Recommendation No 12/2023 (XI.27.) of the Magyar Nemzeti Bank on climate-related and environmental risks and the consideration of environmental sustainability aspects in the activities of insurers

I. Purpose and scope of the Recommendation

The aim of the Recommendation is to set out the requirements of the Magyar Nemzeti Bank (hereinafter: "MNB") with regard to the identification, measurement, management, control and disclosure of climate-related and environmental risks and the consideration of environmental sustainability aspects in the business activities of insurers, thereby increasing the predictability of the application of the law and promoting the uniform application of the relevant legislation.

It is the MNB's explicit intention to make the consideration of environmental factors commonplace and to eliminate negative practices in the day-to-day operations of insurers by publishing the Recommendation. The MNB also aims to facilitate the transition of domestic insurers to sustainable operations and to prepare for legislative changes relevant to climate-related and environmental risks.

The addressees of the Recommendation are insurance and reinsurance undertakings within the meaning of Act LXXXVIII of 2014 on Insurance Activities (hereinafter: "Insurance Act"), except for small insurers within the meaning of Part Six (Section 204) of the Insurance Act, including insurance and reinsurance undertakings subject to group supervision as defined in Section 1 of Government Decree No. 436/2016 (XII. 16.) on the detailed rules for the group supervision of insurance and reinsurance undertakings (hereinafter jointly referred to as "insurer").

In drafting the Recommendation, the MNB has taken into account ongoing EU regulatory changes and ambitions, as reflected for example in the changes to the Solvency II framework[1]. Accordingly, the MNB is publishing this Recommendation in order to help comply with the changing legal environment.

This Recommendation does not fully refer back to the legal provisions when formulating the principles and requirements, but the addressees of the Recommendation are still obliged to comply with the relevant legal requirements.

This Recommendation does not supersede or replace the relevant supervisory regulatory instruments but is intended to provide more detail on the MNB's interpretation of the general expectations regarding climate change and the prudent management of environmental risks.

This Recommendation does not provide any guidance on data processing and data protection issues, does not contain any expectations with regard to the processing of personal data, and the requirements contained herein should not be interpreted in any way as an authorisation to process personal data. Data processing in the context of the supervisory requirements set

[1] https://www.eiopa.europa.eu/media/speeches-presentations/contribution/solvency-ii-leading-way-managing-sustainability-risk en

out in the Recommendation should only be carried out in compliance with the data protection legislation in force at any time.

The 2015 Paris Agreement on Climate Change[2], the UN Sustainable Development Goals[3] and the Intergovernmental Panel on Climate Change Synthesis Report 2023[4] called for urgent and decisive action to reduce greenhouse gas (hereinafter: “GHG”) emissions and to create a low-carbon and climate resilient economy.

The European Union (hereinafter: “EU”) has set ambitious targets to reduce GHG emissions, as well as regarding renewable energy and energy efficiency, to be reached by 2030. In 2018, the European Commission (hereinafter: “Commission”) published its long-term strategic vision for a climate-neutral economy to be implemented by 2050. In Act XLIV of 2020 on Climate Protection, Hungary has set the goal of taking steps to prevent climate change, reduce its impacts and make effective and feasible interventions to adapt to its consequences, and to align with international and EU commitments as part of its national climate policy. This Act states that Hungary will reach full climate neutrality by 2050, i.e. the remaining domestic emissions and removals of GHG will reach parity by 2050, which will obviously entail fundamental changes in the socio-economic system.

The role of the insurance sector in improving the resilience of the real economy to the negative impacts of climate change is indisputable, as is its exposure to potential risks and losses. As institutional investors, insurers can also contribute on the demand side to the transition to a low-carbon and sustainable economy. The International Association of Insurance Supervisors (IAIS) discusses the mainstreaming of climate and environmental risks in the insurance sector in the supervisory framework in more detail[5].

Given that insurers will be affected by the physical and transition risks associated with climate change, the European Insurance and Occupational Pensions Authority (EIOPA) has decided that it is important to encourage a forward-looking management of these risks in the long term. To this end, the EIOPA has developed an (optional) guide on the use of climate change scenarios by insurers to integrate climate change scenarios into their own risk and solvency assessment (ORSA) process[6].

The EIOPA has published an expert paper on the relationship between environmental risks and the insurance sector, identifying possible related actions for insurers, in line with the Kunming-Montreal Global Biodiversity Framework adopted at the UN Conference on Biodiversity in December 2022[7].

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[2] Paris Agreement, United Nations Framework Convention on Climate Change, 2015. https://eur-lex.europa.eu/legal-content/HU/TXT/PDF/?uri=CELEX:22016A1019(01)&from=HU

[3] 2030 Agenda for Sustainable Development, United Nations, 2015. https://ensz.kormany.hu/download/7/06/22000/Vil%C3%A1gunk%20%C3%A1talak%C3%ADt%C3%A1sa%20Fenntarthat%C3%B3%20Fejl%C5%91d%C3%A9si%20Keretrendszer%202030.pdf

[4] Synthesis Report, Intergovernmental Panel on Climate Change, 2023. https://report.ipcc.ch/ar6syr/pdf/IPCC_AR6_SYR_LongerReport.pdf

[5] 210525-Application-Paper-on-the-Supervision-of-Climate-related-Risks-in-the-Insurance-Sector.pdf (iaisweb.org)

[6] Application guidance on running climate change materiality assessment and using climate change scenarios in the ORSA

[7] EIOPA Staff paper on nature-related risks and impacts for insurance

As also defined in the Commission's "Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019/C 209/01)"[8], climate change-related and environmental risks include both the risks arising from climate change to the situation of insurers, including in relation to their customers and their own operations, and the risks arising from the negative impact of insurers' activities on the climate. In the spirit of this dual materiality perspective, the references to risks in the Recommendation refer both to the risks of negative impacts on insurers (transition and physical and liability risks – see below for examples) and to the risks of negative impacts of insurers' activities on the environment and climate (which may arise from their carbon-intensive investments on the one hand, and the environmental burden of their insurance business on the other).

II. Interpretative provisions

1. Potential physical, transition and liability risks affecting the insurer:
   a) Physical risks are those risks that arise from the uncertainty of the likelihood or magnitude of extreme weather events and other nature-related events due to climate change that could result in major human or material damage.
      aa) *Acute physical risks* resulting from specific weather-related events such as storms, floods, droughts, fires and heat or cold waves that may damage human life and health, nature or the physical and built environment that support production and may disrupt supply and value chains.
      ab) *Chronic physical risks* arising from longer-term changes in climate, such as persistent changes in temperature or rainfall or changes in their volatility, rising sea levels, declining water resources, loss of biodiversity and changes in soil fertility.
   b) Transition risks are risks that arise from regulatory, technological or market changes serving the transition to a low-carbon and climate resilient economy.
      ba) *Policy-regulatory risks*, which may arise from, for example, energy efficiency requirements, carbon pricing mechanisms that increase the price of fossil fuels, or policies that promote sustainable land use.
      bb) *Technological risks*, for example, when a technology with a less harmful impact on the climate replaces a technology that is more harmful to the climate. Thus, manufacturers of a more environmentally damaging technology may experience a drop in demand.
      bc) *Market risks*, for example if consumer and corporate clients' preferences and demand shift towards less climate-damaging products and services. Consequently, the customer base of less environmentally aware companies may be reduced.
   c) Liability risks are specific to insurers. This includes risks arising from liability insurance losses caused by climate change, as well as direct actions against insurers, lawsuits arising from inadequate management of climate risks.

[8] Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019/C 209/01), Official Journal of the European Union, 2019. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019XC0620(01)

2. In the MNB's view, not all environmental risks are linked to the effects of climate change. For example, certain agricultural activities can lead to the destruction of natural habitats, which also causes economic and financial losses through biodiversity loss. These, like climate change risks, can be physical or transition risks.[9] For example, biodiversity loss can lead to a reduction in natural resilience, which can lead to faster spread of diseases, higher mortality and thus increased life insurance claims. Policies or consumer preferences aimed at the problem of decreasing biodiversity and protecting ecosystems can create serious transition risks.

3. The MNB stresses that although this Recommendation focuses largely on climate-related and environmental risks, these processes also offer potential business opportunities for insurers, including the development of new innovative products and solutions.

III. General expectations

4. The insurer is expected to apply the supervisory requirements of this Recommendation in accordance with paragraph 10 of MNB Recommendation 12/2022 (VIII. 11.) (at the time of issuance of this Recommendation) on the establishment and operation of internal lines of defence, and the governance and control functions of financial organisations [hereinafter: "MNB Recommendation 12/2022 (VIII. 11.)"], taking into account the principle of proportionality, i.e. to implement the requirements of this Recommendation to the extent commensurate with its size, the nature, scale and complexity of the insurance activities it carries out.

5. The MNB considers it a good practice for an insurer that operates as a Hungarian subsidiary of an insurer based in an EU Member State and whose parent company is subject to the legislation set out in Chapter VII ("Reporting and disclosure requirements for insurers") at a consolidated level to disclose information under Chapter VII concerning itself or its Hungarian group members even if it is not required to do so by law (if this can be ascertained from information available at the parent company).

6. If the insurer's parent company is a signatory to UN initiatives such as the Net-Zero Insurance Alliance[10] or the Principles for Sustainable Insurance[11], the MNB expects the insurer to consider the parent company's commitments and practices as relevant to its domestic entity and to apply them in its own operations.

7. An insurer subject to consolidated supervision under sectoral legislation is expected to also apply the requirements of the Recommendation at group level. In this context, the MNB expects, in particular, that the general risk management requirements laid down in the

[9] NGFS Occasional Paper on Biodiversity and Financial Stability
[10] Net-Zero Insurance Alliance - United Nations Environment - Finance Initiative (unepfi.org)
[11] Principles for Sustainable Insurance - United Nations Environment - Finance Initiative (unepfi.org)

legislation should also take the requirements for group risk management into account in the context of climate-related and environmental risk management activities as well.

8. The MNB expects that, where an insurer uses an external service provider to implement any element of climate and environmental risk measurement, management and control, it should be mindful of the requirements set out in detail in paragraphs 180-186 of MNB Recommendation 12/2022 (VIII. 11) and MNB Recommendation 7/2020 (VI. 3) (at the time of issuance of this Recommendation) on the use of external service providers.

9. The MNB would like to draw attention to the fact that the MNB's position and expectations on sustainability in relation to certain legislation are set out in a separate Management Circular (Management Circular on Regulation 2019/2088/EU on sustainability-related disclosures in the financial services sector[12] – hereinafter: "SFDR Regulation")[13].

IV. Expectations regarding the insurer's business model and strategy

10. The MNB's expectation for the strategy and business model is that the insurer should consider both the climate-related and environmental risks and the opportunities the insurer faces. Namely, climate-related and environmental risks can have a direct impact on the effectiveness of an insurer's existing and future strategies and the resilience of its business model. In this context, the MNB proposes that the insurer
    a) identifies the short-, medium- and long-term (at least 10-year time horizon) risks and opportunities arising from climate change and environmental degradation that are part of the business environment. The identification may cover key sectors, geographical areas, and the products and services in respect of which it operates or plans to operate, taking into account that some of these risks may materialise over a fairly long period of time;
    b) identifies which climate change and environmental risks are relevant to its business strategy in the short, medium and long term (at least 10 years) and how resilient its business strategy is against these risks.

11. The MNB also expects that
    a) the next review of the strategy and business model should also take the results of the activities under the previous point into account and the plans and prospects for achieving the objectives related to climate change and environmental risks;
    b) the insurer identifies the main competitive advantages, vulnerabilities and key implementation risks in relation to climate-related and environmental risks and opportunities in its strategy and business model and that these processes are properly documented;
    c) the main strategic directions and objectives set out in the strategy and business plan

[12] Regulation (EU) 2019/2088 of the European Parliament and of the Council on sustainability-related disclosures in the financial services sector: EUR-Lex - 32019R2088 - EN - EUR-Lex (europa.eu)
[13] https://www.mnb.hu/letoltes/129526-3-2021-sfdr-vezetoi-korlevel.pdf

regarding the risks and opportunities arising from climate change and environmental degradation are consistent with the insurer's overall business strategy and business environment.

12. Given that climate-related and environmental risks may increase and impact the resilience of business models over time, the MNB considers it a good practice for insurers to take steps to reduce their overall carbon and ecological footprint, as well as their climate and environmental risks, in line with the dual materiality perspective.

13. The MNB considers it a good practice for an insurer – at the level of the local subsidiary in the case of an insurer operating under a foreign parent company – to develop a comprehensive plan for the long-term carbon neutrality of its operations and how it can contribute to improving the GHG emissions and adaptive capacity of its (prospective) customers in line with its own business strategy. The plan should include projections based on real data and a detailed documented methodology, with specific deadlines for its objectives.

14. The insurer is expected to take environmental, social and governance (ESG) risks into account when preparing a risk appetite statement approved by the administrative, management or supervisory body, supported by quantitative limits and qualitative requirements.

15. The MNB recommends that the insurer implements the UN Sustainable Insurance Principles, both in terms of its strategy and its internal management system. The initiative groups the proposed measures under four directives:
    a) The insurer integrates ESG issues relevant to its insurance business into its decision-making.
    b) The insurer raises awareness of ESG issues among its customers and business partners and works with them to find solutions thereto.
    c) The insurer works with governments, supervisory organisations and other stakeholders to promote social consensus on ESG issues.
    d) The insurer demonstrates its transparency and accountability by showcasing its results in implementing the principles.

V. Expectations on corporate governance for insurers

16. Having regard to Section 76 of the Insurance Act and MNB Recommendation 12/2022. (VIII.11.) 17/2019 (IX.20.) (at the time of issuance of this Recommendation) on the governance system of insurance and reinsurance undertakings [hereinafter: "MNB Recommendation 17/2019. (IX.20.)"], the MNB expects insurers to establish and operate a governance system that considers the environmental and climate-related risks relevant to the insurer and their potential impact on the insurer. To this end, it is expected that the insurer's department responsible for risk management and the administrative,

management or supervisory body should know and understand these risks and their potential financial implications, so that the level of risks assumed is consistent with the insurer's strategy, internal rules and policies and that the insurer complies with the applicable legal requirements and other obligations. Furthermore, in line with the provisions of Section 77 of the Insurance Act, the MNB expects the administrative, management or supervisory body of the insurer to provide adequate human and financial resources and authority to the departments (with particular attention to high-priority functions) involved in the management of climate-related and environmental risks.

17. It is also expected of the insurer to integrate environmental and social considerations into the duties and responsibilities of most core functions (including administrative, management or supervisory bodies) in areas such as business, actuarial, investment, risk-taking, claims settlement, reporting and risk management.

18. In line with MNB Recommendation 17/2019 (IX.20.), the insurer is expected to set up an organisational and operational structure that
    a) is flexible enough to adapt to the changing business environment and to the continuous evolution of climate-related and environmental risks;
    b) ensures the achievement of its strategic objectives even in the face of the expected negative impacts of the physical and transition risks of climate change;
    c) feeds climate-related and environmental risks into the management information system and thus into decision-making processes.

19. The insurer is expected to clearly define the responsibilities of each of its internal management and internal control functions also regarding climate change and environmental risks, in line with the general principles on internal lines of defence as set out in MNB Recommendation 12/2022 (VIII.11.). In this context, the insurer is expected to develop an organisational structure and operational structure that will assist and support the board in its governance function to better understand and effectively manage the climate-related and environmental risks that affect the insurer or group. It is also expected that the relevant responsibilities would be transparent, clear, well-defined, consistent, adequately documented and that compliance with the scope of responsibilities would be enforceable.

20. The MNB considers it a good practice for insurers to assess the suitability of key management personnel, as defined in Section 55 of the Insurance Act, and also based on their knowledge of climate change and environmental risks, and to provide these key managers with tailored continued training on these risks, where appropriate.

21. In line with MNB Recommendation 12/2022 (11. VIII), insurers are expected to integrate climate change and environmental risks into their internal data reporting systems to substantiate decision-making at management level. The MNB is aware that the relevant metrics and tools are currently evolving and that, for the time being, the data available

from insurers may also be incomplete. However, in line with Section 77 of the Insurance Act and paragraph 42 of MNB Recommendation 12/2022 (VIII. 11.), the MNB expects that

a) the administrative, management or supervisory body of the insurer reviews the implementation of the action plan referred to in paragraph 72 on a regular basis, at least annually, and as a matter of good practice, where necessary on a quarterly or semi-annual basis, taking into account the overall sustainability report required on an annual basis under paragraph 67;
b) the administrative, management or supervisory body of the insurer has adequate information on the insurer's climate change and environmental risks and any changes thereto through the internal information system;
c) the methodologies and information used in reporting on climate and environmental risks are regularly reviewed and improved (in terms of data content and quality) as the range of available data on climate and environmental risks continues to expand.

22. Bearing in mind MNB Recommendation 17/2019 (IX.20.) and Section 77 of the Insurance Act, the insurer is expected to properly document how available information on climate-related or environmental risks has been taken into account in relation to decisions taken at the level of the administrative, management or supervisory body.

23. The MNB expects insurers to assess climate-related risks in their annual financial planning, as well as in their long- and short-term strategic planning processes. The MNB considers it appropriate that the insurer should also ensure that the effects of climate change are clearly reflected in the existing risk categories.

24. The MNB expects the insurer to establish a dedicated department or function (e.g. an "ESG centre") or to designate a dedicated chief sustainability officer responsible for the management and control of climate-related and environmental risks, who will report regularly to the administrative, management or supervisory body – on a quarterly or semi-annual basis, taking account of the principle of proportionality, as considered a good practice by the MNB. In line with the principle of proportionality applied in paragraph 10 of MNB Recommendation 12/2022 (VIII.11.) and in Section 76 of the Insurance Act, a member of the board of directors may be appointed to perform the above tasks in smaller and less complex financial institutions, subject to an appropriate separation of duties and responsibilities. Where the insurer creates a separate department or function for climate and environmental risks, the integration of the separate department or function into existing processes and its relationship with other functions should be clearly defined (division of responsibilities and tasks, cooperation and reporting obligations, etc.).

25. The MNB expects the administrative, management or supervisory body of the insurer to ensure that the insurer has effective and reliable data reporting, disclosure and communication systems in place, including the ability to aggregate climate-related and environmental risk data. In this context, the MNB expects insurers to

a) assess the data requirements of its strategy development and risk management units,

identify data gaps and outline plans to address them and overcome any inadequacies;
b) assess the need to adapt its information and IT systems to be able to collect and aggregate the necessary data to assess its exposure to these risks, in particular the data to be published under Article 8 of the Taxonomy Regulation[14] and, where relevant, the SFDR Regulation;
c) build a data taxonomy on these risks.

26. If the requirements in points (b) and (c) above are not feasible due to lack of common definitions, incompleteness of taxonomies and data gaps, the MNB considers it a good practice for insurers to consider establishing reporting processes and procedures based on internal qualitative data or even external risk metrics. This will ensure that the administrative, management or supervisory body receives adequate reports on climate and environmental risks. In this case, it is expected that the administrative, management or supervisory body is aware of the limitations of the reports thus obtained.

27. The MNB also expects the insurer's internal control system and audit trail to cover climate-related and environmental risks in the short, medium and long term. Internal audit is expected to verify regularly, using individually or in combination the types of controls referred to in paragraph 156 of MNB Recommendation 12/2022 (VIII.11.), that the internal control systems established and operated by the insurer effectively ensure the insurer's preparedness to manage its short, medium and long-term climate-related and environmental risks and its risk management objectives for these risks.

28. It is expected that the responsibilities of those performing internal control functions concerning climate-related and environmental risks will be defined along the following lines:
a) the MNB considers the inadequate integration of climate change and environmental risks into existing processes to be included in the compliance risks under paragraph 129 of MNB Recommendation 12/2022 (VIII.11.);
b) the risk management function is expected to integrate the management of risks arising from climate change and environmental degradation into its processes, in line with paragraph 124 of MNB Recommendation 12/2022 (VIII.11.);
c) as there is insufficient empirical data on environmental risks in terms of quantity and quality, the actuarial function is expected to take into account the inherent uncertainty in the use of historical data when setting pricing and insurance technical reserves;
d) the insurer's chief officer (department head) responsible for the management and control of climate-related and environmental risks is expected to provide its administrative, management or supervisory body with comprehensive and understandable information covering the insurer's climate change and environmental risks;
e) it is recommended that the Compliance Manager, the Chief Risk Officer and the Chief

[14] Regulation (EU) No 2020/852/EU of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088: EUR-Lex - 32020R0852 - EN - EUR-Lex (europa.eu)

Internal Auditor provide the supervisory board with a summary assessment of climate-related and environmental risks at least annually;
f) As climate risk measurement is a relatively new science and risk modelling is constantly evolving, all relevant departments and functions should strive to continuously improve the corresponding tools and methodologies.

29. In order to foster a healthy risk culture, in line with MNB Recommendation 12/2022 (VIII.11.), the MNB expects that
    a) the insurer provides regular training to its employees on climate change and environmental risks affecting the insurer's activities, strategy and risk profile;
    b) all employees of the insurer are aware of their responsibilities in relation to the insurer's climate change and environmental risk management.

30. Having regard to MNB Recommendations 12/2022 (VIII. 11.) and 17/2019 (IX.20.), insurers are expected to consider climate change related and environmental risks and their effective long-term management when designing remuneration policies and practices, in line with the results of the risk analysis carried out under paragraph 10. In this context, the MNB considers it a good practice for insurers to include sustainable funding performance indicators in their remuneration policy for stakeholders.

VI. Expectations regarding the insurer's risk-taking and risk management practices

31. The MNB expects the insurer to assess its exposure to climate-related and environmental risks and to conduct qualitative and quantitative analyses on a regular basis, commensurate with the results of this assessment.

32. The MNB considers it necessary that the assessments and calculations set out in the previous paragraph also cover liability risks arising from physical, transition and environmental risks.

33. For physical risks, it is recommended to monitor the impacts on life insurance risks (e.g. the relationship between heat waves and mortality) and to assess possible deviations from long-term trends.

34. The MNB considers it desirable to conduct regular due diligence on insurers' products, business partners and investments to assess the transition risks involved.

35. The MNB expects that the assessments in points 31–34 and their results will be incorporated into the insurer's risk management system and will be reflected, inter alia, in the insurer's own risk and solvency assessment (ORSA) reports as well. As part of this process, it is also expected that risk appetite will be defined and measures to address these risks will be formulated, in addition to risk assessment.

36. The MNB recommends that insurers conduct the ORSA process in line with the EIOPA's relevant material[15], including by preparing the impact probability matrix used in the risk assessment over a longer time horizon.

37. The MNB expects insurers to develop internal policies that regulate how the assessment and monitoring of climate change and environmental risks is integrated into the insurance process. This may include in particular a description of:
    a) geographical areas, economic sectors or business lines that are likely to be more exposed to climate change-related and nature-based risks;
    b) processes for assessing the material environmental risks inherent in new business practices and existing portfolios;
    c) the use of climate research reports, climate risk models and other analytical tools in the risk-taking decision making process.

38. Climate and environmental risks can affect many types of insurance, but property insurance is considered the most exposed regarding physical risks. The future availability of this insurance makes it crucial to prevent and mitigate damage. Given the expertise of insurers and the generally limited information available to policyholders, the MNB expects insurers to strive to support their customers in increasing their adaptability and resilience to these risks.

39. The MNB considers it necessary for insurers to provide their customers with information on how to mitigate environmental risks, the means of adapting to them and various loss prevention techniques. In this context, the MNB considers it good a practice for insurers to make this information available to their customers on their website in a clear and understandable way (for example, on a dedicated sub-page).

40. The MNB has identified the operation of early warning systems as a good practice, whereby the insurer notifies the policyholder by phone, a mobile app or other means about a threat to the insured property (e.g. windstorm, hail). Notification can be particularly effective in the case of a property that is in a fixed position, i.e. where the geological location is known to the insurer.

41. The use of nature-based solutions can also increase resilience, such as the use of green roofs for building insurance or the cultivation of more climate-resilient varieties in the case of crop insurance. The MNB considers it to be a good practice for insurers to encourage the use of these tools, for example by offering premium discount(s).

42. The MNB proposes that insurers should also take environmental risks into account when

[15] Application guidance on running climate change materiality assessment and using climate change scenarios in the ORSA: https://www.eiopa.europa.eu/system/files/2022-08/application_guidance_on_running_climate_change_materiality_assessment_and_using_climate_change_scenarios_in_the_orsa_0.pdf

making investment decisions.

43. It is also recommended that in the case of unit-linked life insurance, the insurer should also offer asset funds that meet the conditions of Article 9 of the SFDR Regulation.

44. The MNB expects, in line with the amendments to Commission Delegated Regulation 2017/2359/EU which entered into force in August 2022[16], that the insurer's product approval process will also consider the sustainability objectives, if any, of policyholders in relation to the investment products. Compliance with the legislative amendment is also supported by the EIOPA's relevant guidance[17].

VI.1. Operational risk management

45. The MNB expects the insurer to assess the impact of physical, transition and liability risks related to climate change and environmental causes on its own operations, including its ability to quickly restore its capacity to continue providing services. The geographical location where the insurer operates may make it more susceptible to physical risks. This is particularly relevant for outsourced services and computing activities, especially if the service providers are located in places where there is a higher risk of extreme weather events or other negative environmental events. From an operational risk perspective, climate change can also increase an insurer's operating costs through the transition risk channel, for example through higher energy prices or more emissions reporting obligations.

46. In particular, when assessing critical functions and activities, the insurer is recommended to take into account the impact of climate change on the provision of services. If the result of that assessment is material to any of the insurer's business lines or to the overall operation of the insurer, it should be reflected in the insurer's business continuity plan.

47. The MNB expects the insurer,
    a) that its operational risk management framework should also take into account climate-related and environmental risks;
    b) that its loss data collection activities should also cover at least those loss events due to climate change whose impact can be detected in the accounting (general ledger or subledger) records;
    c) where identified as a relevant risk in the assessment set out in paragraph 45, to assess the risk of climate-related and environmental risk events affecting operational risks through scenario analyses;
    d) to develop risk mitigation procedures for climate related and environmental risk events

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[16] Commission Delegated Regulation (EU) 2021/1257 of 21 April 2021 amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as regards the integration of sustainability factors, risks and preferences into the product oversight and governance requirements for insurance undertakings and insurance distributors and into the rules on conduct of business and investment advice for insurance-based investment products (https://eur-lex.europa.eu/legal-content/HU/TXT/PDF/?uri=CELEX:32021R1257&from=EN)

[17] https://www.eiopa.europa.eu/publications/guidance-integration-customers-sustainability-preferences-suitability-assessment-under-idd en

that impact operational risks.

48. The MNB expects insurers to consider the extent to which the nature of their operational and business activities increases the future reputational damage or legal risks (legal accountability or litigation) associated with losses occurring due to physical or transition risks of climate change.

49. The MNB considers it important that the insurer itself also strives to reduce its ecological and carbon footprint, as insufficient knowledge thereof or failure to reduce them effectively, in addition to preventing a constructive contribution to the efforts required by international agreements and the objectives under paragraph 19, also entails legal accountability and reputational risks.

50. With regard to the risk of negative environmental impacts arising from the insurer's own operations, the MNB expects the measurement of direct emissions from activities ("Scope 1")[18] and indirect emissions related to purchased energy ("Scope 2"), and considers it a good practice to measure indirect emissions excluding financed emissions ("Scope 3")[19].

51. Consequently, the MNB considers it a good practice for insurers to operate an environmental management system[20] that complies with internationally accepted standards, and to measure and strive for continuous improvement of their environmental performance. As regards other environmental impacts of operations and measures to mitigate them, the MNB proposes the following:
    a) introducing and promoting cashless payment methods;
    b) achieving paperless or paper-saving administration;
    c) other own-operational initiatives, along the lines of validated environmental performance indicators.

52. Regarding the ecological footprint, the MNB proposes the following:
    a) developing plans to further reduce the ecological footprint;
    b) neutralising and offsetting the emissions remaining after emission reductions that cannot be further reduced technically or economically by implementing, if possible, authentic, verified, primarily domestic habitat rehabilitation projects[21], which, in addition to GHG neutralisation, also serve biodiversity enhancement; secondly, by purchasing carbon credits.

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18 Detailed information on the scope of application is available in the GHG Protocol standards: https://ghgprotocol.org/

19 Insurers should focus on Scope 3 financed GHG emissions, as these are likely to be orders of magnitude higher than Scope 1 or Scope 2 emissions. However, this is relevant from a credit risk measurement, management and mitigation perspective. Expectations and good practices on the measurement and disclosure of financed emissions are reflected in several paragraphs of this Recommendation.

20 The MNB considers the application of the ISO 14001 Environmental Management System and the EMAS Environmental Management and Audit Scheme, which sets higher standards than the requirements of the ISO 14001, to be good practice.

21 For example, the MNB, in cooperation with WWF Hungary, is offsetting CO2 emissions from its operational activities through a complex, long-term habitat restoration ecological project: https://www.mnb.hu/sajtoszoba/sajtokozlemenyek/2021-evi-sajtokozlemenyek/az-mnb-a-wwf-magyarorszaggal-egyuttmukodve-valik-karbonsemlegesse

VII. Expectations regarding the reporting and disclosure obligations of the insurer

53. Disclosure of climate-related and environmental risks will allow market players to better assess physical, transition and liability risks. This will also allow financial institutions and investors to better understand the financial implications of climate change. The MNB expects insurers to start preparing for the new disclosure requirements, if they are subject to them.

54. The insurer's disclosures are expected to be based on reliable data and to provide meaningful information that is easily understandable to market participants on the climate-related and environmental risks relevant to the insurer's operations and on how the insurer's activities contribute to the implementation of climate change related or environmental objectives[22].

55. The MNB draws attention to the fact that, subject to Article 8 of the Taxonomy Regulation, according to Article 19a or 29a of the Non-Financial Reporting Directive[23] (hereinafter: "NFRD") and pursuant to Section 95/C and Section 134(5) of Act C of 2000 transposing these provisions into national law, non-financial undertakings and financial undertakings required to disclose non-financial information shall provide additional transparency as to the extent to which their activities are considered environmentally sustainable as from 1 January 2022.

56. Insurers that are required to disclose non-financial information under Article 19a or 29a of the NFRD[24] [25] must disclose:
    a) From 1 January 2022 until 31 December 2023, the data specified in Article 10(3) of the Disclosures Delegated Act[26];
    b) From 1 January 2024, in addition to the data referred to in point (a), the data specified in Article 10(5) of the Disclosures Delegated Act;

From 1 January 2025, in addition to points (a) to (b), the insurers concerned may make use of the option provided for in Article 9(3) of the Disclosures Delegated Act.

57. When the insurer discloses data, metrics and targets considered relevant for climate change and environmental risks, the MNB expects the insurer to provide market participants with a comprehensive view of the insurer's climate change and environmental risks and risk profile. In this respect, the MNB expects the following:

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[22] The list of relevant environmental objectives can be found in Article 9 of the Taxonomy Regulation (below)

[23] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, transposed into national law by Act C of 2000 on Accounting

[24] Insurance undertakings of public interest covered by Section 95/C of Act C of 2000 on Accounting

[25] The MNB draws attention to the fact that, according to the information available to the MNB at the time of publication of this Recommendation, Article 1(3) and (7) of the draft Corporate Sustainability Reporting Directive (CSRD) are expected to amend Articles 19a and 29a of the NFRD, according to which the scope of companies falling under the personal scope of these Articles (including Article 8 of the Taxonomy Regulation) will be expanded.

[26] Commission Delegated Regulation (EU) 2021/2178 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation

a) The insurer shall also disclose or refer to the methods, definitions and criteria for disclosing data, metrics and targets that are considered relevant to climate change and environmental risks.
b) The methods used for disclosure should be sufficiently flexible, i.e. newly emerging metrics and data should be easy to incorporate and interpret in the context of reporting frameworks.
c) The disclosure should also cover significant changes in climate-related and environmental risk exposures between reporting periods and the appropriate response measures by the administrative, management or supervisory body.

58. In accordance with the SFDR Regulation, the MNB expects that insurers subject to Article 2(1)(a) and (11)(b) of the SFDR Regulation
    a) publish on their website information on their policies for integrating sustainability risks into their investment decision-making processes;
    b) publish on their website information on how they integrate sustainability risks into their remuneration policy;
    c) disclose how sustainability risks are integrated at product and organisational level in a transparent manner;
    d) comply with the relevant disclosure obligations in accordance with the methodology and model documents set out in the Annexes to Commission Delegated Regulation (EU) 2022/1288 of the Council[27] supplementing the SFDR Regulation.

59. The MNB considers it a good practice
    a) for an insurer that is subject to Section 95/C of Act C of 2000 on Accounting to publish its business report – including the non-financial statement pursuant to Section 95/C – or the non-financial statement part pursuant to Section 95/C of its business report.
    b) for an insurer that is not subject to Article 95/C of Act C of 2000 on Accounting, the obligation as per Article 8 of the Taxonomy Regulation, to also voluntarily comply with the disclosure rules under these laws or part of them;
    c) for the insurer to request an auditor's opinion on the information to be disclosed under the legislation referred to in this Chapter, whether required to do so by law or voluntarily.

60. The MNB expects the information disclosed to provide sufficient qualitative and quantitative information on the insurer's processes and procedures for identifying, measuring and managing its climate change and environmental risks.

61. In relation to disclosure obligations regarding climate change and environmental risks, the

[27] Commission Delegated Regulation (EU) 2022/1288 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of 'do no significant harm', specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports: EUR-Lex - 32022R1288 - EN - EUR-Lex (europa.eu)

MNB expects the insurer's disclosure policy to specify how the insurer assesses the materiality of climate change and environmental risks, taking account of the requirements of MNB Recommendation 17/2018. (IV. 9.) (at the time of issuance of this Recommendation) on supervisory reporting and disclosure by insurance and reinsurance undertakings under Solvency II, and MNB Recommendation 6/2018. (II. 21.) (at the time of issuance of this Recommendation) on reporting by insurance and reinsurance undertakings for financial stability purposes. In this context, the insurer is expected to assess compliance with the materiality criterion for both climate-related and environmental risks on a regular basis, at least annually. The MNB draws attention to the fact that insurers should not consider climate-related and environmental risks as non-relevant solely based on the long-term nature of these risks.

62. The MNB expects the insurer to disclose
    a) its exposures by industry sector, based on international sectoral classification systems;
    b) the part of its invested assets that is consistent with existing classification systems (taxonomies) of sustainable or unsustainable activities.

63. The MNB considers it a good practice for an insurer to report on the climate-related risks and opportunities that the insurer has identified in the short, medium and long term, and the impact of climate-related risks and opportunities on the organisation's business activity, strategy and financial planning.

    It is recommended that the reports be supported by quantitative data on the core business, products and services of the insurer, where available and relevant, including information at the line of business, sectoral or geographical level. The insurer should also disclose how the potential impacts of climate-related risks affect the position of policyholders, the education or training of intermediaries and how the insurer supports adaptation to the impacts of climate change (e.g. through products and services).

64. The insurer is also required to disclose how it takes climate-related risks and opportunities into account in its relevant investment policies. This can be presented in terms of the overall investment policy or the individual investment policies of the different asset classes.

65. The MNB considers it a good practice for insurers to disclose how the investment framework treats asset classes such as real estate and mortgage-based investments that are more exposed to rising ocean levels, coastal flooding, storms, droughts, forest fires and other natural disasters. It is worth describing how climate-related risks are considered in investment portfolio decisions and processes, and the potential impact on capital adequacy of the proportion of the portfolio that consists of high carbon assets. It is also a good practice to make public policies on investing in funds focused on innovation, clean technologies and biofuels, or in companies committed to climate resilience.

66. Where an insurer does not consider climate-related and environmental risks to be material

in relation to its own operations and activities, the MNB expects the insurer to document this decision with qualitative and quantitative information supporting the assessment. The MNB also expects that when an insurer decides not to disclose information on the grounds that it is not material, it should clearly disclose this fact in the relevant report.

67. The MNB also considers it a good practice
    a) for the insurer to publish, at least annually, a comprehensive sustainability report containing, inter alia, meaningful information on the insurer's own GHG emissions, climate exposure and the insurer's contribution to climate change-related or environmental objectives;
    b) for the parent company of the insurer to already publish a regular sustainability report at group level, the Hungarian subsidiary also to publish information – even in a supplementary manner – on the Hungarian entity.

68. Given the rapidly evolving climate and environmental risk disclosure frameworks and the needs of market actors in this area, it is recommended that disclosures should be actively developed on an ongoing basis.

VIII. Closing provisions

69. The Recommendation is a regulatory instrument issued pursuant to Section 13(2)(i) of Act CXXXIX of 2013 on the Magyar Nemzeti Bank, which is not binding on supervised financial institutions. The content of the Recommendation issued by the MNB expresses the requirements imposed by the legislation, the principles and methods proposed to be applied on the basis of the MNB's enforcement practice, market standards and conventions.

70. Compliance with the Recommendation will be monitored and assessed by the MNB in the course of its monitoring and surveillance activities of the financial institutions it supervises, in line with general European supervisory practice.

71. The MNB draws attention to the fact that a financial institution may make the content of the Recommendation part of its policies. In this case, the financial institution is entitled to indicate that its rules comply with the relevant number of Recommendations issued by the MNB. If a financial institution wishes to include only parts of the Recommendation in its policies, it should avoid referring to the Recommendation or should only use reference thereto in respect of the transposed parts of the Recommendation.

72. The MNB expects the insurer to carry out a self-assessment survey, including a detailed gap analysis, in relation to the requirements detailed in this Recommendation, and, on the basis of this survey, to develop an ambitious but feasible plan to address the gaps and submit it to the MNB by 30 June 2024.

73. With the exception of paragraph 72, the MNB expects the relevant financial institutions to apply this Recommendation from 1 January 2025.

Dr György Matolcsy sgd
Governor of the Magyar Nemzeti Bank