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Position Paper

Response to EC consultation on the draft amendments to the Solvency II Delegated Regulation

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Summary

The European insurance industry supports the EC's sustainability objectives and is fully committed to integrate sustainability into its business model. The sector already does this in a number of ways: eg, prevention and adaptation, loss protection/compensation and long-term, sustainable financing of the economy.

The Solvency II framework currently does not represent an obstacle to the integration and measurement of sustainability risks. In fact, financially material sustainability risks can be taken into account in risk management, the own risk and solvency assessment (ORSA) and decision processes of the administrative management or supervisory board (AMSB). In this context, the explicit references to sustainability proposed by the EC will help strengthen the integration of sustainability risks into the Solvency II framework in a consistent and efficient manner.

The sector generally welcomes the EC amendments to integrate sustainability risks into insurers' prudential framework and appreciates the explicit integration of sustainability risks in certain aspects of the regulation. However, Insurance Europe offers the following suggestions to improve the EC's proposal.

Definitions (article 1)

- The **proposed definition (article 1, point 55e) of sustainability preferences is inconsistent and should be removed** or amended to avoid misalignment between regulations and unintended effects. Clarification with respect to the Disclosure Regulation (SFDR) should be provided in the regulatory technical standards (RTS) of the SFDR, not in the sustainability preferences definition in the context of the Insurance Distribution Directive (IDD) or Solvency II (see detailed comments).

Risk Management Areas (article 260)

The industry appreciates the EC's amendment proposals for risk management areas:

- With respect to article 260 (1)(a)(i), Insurance Europe suggests the following addition to clarify the amendment: *"(…) due to internal or external factors, including sustainability risks **where appropriate**"*.

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- Regarding paragraph 1(c)(vi) of article 260, given the inclusion of sustainability risks in the prudent person principle (Article 275a(2)), Insurance Europe deems this new paragraph redundant. Paragraph 1(c)(i) already requires consideration of sustainability risks via the prudent person principle.
- Regarding the wording of article 260 new paragraph 1a, the following wording would offer improved clarity: *"The insurance and reinsurance undertakings shall integrate **sustainability risks where appropriate** in their policies referred to in points (a) and (c) of paragraph 1, and where relevant, **in the** policies on the other areas referred to in paragraph 1, ~~sustainability risks~~."*

Risk management function (article 269)

- Regarding paragraph 1a) in article 269, the industry agrees that the **consideration of material sustainability risks should be included in the ORSA**. Nevertheless, insurers should be able to decide whether the ORSA is the right instrument to capture sustainability risks over time. Sustainability risks can materialise via existing risk categories and should therefore be considered at the same level as other risks. Therefore, it is key that the analysis of sustainability risks is dependent on the company-specific strategy and risk assessment, based on financially material effects.

Actuarial function (article 272)

- The proposed amendments regarding the tasks of the **actuarial function** are welcome.

Remuneration policy (article 275)

- The amendment on the **remuneration policy** should not overlaps with existing requirements.

Sustainability in the prudent person principle (article 275a)

The insurance industry believes that article 275a should be improved for consistency and feasibility. As Solvency II is designed for the policyholder's protection, considerations on the policyholder's preferences should not be introduced in this article.

- To avoid an imbalance in regulatory requirements caused by highlighting only particular risks in an area under development, the following amendment is proposed to **article 275a (1)**: *"When identifying, measuring, monitoring, managing, controlling **and** reporting ~~**and assessing**~~ risks arising from investments, as referred to in the first sub-paragraph of Article 132(2) of Directive 2009/138/EC, insurance and reinsurance undertakings shall take into account **all actual or a potential financially material risks, including** sustainability risks."* This clarification would help insurers implement a more proportionate investment strategy in the interest of policyholders and shareholders.
- **Regarding article 275a (2)**, the sector suggests that the current wording should be amended to:
  - Recognise the existing difficulties in terms of feasibility and proportionality.
  - Acknowledge that the impact of investment decisions on sustainability factors (eg via engagement) can be very costly and that its effectiveness can be questionable depending on the type of portfolio (eg, equity versus bond) and the size of the investing undertaking.
  - Not contradict the principle of freedom of investment.
- **The reference to the ESG preferences of policyholders** in article 275a(2) should be removed. The sector takes the view that the ESG preferences of policyholders should be taken into account under the IDD, rather than under Solvency II. This will prevent potential inconsistencies with the Solvency II objective of policyholders' protection.

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Detailed Comments on the EC's draft Solvency II amendments

Definitions (article 1)

- With respect to the **proposed amendments to the Solvency II** Delegated Acts, the insurance industry welcomes that the EC provides clarity on the definition of sustainability risks and factors, and that this is consistent with existing legislation.
- The industry also welcomes the fact that sustainability risks are considered within **existing Solvency II requirements and in relation to the undertaking's risk profile,** based on their financial materiality and that they are coherent with the specific undertaking's organisational structure and governance.
- With respect to sustainability risks, the industry also notes that Solvency II has been designed as a **risk-based framework with the objective of protecting policyholders**. In this respect, any proposal to change the framework should ensure that it remains risk-based. Therefore, sustainability risks should be considered at the same level as other risks, especially given that these risks can materialise through already existing risk categories.
- On article 1, point 55 e) regarding **sustainability preferences, the insurance industry is concerned by the proposed wording and strongly encourages the EC to re-examine the current definition. Specifically:**
  - The reference to sustainable investments (Article 1, 55e, point i) and the consideration of principal adverse impacts (Article 1, 55e, point ii) for products promoting environmental or social objectives is not relevant and should be removed to avoid confusion and inconsistencies.
  - The industry appreciates the EC's efforts to achieve legislative coherence across EU legislation and acknowledges the need for clarifications on the difference between "article 8" and "article 9" products of the Sustainable Finance Disclosures Regulation (SFDR) and the consideration of principal adverse impacts on sustainability factors. However, **these clarifications should be given in the RTS of the SFDR and not in the definition of the sustainability preferences in the context of the IDD or Solvency II**. If such references are introduced, there is a risk of misalignment between regulations and unintended effects.
  - To illustrate the above-mentioned issues, let us consider the following example of French Sustainable Responsible Investment (SRI) labelled products. These products are eligible as an article 8 product under the SFDR; do not have sustainable investments as an objective; nor do they require excluding underlying assets with significant adverse impacts. However, these products would still promote environmental and social characteristics as the awarded funds select investee companies based on their ESG performance. Therefore, they should not be excluded by the definition of sustainability preferences. This example shows how the current definition – by making references to sustainable investments and consideration of principal adverse impacts – would consider such SRI labelled products as inadequate to meet customers' ESG preferences, even if they are eligible as article 8 products of the SFDR. To ensure consistency, the industry stresses that article 8 and article 9 products under the SFDR should be able to answer consumers' sustainability preferences with no further requirements proposed under the Solvency framework. The proposed definition lacks the flexibility to allow insurers to react to the needs of their customers.

Risk Management Areas (article 260)

Being supportive of the EC's sustainability objectives, the insurance industry appreciates the EC's amendments for risk management areas. Even if the current Solvency II framework does not represent an obstacle to the integration of sustainability risks – including in the risk management function, the proposed explicit references might help integrate sustainability risks consistently and more efficiently in the risk management function. This is appreciated especially in consideration of the importance of this subject and its relevance in the years to come.

- With respect to article 260 (1)(a)(i) on underwriting and reserving, the industry is of the opinion that, while consideration of sustainability aspects as part of all business processes is supported, the proposal to consider sustainability risks in the underwriting policy would represent a duplication of the

requirements already implied in the Solvency II framework. Should the EC consider it necessary to include an explicit reference to sustainability risks, Insurance Europe suggests the following addition to the amendment: *"(…) due to internal or external factors, including sustainability risks **where appropriate**"*. The need for this clarification is even more relevant for the liabilities of non-life insurers, with the effects of climate change possibly becoming more evident over time. If time-series trends in the technical provisions show an increase in the claims expectations, insurers will normally react by means of premium adjustments – possible because of the short-term nature of insurance contracts – or by means of adjusting their reinsurance programmes.

- Regarding paragraph 1(c)(vi) of article 260, given the inclusion of sustainability risks in the prudent person principle (Article 275a(2)), Insurance Europe considers this new paragraph 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. Should the EC maintain this amendment, it needs to be clear that the insurance undertaking should aim to identify, assess and manage these sustainability risks only when the risks can have a material financial impact on the insurance undertaking.
- The wording in article 260 (new paragraph 1a) requires the integration of sustainability risks within appropriate policies. In this respect, the industry appreciates that insurers will be allowed to consider the inclusion of references to sustainability risks in other risk management policies based on financial materiality and relevance. Therefore, Insurance Europe welcomes the inclusion of "where relevant" in the wording of paragraph 1a. While references to material sustainability risks in risk management policies are acceptable, it is important to strike the right balance of risk consideration in risk management practice and supervisory review, without putting excessive focus on sustainability risks at the expenses of other risks. Therefore, the industry encourages the EC to consider the following wording in order to improve the clarity of the article: "*The insurance and reinsurance undertakings shall integrate **sustainability risks where appropriate** in their policies referred to in points (a) and (c) of paragraph 1, and where relevant, **in the** policies on the other areas referred to in paragraph 1, ~~sustainability risks~~*."

Risk management function (article 269)

- The insurance industry understands that the amendment regarding article 269(1) of the Solvency II Delegated Regulation is a way to ensure the effectiveness and adequacy of sustainability risk integration.
- Regarding the addition of paragraph 1a) in article 269, the industry agrees that the consideration of the effect of material sustainability risks should be included in **the ORSA**. In this respect, the industry notes that the link between sustainability risks and the ORSA is critical, but that the analysis of sustainability risks is dependent on the company-specific strategy and risk assessment. Therefore, the measurement and quantification of the effects of sustainability risks for the undertaking's ORSA is necessary only for financially material effects. In addition, sustainability risks can materialise through already existing risk categories, therefore insurers should be able to consider them at the same level as other risks.
- In addition to the EC's proposed changes, the industry notes that the current sparseness of **ESG data** represents an obstacle in monitoring exposures from a sustainability viewpoint. Information and related data would need to be available and transparent across the whole financial sector and various market players to facilitate and improve the integration of sustainability risks in insurers' investment processes. Equally important, Insurance Europe wishes to emphasise the need for proportionality with respect to information requirements associated with the integration of sustainability risks. Excessive additional burdens on small insurers with respect to any new information requirements should be avoided.

Actuarial function (article 272)

- The proposed amendments on sustainability risks regarding the tasks of the **actuarial function** are welcome. Their inclusion at the same level of other considerations – such as inflation, legal risk, etc –

ensures that the consideration of sustainability risks will not prevail over other equally important risks/ consideration and vice versa.

- Insurance Europe also wishes to highlight that risks that are relevant to the risk return profile, including sustainability risks, already need to be considered by the undertaking under the existing regulatory provisions and that the tasks of the key functions in relation to ESG investment risks should be the same as those regarding any other risk.

Remuneration policy (article 275)

- While Insurance Europe supports the Commission's ambition for sustainability risks to be properly managed, the insurance industry is of the opinion that any regulation must be sufficiently flexible to allow insurers to embed sustainability risks within their specific organisations and risk areas.
- In this respect, the proposed amendment overlaps with these existing requirements:
  - Article 275 of the Regulation (paragraph 1,a) already requires the remuneration policy to be in line with the risk management practices, which are supposed to be amended by an explicit reference to sustainability risks.
  - Regulation 2019/2088 of 27/11/2019 on sustainability-related disclosures in the financial services sector already indicates (see article 5) that "*financial market participants and financial advisers shall include in their remuneration policies information on how those policies are consistent with the integration of sustainability risks, and shall publish that information on their websites*." In its consultation paper, EIOPA did not consider it necessary to make any amendment related to remuneration under article 275 and proposed consistency with remuneration only later for consistency with corresponding disclosures requirements in Regulation (EU) 2019/2088. In this respect, the industry believes that alignment of these regulations is not a compelling rationale as they differ both in terms of scope and regulatory objectives.
- In addition to these overlaps, the insurance industry points out that special emphasis on sustainability risks might suggest that other risk areas are less important for remuneration purposes.

Sustainability in the prudent person principle (article 275a)

The insurance industry agrees with the rationale for including sustainable risk in the prudent person principle, but it believes that article 275a should be improved for consistency and feasibility purposes. As Solvency II is designed for policyholders' protection, considerations on the policyholders' preferences should not be introduced within this article.

- **Regarding article 275a (1)**, the industry notes that the prudent person principle already allows for the adequate integration of sustainability risks, as insurers are under the obligation to properly identify, measure, monitor, manage, control and report all types of risks that could have a potential material impact on investments, including sustainability risks. In this respect, Insurance Europe notes that:
  - Sustainability risks should be recognised within the existing prudent person principle, not as another criterion alongside security, liquidity, profitability and quality.
  - Sustainability risks should be treated as other risks. To avoid an imbalance in regulatory requirements caused by highlighting only particular risks in an area which is still under development, the following amendment is proposed: "*When identifying, measuring, monitoring, managing, controlling,* ***and*** *reporting ~~and assessing~~ risks arising from investments, as referred to in the first sub-paragraph of Article 132(2) of Directive 2009/138/EC, insurance and reinsurance undertakings shall take into account* ***all actual or a potential financially material risks, including*** *sustainability risks."* This clarification would also help insurers implement a more proportionate investment strategy in the interest of policyholders and shareholders. The deletion of "assessing" is for alignment with the wording of Article 132(2) of the Solvency Directive.
- **Regarding article 275a (2)**, the sector acknowledges the EC's objective to promote better consideration of the potential impact of investment decisions on sustainability factors, but highlights that the current wording should be amended to:
  - Recognise the existing difficulties in terms of feasibility and proportionality, as well as the limitation of "stewardship".

- Acknowledge that the impact of investment decisions on sustainability factors (eg via engagement) can be very costly and that its effectiveness can be questionable depending on the types of portfolio (eg equity versus bonds) and the size of the investing undertaking.
  - Not contradict the principle of freedom of investment (article 133 of the Solvency II Directive).
- As it stands, the industry notes the following shortcomings of article 275a (2):
  - The current meaning of article 275a (2) risks distorting the Solvency II framework in its current wording. It is essential to clarify that the requirement *"to take into account the potential long-term impact of investment decisions on sustainability factors*" does not imply investment restrictions and/or limitations, which would contradict the principle of freedom of investment in article 133 of the Solvency II Directive.
  - While the EC's aim to encourage stewardship is well understood, the insurers' measurement of the impact of investments on sustainability would be facilitated if relevant information on the sustainability profiles of investees companies would be readily available. Asking insurers to capture the impact of their investments on sustainability is generally very difficult in terms of available information, data and measurement methods. In some cases, this assessment might only be qualitative.
  - While the industry takes the view that assessing the impact of investments on sustainability factors is desirable, this can be problematic for small and medium sized insurers as they may not have the resources to adequately build up the necessary tools within their portfolios and might be forced to outsource the necessary engagement activities. In addition, the impact of stewardship can be less effective for some asset classes, such as government bonds. For this reason, proportionality needs to be duly considered in the implementation of the requirements.
- Regarding **ESG preferences of policyholders** (in article 275a(2)), the sector supports the fact that the ESG preferences of policyholders should be taken into account under the IDD, rather than Solvency II. This will prevent potential inconsistencies with Solvency II's objective of policyholder protection. Specifically, the sentence in Article 275bis (2) (ie *"and, where relevant, that strategy and those decisions shall reflect the sustainability preferences of its customers taken into account in the product approval process as referred to in Article 4 of Commission Delegated Regulation (EU) 2017/2358*") should be deleted. Should the EC propose this amendment, it must take note that:
  - The use of relevance is necessary, as the ESG preferences of policyholders and beneficiaries cannot be systematically collected for all insurance products.
  - Reinsurance undertakings cannot reflect the ESG preferences of their customers in the product approval process due to their very nature, therefore this requirement should be removed. EIOPA acknowledged this difference in its advice and proposed that only insurance undertakings reflect the ESG preferences. In this regard EIOPA's reference to article 25 of regulation 2016/97 is more appropriate than the proposed reference to Article 4 of regulation 2017/2358 (IDD).
  - The reference to Article 4 of Regulation 2107/2358 is also inappropriate, as this refers directly to establishing a target market under the IDD. The identification of a target market is carried out at a more generalised level and prior to start of the sales process. It is distinct from establishing the demands, needs and preferences of an individual customer and to carrying out a suitability assessment where appropriate. Conflating individual recommendations with the generalised identification of the IDD target market is contrary to Recital 5 of 2017/2358 which makes explicit the distinction between these two processes.

Implementation timeframe (article 2)

- Insurance Europe welcomes the implementation period of 12 months starting with the entry into force of the Act, as this will facilitate insurers' implementation.

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