Solvency II Sustainability risk plans

European insurers strongly support the drive towards sustainability and are ready to build on their current actions to contribute further to the transition to a more sustainable society and to play their role in achieving the targets of the EU Green Deal. At the same time, it is important to note that sustainability risks are already addressed in Solvency II, with further enhancements implemented in August 2022. Any new requirements detailed in the Level 2 texts stemming from the Level 1 Solvency Review should be strictly limited to those truly required and should avoid overlaps with other legislation.

The SII Review text (recital 5a) also recognises that, "numerous legislative acts have recently been proposed and adopted to improve resilience and contribution to sustainability, in particular in relation to sustainability reporting". Sustainability risk plans form a part of the new sustainability requirements agreed for inclusion in Solvency II (see Art 44 of the draft amending Directive). It is important to note the sustainability risk plan requirements are in addition to the other legislative acts and are different from Corporate Sustainability Reporting Directive (CSRD) and Corporate Sustainability Due Diligence Directive (CSDDD) requirements.

This paper outlines initial views on the "sustainability risk plan" requirements and offers emerging industry perspectives. It is aimed at clarifying the interpretation and implementation of rules in various directives, not as guidance for implementation. The paper emphasises that insurers should have maximum freedom to implement these rules.

Naming conventions

To facilitate future discussion on the content, approaches, and requirements of the differing sustainability regulations, it is important to use consistent and understandable language to describe the various requirements.

For completeness it is noted that CSRD also includes the option to disclose biodiversity elements as part of the transition plan[1].

Insurance Europe view:

The industry supports the use of the following naming conventions:

- Sustainability risk plan: Requirements arising from amendments to Article 44 of the Solvency II Directive
- Net-Zero transition plan: Requirement arising from CSDDD/CSRD for a transition plan ensuring that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement.

[1] See ESRS 2 E4-1 – Transition plan and consideration of biodiversity and ecosystems in strategy and business model.

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Emerging industry views

A consolidated view of climate change risks will result in inherent consistency between the distinct requirements for sustainability risk plans and net-zero transition plans

While consistency is paramount in addressing both sustainability risk plans and net-zero transition plans, the industry advocates for a clear regulatory separation between sustainability risk plans and net-zero transition plans due to their distinct focuses.

Consistency between the two plans should be a natural consequence of the fact that insurers will only have a single view on the development of their business model and strategy due to climate change. Both plans will be developed from this starting point.

- **Sustainability risk plans:** monitor and address the financial risks arising from sustainability factors, focusing on risk-management aspects (part of Art 44 on risk-management) of the transition, such as the strategic/financial risks associated with not implementing transition strategies (including those for transitioning towards the relevant MS/Union regulatory objectives and legal acts in relation to sustainability factors).
- **Net-Zero transition plans:** adopt and implement a transition plan for climate change mitigation compatible with the Paris Agreement, that may include for example certain emission reduction objectives/targets set by the company (note that the sustainability risk plan also requires having targets but these are not focused on emissions).

A regulatory separation of the plans should:

- Ensure Solvency II requirements focus on prudential aspects i.e. the financial risk aspects of sustainability.
- Ensure that NSA supervision remains based on prudential aspects and is not impaired by supervision of the net-zero transition plans.
- Mitigate timing issues arising from differing implementation timelines (e.g. arising from potentially earlier implementation of Solvency II requirements compared to CSRD)[2].
- Limit sustainability risk plan disclosure requirements to what is necessary.

Insurance Europe view:

- A single strategy as well as a unified risk management perspective underlies the requirements and companies have flexibility on how to fulfill these requirements.
- There is a clear regulatory separation between sustainability risk plans and net-zero transition plans. Duplicating requirements across both plans should be avoided.
- Only sustainability risk plans should fall under EIOPA's mandate and NSA supervision.

Place and content of sustainability risk plans

Sustainability risk plan requirements fall under risk management requirements (Art. 44), and, as such, should be allowed to leverage relevant work conducted within the ORSA context. This ensures company ownership and responsibility for analysis and conclusions.

While individual companies may determine the content of sustainability risk plan, EIOPA's mandate to draft RTSs on various aspects suggests a level of standardisation. Since August 2022, Solvency II already includes significant sustainability requirements based on EIOPA's advice on integrating sustainability risks[3].

A logical starting point for the plans' content is the work companies are already doing. Conducting a gap analysis can identify any additional requirements. For climate change risks, the gap analysis should be straightforward since assessing financial risks from transitioning to net zero is similar to ORSA's climate change scenario analysis.

[2] CSRD started applying on 1/1/24. Important question revolves around the phasing in of requirements to consider and quantify financial impacts (3-year period for full compliance).

[3] EIOPA opinion on sustainability within Solvency II' here and 'Technical advice on the integration of sustainability risks and factors in Solvency II and the IDD' here.

Insurance Europe view:

- Sustainability risk plans should be allowed to be based on relevant ORSA work, particularly climate change scenario analysis.
- Further content of the sustainability risk plan is expected to be limited and should be determined through a step-by-step approach. This includes first reassessing existing requirements, followed by conducting a gap analysis. At the same time, the content of the plans should be strictly limited to the ESG-factors/risks deemed material by the undertaking.

Disclosure

The co-legislators have agreed that insurers must annually disclose the quantifiable targets outlined in the sustainability risk plan. EIOPA must advise on the elements requiring disclosure. Dir Article 51 1c (cc) **mandates disclosing the relevant sustainability risk plan items as determined by EIOPA in the SFCR.** When specifying the items to be disclosed, EIOPA should also specify that these elements only have to be required to be disclosed in the part for other market professionals.

There are already extensive reporting and disclosure requirements in the sustainability area including, CSRD, SFDR, CSDDD and the sustainability taxonomy. To minimise the risk of inconsistencies, misinterpretation and overlap, further disclosure requirements for sustainability risk plans are considered to be unnecessary and should be limited.

Insurance Europe view:

- Disclosure requirements should be limited to the strict regulatory minimum, to avoid confusion, ensure consistency and prevent duplication.

Targets

Companies must set and disclose quantifiable targets as part of their sustainability risk plans. The methodologies and assumptions underlying these targets must be consistent with methodologies and assumptions underlying the targets, the commitments and strategic decisions of the net-zero transition plans, where relevant. While net-zero targets are clear, appropriate targets for sustainability risk plans are less obvious (e.g. "maximum acceptable amount of loss on stranded assets" or "maximum % of portfolio exposed to assets identified as having stranded asset risk").

Regarding potential targets (Dir Art 44 (2b)):

- Sustainability risk plans should focus on the financial impacts for the insurer stemming from sustainability factors. For example, GHG transition would not need to be reported, but the plan should address how this transition will impact insurers.
- Sustainability risk plan targets must consider the latest reports and measures prescribed by the EU Scientific Advisory Board on Climate change, particular in relation to the achievement of the climate targets of the Union.
- Suggested potential targets:
    - Exposure to climate change-related risks, detailed by main perils and zones (macro level), with the evolution of these exposures according to plan.
    - A prevention index could be devised from internal plans to develop prevention on targeted risks (e.g. annual expenses on prevention for flood, subsidence, etc.)

Insurance Europe view:

Specifically, regarding **the targets to be disclosed:**

- Only the highest priority targets should be disclosed.
- The targets should be sufficiently high level to maintain business strategy confidentiality.
- There must be consistency between methodologies and assumptions underpinning the net-zero transition plan targets and sustainability risk plan targets.
- The targets should take into consideration all current and forthcoming required sustainability information, in order to avoid duplication and ensure usefulness to stakeholders, including policyholders and beneficiaries.

Implementation and sequencing

Ensuring a smooth transition period is essential to minimise disruptions to insurers' operations from potential simultaneous legislative implementations. There will be interlinkages between sustainability risk plans and net-zero transition plans. Additionally, the SII Directive requires consistency in disclosed information and actions regarding the business model and the strategy. Given CSDDD's likely later application compared to Solvency II, the RTS prepared by EIOPA should avoid inconsistencies where possible.

Insurance Europe view:

- The RTS being prepared by EIOPA should avoid inconsistencies with other regulatory requirements.
- Flexibility should be allowed for companies not covered by CSDDD to develop sustainability risk plans without mandatory net-zero targets.

Groups

An exemption from individual plans is foreseen for subsidiaries that are covered by the group sustainability risk plan (Dir Art 44 2e). This is important because it ensures consistency within the group and reduces the operational burden by avoiding duplication of work at the subsidiary level.

Insurance Europe view:

- Group-level plans can be used to satisfy any subsidiary-level requirements.

Proportionality

The requirements should be restricted to material financial risks. The Directive text states that the targets, processes and actions in the plans should be proportionate to the nature, scale and complexity of the business model's sustainability risks. SNCUs are not automatically exempted, but ideally should be, in line with the exemption for climate change scenario analysis.

Insurance Europe view:

- Requirements should be restricted to material financial risks[4].
- Exempt SNCUs from sustainability risk plan requirements, aligning with climate change scenario analysis exemptions.

[4] Note the CSRD already requires the disclosure of anticipated financial effects from material physical/transition risks and the potential to benefit from material climate-related opportunities. (Disclosure Requirement E1-9)