EIOPA-IRSG-18-30

Consultation Paper on Technical Advice on the integration of sustainability risks and factors in the delegated acts under Solvency II and IDD

Fields marked with * are mandatory.

EIOPA welcomes comments on its draft technical advice regarding possible amendments to the delegated acts under Solvency II and IDD concerning the integration of sustainability risks and factors. The Consultation Paper with the draft technical advice is published in EIOPA's website: https://eiopa.europa.eu/publications/eiopa-consultations

Comments are most helpful if they:

• respond to the question stated, where applicable;
• contain a clear rationale; and
• describe any alternatives EIOPA should consider.

Please send your comments to EIOPA by responding to the questions in this survey by 30 January 2019.

Contributions not provided using the survey or submitted after the deadline, will not be processed.

Publication of responses
Contributions received will be published on EIOPA’s public website unless you request otherwise in the respective field in this survey. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.
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Contributions will be made available at the end of the public consultation period.

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*Name of your organisation

IRSG

* Your name

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*

Response to this survey to be treated as confidential

- (selected) No
- Yes

*

Your member state

- Austria
- Belgium
- Bulgaria
- Croatia
- Cyprus
- Czech Republic
- Denmark
- Estonia
- Finland
- France
- (selected) Germany
- Greece
- Hungary
- Ireland
- Italy
- Latvia
- Lithuania
- Luxembourg
- Malta
- Netherlands
- Poland
- Portugal
- Romania
- Slovak Republic
- Slovenia
- Spain
- Sweden
- United Kingdom

Type of organisation

- [ ] Insurance or reinsurance undertaking or group
- [ ] Insurance mediation firm
- [ ] Industry association
- [ ] Consumers' representative
- [x] Other

If other, please describe

50 character(s) maximum

EIOPA Insurance and Reinsurance Stakeholder Group

1. What would you estimate as the costs and benefits of the possible changes to the delegated acts under Solvency II outlined in this Consultation?

GENERAL COMMENTS ON THE CONSULTATION PAPER

• The IRSG welcomes the European Commission initiative and the EIOPA proposals on integrating sustainability risk and factors. This is a key topic for society at large and one in which insurers as product providers and investors play a key role.

• Overall, the draft technical advice appears to support the general principle that undertakings are already required to consider material sustainability risks. Risk events such as hail, windstorm and flood risk are examples of these considerations. The majority of EIOPA's proposed amendments seem to be aimed at clarifying this, rather than introducing any new principles.

• We agree with and welcome this approach for material sustainability risks which may result in financial losses (e.g. the financial risks associated with climate change).

• Many of the proposed requirements are already in practice in effect for most firms through local and European legislation, in particular the Non-Financial Reporting Directive (NFRD) requirements which are likely to put the onus on firms to ensure that they have appropriately considered these elements within their Solvency II Pillar 2 frameworks. The proposals may also need to fit with the Shareholder Rights Directive II in certain places.

• EIOPA and EC should consider the implications of implementing the proposed changes in advance of factual and legal clarity regarding the definition and scope of "sustainability risk", as well as the absence of education, testing, operational implementation and consideration of practical implications. Different interpretations across borders is a distinct possibility in the absence of clarity of definition.

• We consider that the proposed explicit references to sustainability risks may help insurers to integrate such risks into their risk management function. That being said, some stakeholders have expressed concern that isolating sustainability risks in the regulation may give inappropriate emphasis to sustainability potentially at the expense of other risks.

• EIOPA should consider including a distinction between "financial" risks which impact on insurance companies and their customers and broader "non-financial" or societal sustainability risks. Solvency II legislation, as prudential insurance regulation, is not designed to address the wider societal risks and implications.

- It can be difficult to ascertain the nature of customer preferences, particularly relating to something such as sustainability which is relatively intangible for many in an investment context. We suggest that caution be exercised in requiring actions based on an interpretation of customer preference which may be not fully formed, particularly in the absence of clear taxonomy, and may differ from undertaking to undertaking. An alternative suggested within the IRSG may be to consider the approach adopted in the Shareholder Rights Directive II.

ANSWER TO QUESTION 1
The scope and regulatory burdens are difficult to estimate in the absence of a clear definition of sustainability risk. Having said that, most costs are linked to:

- working with specialists (e.g. internal recruitment, external services),
- access to sustainability data, and
- IT systems

At fund level, costs would also come from the additional reporting requirements to demonstrate ESG compliance, which are expected to raise the cost of the funds to the customer. If a recognised index data, for example MSCI or sustainability, is used, this is likely to come with large licence costs.

Potential benefits can be identified in the promotion of sound risk management and an enhanced awareness of the issue of sustainability. This can contribute to mitigating and building resilience against long term climate risk, which represents a significant threat to the insurance sector and wider financial system. This is on the basis that amendments made:

- maintain, but do not exceed, the overall established risk-based framework
- do not put excessive focus on sustainability risks at the expenses of other risks.

As far as possible, please link the costs and benefits you identify to the possible changes that would drive these. In relation to that, please provide, where possible, stating the assumptions underlying your calculations:

a) estimates of one-off and ongoing quantitative costs of change, in euros and relative to your turnover as relevant;

b) evidence on potential qualitative costs of change, please consider both the short and longer term;

c) evidence on potential benefits of the possible changes, please consider both the short and longer term.

2. What would you estimate as the costs and benefits of the possible changes to the delegated acts under IDD outlined in this Consultation?

The exact costs are difficult to estimate, but implementation costs in relation to the types of change proposed for insurance undertakings could be high. The potential burden on providers and ultimately on customers should be taken into account when new distribution obligations are introduced. This includes the disclosure requirements on ESG and the additions to the regulations on advice which are currently developed as separate legislative acts.

Unnecessary cost drivers should be avoided. An example would be the introduction of obligations on disclosure and advice before the underlying regulation on a common taxonomy is finalised. In this case, providers would have to develop processes and criteria to comply with the obligations twice within a relatively short time, which would not be appropriate. In addition, being obliged to develop own ESG criteria ahead of the agreement on an EU taxonomy also creates considerable liability risks as customers might challenge companies' ESG criteria, once the EU taxonomy is available – possibly years after the companies have been obliged to develop their own criteria.

Creation of awareness among policyholders and new customers buying insurance services on how sustainability has been taken into account in the offering will be a valuable development. When the awareness increases it is likely that there will also be more demand for insurance products taking into account the different aspects on sustainability (e.g. carbon footprint). Actual benefits are difficult to quantify, with elements such as demand for and supply of sustainable investments as well as counterparty risk factors adding to complexity.

As far as possible, please link the costs and benefits you identify to the possible changes that would drive these. In relation to that, please provide, where possible, stating the assumptions underlying your calculations:

a) estimates of one-off and ongoing quantitative costs of change, in euros and relative to your turnover as relevant;

b) evidence on potential qualitative costs of change, please consider both the short and longer term;

c) evidence on potential benefits of the possible changes, please consider both the short and longer term.

3. Do you agree with the proposed reference on the tasks of the risk management function?

- (selected) Yes
- No

Please give reasons for your answer:

Yes, in fact, already now financial material sustainability risks are implicitly taken into account in risk management, ORSA and decision processes of AMSB. The proposed explicit references might help insurers to further integrate sustainability risks in the risk management function.

In order to ensure that the focus on the policyholder's protection is maintained, we suggest that the amendment to point (e) be revised to include the words "…which affect the undertaking's risk profile" at the end.

We also explicitly support the statement in paragraph 17 of the consultation paper (ie "sustainability risks, in the same way as legal or emerging risks, tend to materialize through existing risk categories such as credit risk or property risk" and "EIOPA does not consider sustainability risks to be a sub-category of emerging risks"). Sustainability risks should be considered at the same level as other risks, being more of a new risk driver rather than a separate category. There is a risk that isolating sustainability risks in the regulation may give inappropriate emphasis to sustainability potentially at the expense of other risks.
Overall, the draft technical advice appears to support the general principle that undertakings are already required to consider material sustainability risks. The majority of EIOPA's proposed amendments seem to be aimed at clarifying this, rather than introducing any new principles. We agree with and welcome this approach for material sustainability risks which may result in financial losses (e.g. the financial risks associated with climate change).

That being said, the draft advice does not propose a definition for sustainability risks, and makes no distinction between insurance- and company-specific financial sustainability risks and those risks which are "non-financial". It is not clear whether the existing framework would be effective for integrating sustainability risks which may result in damage to the environment or society, but not in direct financial losses to the undertaking. EIOPA may wish to emphasise to the EU Commission that Solvency II legislation, as prudential insurance regulation, is not designed to address the wider societal risks and implications.
We agree that the principle of proportionality should remain central and this should lead to simplification of approach for smaller and less complex insurers. Shortage of ESG skills could be a particular barrier for smaller undertakings.
The EIOPA consultation paper mentions a gap in the necessary skills and knowledge to identify, measure and manage sustainability risks. This is a fundamental issue because the prudent person principle relies on the fact that an insurance undertaking will only invest in assets and instruments whose risks can be properly identified, measured, monitored, managed, controlled and reported (point 49). EIOPA should engage with the risk management community with regards to the ways in which these risks can be identified and measured through quantitative and qualitative methods.

4. Would you propose any other amendment to the organisational requirements in the Solvency II Delegated Regulation to ensure the effectiveness and adequacy of sustainability risk integration?

No.

We support EIOPA’s view regarding the fitness requirements and the content of the remuneration policy. Specifically, the fitness requirements and the content of the remuneration policy do not need to be adapted in Level 2 as the Delegated Regulation does not contain any specific organisational provisions for specific risk areas. Adding explicit reference to sustainability risks would not be consistent with this approach.

In addition to EIOPA’s proposed changes to the Delegated Regulation under Solvency II and IDD, the integration of sustainability risks in the insurers’ investment processes would also benefit from more clarity with regard to the role of asset/fund managers and debt/equity issuers in terms of the sustainability information they are required to publish. This is key especially given the high level of outsourcing of these activities.

5. Do you agree with the proposed new article for the integration of sustainability risks into the prudent person principle?

- Yes
- No

Please give reasons for your answer:

We welcome the proposal to integrate sustainability into the prudent person principle PPP. It is though already implicitly included as sustainability related risks form part of the risk universe to be considered by insurers in their decision making. In current legislation, the prudent person principle requires undertakings to consider any factors that impact the security, quality, liquidity and profitability of the portfolio. Therefore, sustainability risks should be recognised within the existing prudent person principle as other risks.

An explicit reference to sustainability risks in the first paragraph of the new Art. 275bis should refer to all “financially relevant risks” and should not focus on sustainability risks at the expense of other risks. Therefore, we would propose the following amendment to Art. 275bis (1):

“1. Within the prudent person principle, insurance and reinsurance undertakings shall take into account "all financially relevant risks the undertaking is or could be exposed to, including" sustainability risks, when assessing the security, quality, liquidity, and profitability of the portfolio as a whole.”

This specification would help limit the risk of imbalance in regulatory requirements caused by highlighting specific risks in an area still under development. The risk of over-emphasizing ESG aspects and of promoting investments in certain assets would also be limited, as well as the related unintended consequences arising from it.

This clarification is also in the interest of policyholders and shareholders as it would help insurers implement a more proportionate investment strategy and it would limit the burden to analyse sustainability risks that are not financially relevant for policyholders.

Regarding Art. 275bis (2), the proposed recital could set an impossible task for insurers as, even should insurers be aware of the ESG preferences of their policyholders (which is not the case across all policyholders at all times) it would realistically not be practical to reflect the preferences of all policyholders. It may also result in a contradiction to Art. 133 of the Solvency II Directive (freedom of investment). In order to allow and even promote engagement strategies and stewardship activities by (re)insurers, the proposed

amendment to the second paragraph of the new Art. 275bis should:

- recognise the existing issues in terms of feasibility and proportionality.
- be in line with existing requirements posed by the IORPII Directive, (as per paragraph 62 of the consultation paper)
- acknowledge that engagement (in direct as well as indirect investments via funds) can be very costly and that its effectiveness can be questionable depending on the portfolio types (eg equity versus bond) and the size of the investing undertaking (eg small versus large).

Some stakeholders support the requirement to reflect policyholders' ESG preferences as part of the prudent person principle, where relevant and known (i.e. where the underlying insurance product is designed to give policyholders a choice to select their ESG preferences). This is also consistent with the proposed new recital. On Art. 275bis (2), some stakeholders suggested that the proposed requirement to "take into account the potential long-term impact of investment decisions on sustainability factors" should be an option and not compulsory.
Other stakeholders believe that, with respect to the preferences of policyholders, ESG policyholders' preferences should not be referenced in the prudential framework on the basis that this is not the proper area to deal with this issue. As a consequence, they propose that the reference to policyholders' preferences should be removed from Art. 275bis, with the proposed new recital in the Solvency II Delegated Regulation being amended as follows:

"(xx) Insurance undertakings should reflect the preferences of policyholders and beneficiaries, including environmental, social and governance preferences, in their investment portfolio where these preferences are relevant for the product oversight and governance arrangements according to Directive 2016/97 and Commission Delegated Regulation 2017/2358."

These changes would ensure the maintenance of the link between Solvency II and IDD with regard to policyholders' preferences and that all types of preferences, not only ESG preferences, are dealt with in the IDD. This will also avoid that changes negatively affect policyholder protection and the risk-based framework.

6. Do you agree with the proposed amendment of the article for the actuarial function?

- (x) Yes
- ( ) No

Please give reasons for your answer:

Yes, we agree with the inclusion of sustainability risks in the list of other risks such as inflation, legal risk, etc. In doing so it is important that sustainability risks are adequately addressed but do not take precedence over other risks. We note that this requirement in relation to the actuarial function is limited to the underwriting policy and does not extend to requiring additional reserves or risk capital, as is appropriate in light of the mandate for this advice.

7. Do you agree with the proposed reference to sustainability risks under the investment as well as the underwriting and reserving risk management policy?

- ○ Yes
- ○ No

Please give reasons for your answer:

Regarding changes to Art 260 (1)(a)(i)
We suggest that sustainability risk is already a factor to be considered and does not need to be separately identified. If it is to be separately identified, we suggest the following addition to the amendment, reflecting the fact that sustainability risks will not always be a factor in these considerations: "(…) due to internal or external factors, including sustainability risks where appropriate".

Regarding Art 260, new paragraph 1(c)(vi)
Given the inclusion of sustainability risks in the prudent person principle (Article 275bis (1)), we believe that this new paragraph is redundant. Paragraph 1(c)(i) already requires the investment risk management policy to include "actions to be taken by the insurance or reinsurance undertaking to ensure that the undertaking's investments comply with the prudent person principle". Therefore, sustainability risks are already considered.

In case EIOPA decides to include paragraph (vi), it should be clear that this responsibility should fall first with the investee who has to identify, manage and assess their own exposure to sustainability risks.

In addition, the insurance undertaking should identify, assess and manage sustainability risk only when these risks can have material financial impacts on the insurance undertaking.

8. Do you agree that other risk management policies may include reference to sustainability risks?

- ● Yes
- ○ No

Please give reasons for your answer:

Yes, provided sustainability risks are financially relevant and material. The inclusion of "where appropriate" is welcome as this amendment allows for considering sustainability without putting too much focus on this specific risk at the expense of other risks. There is a danger that this change as drafted could lead to a change other than in the area of investment management policies; such other areas are not covered by EIOPA's mandate.

9. Do you agree with the proposed requirement to include consideration of the effect of sustainability risks in the overall solvency needs assessment of the undertakings' ORSA?

- [x] Yes
- [ ] No

Please give reasons for your answer:

Yes, the link between sustainability risks and the ORSA is critical and the "effects of sustainability risks" on the risk profile should be taken into account.

It is key that sustainability risks get the same treatment as operational risks; therefore we propose the following amendment (including the removal of point iii from the proposal): “risks the undertaking is or could be exposed to, taking into account potential future changes to its risk profile, including operational risks and sustainability risks where appropriate, due to:
i. The undertaking’s business strategy
ii. The economic and financial environment”

10. Do you agree that conflicts of interest may also arise with regard to the ESG objectives of customers of insurance undertakings and insurance intermediaries.

- [ ] Yes
- [ ] No

Please give reasons for your answer:

The IDD and its Delegated Regulation already establish criteria for determining different types of conflicts of interest. Any potential conflicts of interest that may arise with regard to ESG objectives will be captured by these criteria and should be handled in the same way as any other conflict of interest under the IDD.

It is important that there is legal certainty in relation to terms used in regulation in order to avoid liability risks. The suggested draft technical advices in the IDD Delegated Regulation 2017/2359 and 2017/2358, in particular the term "where relevant" should be defined in the IDD itself (Level 2) and not in the Delegated Acts. Ideally, the full set of criteria relevant to ESG should be adopted in the EU and national legislative processes, including testing and implementation in product development and investment processes, before they become legally binding. This process should also include sufficient financial education and understanding for all concerned, including financial advisors and intermediaries, including understanding the consequences of choices made by consumers. It will take considerable time for the real economy and target investments to qualify against a new ESG taxonomy and for product development for insurance products, including testing and training, to be complete. Some stakeholders suggest that, while such transition is taking place, the requirements should start with a voluntary testing phase for ESG advice, with provisions becoming compulsory following transition.

11. Do you agree that conflicts of interest with the ESG objectives of customers may arise, particularly in regards to the investment strategy for the customers’ assets and the shareholder rights in companies in which the customers’ assets with ESG preferences are invested?

- [ ] Yes
- [ ] No

Please give reasons for your answer:

The IDD and its Delegated Regulation already establish criteria for determining different types of conflicts of interest. These criteria already capture any such conflicts of interest that might arise from taking into account sustainability considerations.

Assets invested according to ESG concepts could have a higher, lower or the same yield than other investments. The assessment of what factors are deemed relevant to best meet the insurer's objectives and liabilities against those of its policyholders needs to be a company specific decision. Requiring insurance undertakings to invest under considerations of sustainability factors could result in a detriment to customers without such preferences.

12. What other situations do you envisage might give rise to conflicts of interest between the interest of customers in attaining their ESG objectives and an interest of another party?

The IDD states that there should be no incentive to recommend a given product other than in the best interests of the customer (Article 17(3) IDD, Recital 46). MiFID II sets similar requirements (Recital 56 and Article 23(1)). The proposal for a regulation on disclosures on sustainable investments and sustainability risks aims to contribute to long-term sustainable growth in general and encourages market participants to act accordingly (Recital 5). Article 4 (1) (c) and (2) (c) of the EC´s draft sets out disclosure obligations on how remuneration policies are consistent with the sustainable investment target of the product in question. Conflicts of interest might therefore arise if remuneration policies are required to be set up in such way as to meet certain sustainability targets, such that employees would be incentivised to recommend a particular product to a customer. This would potentially conflict with the customer's demands and needs, and the requirement to act in his or her best interests.

13. What measures, if any, should be taken to address conflicts of interest arising specifically between the customer's interest in attaining his ESG objectives and the interest of another party?

The steps to be taken should be the same as for conflicts of interest which may arise in relation to any other objectives of the customer. Any potential conflicts of interest that may arise will therefore be addressed in the same way as any other conflict of interest under the IDD.

Some stakeholders are concerned that qualitative requirements should not distract the customer from their primary demands and needs where these relate to insurance, and that ESG related advice should therefore be offered to the customer as an additional service on a voluntary basis in such circumstances.

14. What current market standards or "labels" are you going to take into account or already taking into account for the consideration of ESG factors? Do you see any issues when relying on current market standards or "labels"? Please describe.

For industrial business, with UNEP_FI and the Principles for Sustainable Insurance the industry is developing shared industry guidance on material ESG factors for different types of sectors/underwriting. On the personal lines side there are currently no market standards, however some property coverage recognizes energy efficiency standards in the pricing or when implementing sustainable claims (e.g. BREEAM, LEED), but this is in the minority.

An example is available relating to Folksam in Sweden, where non life insurance had the Swedish label ”Bra miljöval” (good environmental choice). The undertaking thereby committed not only to the physical aspects to the insurance (like replacement cars, rebuilding material etc) but also to certain environmental standards in the investment portfolio. This was a way to address consumer preferences.

15. Do you agree with the proposed amendments, in particular whether the ESG preferences of the customers should be considered in the assessment of the target market?

- Yes
- No

Please give reasons for your answer:

We would support the proposed approach of EIOPA that insurance undertakings would not be required to consider ESG factors in the product approval process of all insurance products, but only if the insurance product is to be addressed to customers with ESG preferences. In other words, that the ESG preferences of customers would be considered in the assessment of the target market only with regard to "ESG products". Please note the comments below for some qualifications in relation to this point.

However, it can be difficult to ascertain the nature of customer preferences, particularly relating to something such as sustainability which is relatively intangible for many in an investment context. We suggest that caution be exercised in requiring actions based on an interpretation of customer preference which may be not fully formed, particularly in the absence of clear taxonomy.

The objective of the POG rules is to make sure that a product is compatible with the needs, characteristics and objectives of the customers belonging to the target market. If the product is addressed to customers whose specific requirements with regard to the product contains ESG preferences, these preferences are part of the targeted customers' objectives and needs. They should therefore be included in the assessment of the target market for this particular product.

Too detailed requirements for sustainability in the POG regulations would be a hindrance, as there is no taxonomy created for ESG criteria yet that would form a transparent basis for customer information and product qualification. Against this background any compulsory advice on such aspects is prone to be misleading and causing liability issues in addition to potential frustration on the customer side towards the overall aims of sustainability. Additional aspects of the investment strategy such as sustainable investment and environmental targets are not conducive to providing customer risk protection per se. As the main purpose of life (and some investment) related insurance products is to cover longevity and mortality risk and to therefore provide a sound investment strategy for such risks, the currently established methodology to define and assess target markets for such products rightfully concentrates on the specific needs of customer groups with regards to those needs. Whether and to what extent the underlying investment strategy would include in addition sustainability considerations should be optional, both for the product manufacturer and also for the retail customer. Currently, there is not sufficient evidence that such sustainability considerations would be sufficiently clearly defined and the investment benefit or superior viability of such investments is not proven with sufficient evidence. Therefore some stakeholders consider that there should not be a requirement for mandatory sustainability considerations in target market assessment.

16. Do you agree that the identification of the target market should specify whether an insurance product is compatible being distributed to customers with ESG objectives or not?

- Yes
- No

Please give reasons for your answer:

ESG objectives, like any other features, should be considered in the description of the target market only if the product is designed for customers with these preferences (see comments elsewhere in relation to the need for clear definition).

While ESG products might offer a new category of products it should be stressed that it is currently highly uncertain under which circumstances and to which costs a compatible ESG product could be developed.

17. Do you agree that the testing of the insurance product during the approval process as well as the monitoring and reviewing of the insurance product during its lifetime should comprise the ESG factors?

- Yes
- No

Please give reasons for your answer:

Insurance products with an explicit ESG profile have to be validated initially and over time to ensure the trust of customers. However, such testing should be voluntary and at best be marketed by an ESG label that is based on a common taxonomy. Sustainability considerations affect the whole POG requirements for insurers, e.g. of course the product approval process and identification of the target market and the group of compatible customers during the product approval process.

Contact

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