19 September 2017

Comments on the interim report of the HLEG on sustainable finance

Question 2. What do you think such an EU taxonomy for sustainable assets and financial products should include?

The taxonomy should provide for an objective and transparent classification of all relevant financial products. Where the taxonomy considers several of the objectives that the concept of sustainability may comprise (environmental, social, economic, governance objectives according to chapter 1 of the interim report) it should clarify how to classify investments that fulfil not all of these objectives, for example where assets provide funding for activities that contribute to economic growth but may be detrimental to the environment.

Question 5. It is frequently stated that the inherent short-termism in finance, especially financial markets, represents a distraction from, or even obstacle to, a long-term orientation in economic decision-making, including investments that are essential for sustainability. Do you agree with this statement?

Yes

Question 5.1. If you agree with this statement, which sectors of the economy and financial system are particularly affected by the 'mismatch of time horizons'? What are possible measures to attenuate this conflict?

With regard to insurance and pension: Policyholders of long-term insurance contracts and long-term beneficiaries of pension funds are prone to have a long-

term time horizon with regard to their insurance cover and the related investments. Apart from specific insurance products like unit-linked life insurance, policyholders and beneficiaries do not have direct influence on the investments made with their premiums. The time horizon of the owners of the insurers, in particular for stock companies, may be significantly shorter than the time horizon of policyholders and beneficiaries and the time horizon for investments that are essential for sustainability. This mismatch may not exist for mutual insurers where owners and policyholders coincide, for insurers with only short-term activities and, for example, for IORPs owned by social partners.

Solvency II contributes to narrowing the mismatch of time horizons by requiring insurers to invest according to the prudent person principle, in particular in a manner appropriate to the duration of liabilities. Furthermore, Solvency II requires asset-liability management and introduces capital requirements for asset-liability mismatch and specific measures on the treatment of insurance products with long-term guarantees. The IORP II Directive requires that IORPs invest assets in the best long-term interests of members and beneficiaries and allows IORPs to take into account the potential long-term impact of investment decisions on ESG factors.

Question 10. What would be the best way to involve insurers more strongly on sustainability, particularly through long-term investments?

Sustainable investment by insurers can be further promoted by comparable disclosure on their sustainability policies and investments, by establishing a clear EU taxonomy for sustainable assets, by labelling sustainable assets, by including ESG factors in insurers' risk and investment management, in particular in their own risk and solvency assessment, and by public ESG-grading of insurers.

Insurers need to hold capital to absorb losses they may incur on their investments. Ignoring these risks in capital requirements may result in misallocation of funding and facilitate boom and bust cycles. Measures taken to promote sustainability should be in line with general Solvency II principles and should not put at risk the financial stability which is a prerequisite for sustainable investment and meeting ESG objectives.

The market-consistent valuation of assets and liabilities under Solvency II is forward-looking and therefore best suited to reflect ESG factors. Unlike other approaches it provides a realistic, objective and comparable basis for the supervisory assessment.

Solvency II supports long-term investments by insurers, in particular by requiring asset-liability management, by introducing the prudent person principle, capital requirements for asset-liability mismatch and by means of

specific measures on the treatment of insurance products with long-term guarantees.

It should be noted that only a portion of equity and long-term investments are in sustainable investments.

Question 12. Do you have any comments on the policy recommendations or policy areas mentioned in the Interim Report but not mentioned in this survey?

Regarding pension funds EIOPA acknowledges three main areas to strengthen the role of ESG factors:

- The IORP II Directive refers to the consideration of ESG factors in its provisions on investment policies, risk management and risk assessment as well as information to members and beneficiaries. The United Nations-supported PRI may be a good starting point to develop further guidance for pension funds.
- EIOPA's Common Framework for Risk Assessment and Transparency for IORPs can be further developed to strengthen the analysis of risks stemming from climate change, use of resources and the environment, social risks and risks related to the depreciation of assets due to regulatory change.
- EIOPA's methodology for IORP stress tests can be complemented by aspects related to stranded assets and can address long-term risks for the sustainability of the pension funds, for example relating to climate change.

All three initiatives aim to equip European pension funds with appropriate tools and a regulatory environment to address sustainability.

EIOPA could consider including sustainability aspects also in the stress testing of the insurance sector.

EIOPA supports the recommendation to clarify and enhance the role of the ESAs in assessing ESG related risks. The main objective of supervision, namely the protection of policy holders and beneficiaries should be kept.

EIOPA considers including expertise on sustainability issues in the ESAs' stakeholder groups as being of value.