of climate change for risk management as climate-related shocks may affect the riskiness of their financial portfolios and market operations.[261]

[261] Network for Greening the Financial System (2020) **Climate Change and Monetary Policy**

Info: Climate stress testing progress within European Member States

Central banks and supervisors have a duty to take action to prevent systemic risks from arising. The main risk management approach currently being promoted to integrate climate change risks in the financial sector is the use of scenario analysis and stress testing.[262]

Central bank stress testing methodologies are now being adapted to incorporate climate risk scenarios. Climate stress tests on the Dutch financial system carried out by De Nederlandsche Bank in 2019 indicated significant exposure to transition risks, with losses on portfolio values declining by 1% to 3% for banks, 2% to 11% for insurance companies, and 3% to 10% for pension funds. [263] However, the second and third order effects due to physical risks have not yet been quantified.[264] A subsequent study revealed that the Dutch financial system is also exposed to environmental and social risks such as water stress, biodiversity loss, resource scarcity and human rights controversies.[265]

Apart from the Dutch central bank, financial regulators and central banks from England, France, Denmark and the EU have also announced plans to incorporate climate change into scenario analyses and stress tests.[266] France's financial regulator, the Autorité de Contrôle Prudentiel et de Résolution, will publish the results of its first climate stress test in April 2021, while the Bank of England is working on a climate stress testing process, although this is postponed due to the COVID-19 pandemic.[267] The European Banking Authority has launched a voluntary stress test focusing on transition risks[268] together with other actions under its Action Plan on Sustainable Finance.[269]

[262] UCL Institute for Innovation and Public Purpose (2019) **Climate-related financial policy in a world of radical uncertainty: Towards a precautionary approach**

[263] De Nederlandsche Bank (2019 **The Heat is on: A framework measuring financial stress under disruptive energy transition scenarios**

[264] International Monetary Fund (2019) **Stress-Testing for the Transition to a Low-Carbon Economy**

[265] De Nederlandsche Bank (2019) **Values at risk? Sustainability risks and goals in the Dutch financial sector**

[266] Bank of England (2019) **The 2021 biennial exploratory scenario on the financial risks from climate change**; Banque de France (2020) **Présentation des hypothèses provisoires pour l'exercice pilote climatique**; Danmarks Nationalbank (2019) **Climate change can have a spillover effect on financial stability**; European Systemic Risk Board (2020) **Positively green: Measuring climate change risks to financial stability**

[267] S&P Global (2020) **Stress tests promise greater clarity around European banks' climate risk**

[268] European Banking Authority (2020) **EBA launches 2020 EU-wide stress test exercise**

[269] European Banking Authority (2019) **EBA pushes for early action on sustainable finance**

For the second year in a row, the European Central Bank has identified climate-related risks as a key risk driver for the euro area banking system.[270] The European Central Bank committed to conducting a climate stress test by 2022 and is in the process of creating a guide on the management and disclosure of climate-related and environmental risk.[271]

The European Central Bank should set the European standard for whole-economy stress-testing against scenarios for climate-related financial risk

> The European Central Bank should build on the best practice that is already emerging from leading Member States when publishing its stress test of the European economy, in order to support risk management by all European Member States.

> The Bank's stress testing methodology should also build on and inform best practice within the Central Banks and Financial Supervisors' Network for Greening the Financial System.

Integrating sustainability into prudential requirements

Climate scenario analysis and stress testing is far from being normal practice in the financial sector. Only 7% of financial institutions conduct 1.5°C-compatible scenario analyses.[272] A mere 12.6% of financial institutions calculate the amount of carbon-related assets in their portfolio and just 2.4% report on the alignment of portfolios against 1.5°C-compatible trajectories, despite these indicators being suggested in the European Commission Guidelines on Reporting on Climate-Related Information.[273] In addition, disclosure practices do not provide sufficient transparency on financial impact models and the underlying asset-level data.[274]

The 2008 financial crisis demonstrated the reliance of the EU economy on bank lending. The banking sector is the largest provider of finance to the real economy

[270] European Central Bank (2020) **Guide on climate-related and environmental risks**

[271] Ibid.

[272] Alliance for Corporate Transparency (2019) **2019 Research Report**

[273] Ibid.

[274] European Securities and Markets Authority (2020) **ESMA Report on Trends, Risks and Vulnerabilities**

and its stability is of utmost importance to maintain economic stability.[275] But European banks continue to finance activities that contribute to climate change and environmental breakdown, and do not adequately disclose the related risks.

In Europe, only two out of the largest 17 banks had committed to a larger amount of sustainable investment per year than the fossil fuel finance provided as of July 2019.[276] Among the 12 largest banks and 14 largest insurers in Europe, only five partially disclose the impact of their financial portfolios, and none provide full disclosure.[277] In addition, many banks continue to take a short-term or superficial approach to climate change.[278] Most of the current approaches to climate risk management by banks remain voluntary, but 17 banks globally are piloting the 2° Investing Initiative's climate scenario analysis methodology.[279]

There is an opportunity to use macroprudential policy to redesign bank capital rules to encourage a more rapid shift away from fossil fuels.[280] This could be done either by reducing regulatory capital risk weightings on sustainable finance or raising it on unsustainable finance. Experts have advised that policies to penalise carbon-intensive assets are more effective than policies to support green assets.[281] A green supporting factor would risk weakening the banking system and undermine the efficacy of sustainable finance efforts.

Following the 2008 financial crisis, the banking sector has been going through a reform process under the Basel III framework to increase its financial stability and resilience.[282] The EU also developed several macro-prudential instruments for the banking sector aiming to address systemic risk in the financial system. Notably, the Capital Requirement Directive and Regulation review (CRD V/CRR II) proposed a mandate for the European Banking Authority to assess whether a dedicated prudential treatment of exposures related to assets or activities

[275] European Investment Bank (2020) **Investment Report 2019/2020**

[276] World Resources Institute (2019) **How Are Banks Doing on Sustainable Finance Commitments? Not Good Enough**

[277] European Central Bank (2019) **Financial Stability Review**

[278] University of Cambridge Institute for Sustainability Leadership (2020) **Bank 2030: Accelerating the transition to a low carbon economy**

[279] 2° Investing Initiative (2019) **17 international banks now piloting the 2° Investing Initiative's flagship climate scenario analysis methodology**

[280] New Economics (2020) **The ECB and climate change: outlining a vision for success**

[281] Finance Watch (2018) **A green supporting factor would weaken banks and do little for the environment;** Bruegel (2018) **Climate change adds to risk for banks, but EU lending proposals will do more harm than good;** New Economics (2020) **The ECB and climate change: outlining a vision for success;**

[282] Basel Committee on Banking Supervision (2017) **High-level summary of Basel III reforms**

associated substantially with sustainability objectives would be justified.[283] The European Banking Authority plans to publish a report on the prudential treatments of assets from a sustainability perspective in June 2025, indicating that changes to prudential requirements may not be implemented until after 2025.

The regulation review also proposed a mandate for the European Banking Authority to assess and possibly issue guidelines regarding the inclusion of ESG risks in the Supervisory Review and Evaluation Process, and a requirement for large, listed institutions to disclose Environment, Social and Governance risks. The European Banking Authority plans to launch a report on incorporating these risks into risk management and supervision by June 2021[284] although actions may not be implemented until 2024.

Action is also underway by the European insurance supervisor. According to a stress test run by EIOPA in 2019, only about 30% of Institutions for Occupational Retirement Provision have a strategy in place to manage Environment, Social and Governance risks to their investments, while 19% assess the impact of sustainability factors on investment risks and returns.[285]

The Solvency II Directive sets out the prudential framework for insurance companies.[286] In February 2019, the European Commission requested technical advice from the European Insurance and Occupation Pensions Authority on the integration of sustainability risks and sustainability factors in Solvency II.[287] The European Commission also mandated the European Insurance and Occupation Pensions Authority to investigate whether there is undue volatility of their solvency position that may impede long-term investments, as part of the 2020 Review of Solvency II.[288]

In September 2019, the European Insurance and Occupation Pensions Authority provided an opinion on sustainability within Solvency II.[289] It identified

[283] European Commission (2020) **Prudential requirements**

[284] European Banking Authority (2019) **EBA pushes for early action on sustainable finance**

[285] EIOPA (2019) **EIOPA publishes the results of the 2019 Occupational Pensions Stress Test**

[286] European Parliament, Council of the European Union (2009) **Solvency II Directive**

[287] EIOPA (2019) **Technical advice on the integration of sustainability risks and factors in Solvency II and the Insurance Distribution Directive**

[288] European Commission (2019) **Formal request to EIOPA for technical advice on the review of the Solvency II Directive**

[289] EIOPA (2019) **Opinion on Sustainability within Solvency II**

additional practices that should be adopted by insurance companies to ensure that sustainability risks are duly considered in companies' risk management. The European Commission will publish a report with analysis and clarifications of insurers' obligations as part potential Solvency II legislative changes, building on advice from European Insurance and Occupation Pensions Authority which has been delayed to December 2020 in light of COVID-19.[290]

The European Commission should support EBA, EIOPA and the ECB to take forward strong actions on financial supervision of climate-related financial risk

> The European Commission should work with the European Banking Authority to bring forward into 2021 its report planned for June 2025 on 'Prudential Treatment of exposures related to environmental and/or social objectives'.

> The European Commission should cooperate with the European Banking Authority, the European Insurance and Occupational Pensions Authority, the European Central Bank and the European Systemic Risk Board to develop risk-based differentiated capital requirement frameworks that are based on a long-term risk horizon and a higher capital requirement for carbon-intensive assets.

> The European Commission should work with the European Supervisory Authorities to make climate stress-testing for providers of credit and insurance mandatory, including bottom-up and top-down scenario analysis. In addition to stress-testing transition and physical risks at portfolio level, stress testing the resilience of most-exposed physical assets should be required. The forthcoming implementation of Basel III should be used to integrate sustainability risk management across bank supervision and appropriate reforms should also be made under Solvency II.

[290] EIOPA (2020) **EIOPA revises its timetable for advice on Solvency II Review until end December 2020**