

To: Economics and Finance Committee

From: ECOFIN Team

Meeting: 7 December 2018

Reference: ECO-18-120

Subject: Sustainable finance

Objective

For discussion

Input requested

Members will be invited to share views and advise on how Insurance Europe can continue its advocacy in the area of sustainable finance, recognising that:

- **The industry has to be overall positive** and supportive of policymakers' objective to support a sustainable future and in fact the topic is supported by many insurers who are, or have for many years been taking significant steps towards a positive ESG agenda.
- **The industry cannot be shy in raising strong concerns** when the wrong tools and the wrong measures are used by regulators.
- **Some form of new/refined regulatory requirements is unavoidable**, and it is key to engage in their shaping so that the (negative) impact is minimised.

At the Executive Committee meeting the secretariat was mandated to liaise with members to get concrete guidance on the way forward for engaging positively and constructively in the ongoing and upcoming EC/EIOPA policy discussions, while avoiding excessive and overly detailed new requirements, particularly in the area of Solvency II. Specific points on which the secretariat seeks discussion include:

- *What type of disclosures could be accepted in order to avoid other specific mandatory requirements? Are there any examples of acceptable disclosure requirements from member states that could be used as the basis for constructive input?*
- *Do members have any initial views on which of the areas proposed in EIOPA's draft technical advice on the changes to delegated acts under Solvency II and IDD risk creating the most unjustified/problematic burdens?*

Background

Sustainable finance remains a key priority for European policymakers, with ambitious objectives and timetables. Ongoing policy actions will have a direct impact on the insurance industry. In fact, work in this area has revealed political opportunities for the industry, given the natural fit between insurers business model and sustainability, but also concerns related to some of the potential measures related to key regulations, such as Solvency II and IDD.

Insurance Europe has so far, in line with the ExCo mandate, adopted a constructive approach towards the sustainable finance agenda and has engaged in the technical details of the proposals with the aim of achieving proportionate and feasible regulatory measures. However, significant concerns have been raised at working level regarding the increase in unnecessary and onerous regulatory requirements.

The **EIOPA work on the Solvency II** framework is likely the **biggest regulatory challenge** on the horizon in terms of risks of excessive or counter-productive requirements. The secretariat provides below an overview of the EC workstreams, followed by an overview of the work conducted by EIOPA.

Developments at EU level

Regarding work at the level of EU policymakers, there are three key developments that impact the insurance industry:

1. Regulation covering sustainability disclosures

This regulation is aimed at requiring more transparency on sustainability, in the form of pre-contractual customer disclosures, sustainability risk policies on websites, marketing communication.

The secretariat [responded](#) to the public consultation on the EC proposal in August and provided analysis and support for members in their engagements. Insurance Europe's position has remained high level and focused on the following messages on sustainable finance:

- **Insurance Europe strongly supports the Commission's efforts towards financing a more sustainable world** and welcomes the EC initiatives as positive steps towards making the European economy greener and more resilient.
- Insurance Europe supports **increased consumer disclosures**. Care must be taken to ensure those disclosures help consumers make informed decisions in practice and avoid information overload and duplication.
- Setting mandatory requirements before there is a robust sustainability taxonomy in place will create unacceptable legal uncertainty and complexity, especially given the long-term nature of insurance products. Therefore, **any initiatives related to the taxonomy should be voluntary until the taxonomy is finalised**. The Commission's focus on sustainable finance has already had an impact to accelerate and widen insurer's incorporation of ESG elements into their business operations and well-designed voluntary initiatives can be as, if not more, effective than compulsory actions.

While the EC proposal was not ideal, the EP's report, which forms the basis for the EP negotiating position, goes significantly beyond the EC proposals by enhancing scope and requirements. The secretariat assessed the Parliament work and provided members with assessment of the proposals and potential arguments for engagement. It has engaged itself with key MEPs involved in the file, as well as with the BG and AT Council presidencies.

Some improvements were achieved in the EP report. For example, the proposed requirement for sustainable investment targets of minimum 50 per cent for variable remuneration was dropped and the EP has recognised the need for proportionality and materiality. However, other far-reaching EP proposals remain in the final report, including expansion of the scope from the EC's focus on life insurers and sustainable products to covering also non-life insurers and all financial products. The EP also seeks to embed sustainability in financial reporting.

The key challenge at working level is that views vary widely and it has been (and remains) difficult to reach agreement on a limited number of priorities where the industry should focus its lobbying activities to achieve a workable set of disclosures.

Members are therefore asked to discuss: *What type of disclosures could be accepted in order to avoid other specific mandatory requirements? Are there any examples of acceptable disclosure requirements from member states that could be used as the basis for constructive input?*

The file is currently still under discussion by the Council, and trilogue is expected to commence early next year. It is at this stage likely that the regulation will be adopted during this Commission mandate.

2. Regulation on an EU sustainability taxonomy

This regulation is aimed at defining a common classification of sustainable activities. Insurance Europe has supported the work on a taxonomy from the outset. However, although the Commission is looking into disclosure and potentially other requirements relating to all three environmental, social and governance (ESG) factors, its current work on taxonomy is only considering the "E" aspects, ie the environmentally sustainable activities. Insurance Europe's position is that:

- The industry welcomes the taxonomy as a means to fight “green washing” and enhance standardisation and comparability. Insurance Europe supports the EC efforts to reach a **shared understanding of sustainability** and considers the taxonomy proposal as the **key priority** of policymakers given the critical role that the taxonomy will play in driving and supporting change.
- The industry believes that the **EU taxonomy** should include **environmental, social and governance (ESG) factors**. All three aspects are key to achieving sustainable finance and **the taxonomy project planning needs to be expanded to cover all three elements**, not only the environmental aspects.
- Setting mandatory requirements before there is a robust taxonomy in place will create unacceptable legal uncertainty and complexity, especially given the long-term nature of insurance products. Therefore, **any initiatives related to the taxonomy should be voluntary until the taxonomy is finalised**.
- Already **established market features and existing differences** in investors’ preferences should be acknowledged and respected in the criteria for labels or other standards. In this respect, the industry believes that flexible arrangements have the potential to stimulate the appetite for sustainable investments for more investors, while allowing for market innovation and avoiding switching costs.

Looking ahead, the adoption of this regulation is expected to be postponed to the next Commission. Little progress has been made so far in the Council. The EP has put forward some proposals in its draft report, including the basis for a brown classification with potential implications on insurers’ investment activities.

3. Regulation on low carbon and positive carbon impact benchmarks

The regulation is aimed at developing uniform sustainability benchmarks which will work as a market standard to measure a company’s footprint and therefore an investment portfolio’s carbon footprint. The EP recent discussions go beyond the EC proposal by enhancing scope and requirements. For example, the draft EP report requires alignment of both types of benchmarks with the 2^o objective of the Paris Climate Agreement. This alignment is required for all published benchmarks by 2022.

The benchmark initiative is somewhat similar to the taxonomy work, in that the intention is to increase the trust and standardisation and avoid “greenwashing”. Insurance Europe has, therefore, taken a high-level position consistent with its position on taxonomy and has welcomed policymakers’ intention to increase the standardisation of the methodologies/features of benchmarks and to enhance transparency and comparability of investment performance. However, due to limited resources the secretariat is doing no further work on benchmarking other than monitoring.

The file is under discussion at the Council, while it is moving faster at the EP level with voting at the ECON Committee taking place in December. Trilogues are expected to commence early next year provided that the Council position is agreed.

Developments at EIOPA level

On **Solvency II Pillar II** - Following the July EC [request for advice](#), with a deadline of 30 April 2019, EIOPA first conducted an online survey to gather stakeholder feedback on how to integrate sustainability in the delegated acts under the IDD and the Solvency II Directive. Insurance Europe provided input in order to shape EIOPA’s approach. On 28th November, EIOPA published its [draft technical advice](#) on possible amendments to the Solvency II and IDD delegated acts for consultation until 30 January 2019.

ECOFIN is focusing on Solvency II elements while coordinating for consistency with COB who are working the IDD proposals. Initial assessment of EIOPA’s Solvency II related draft advice indicates that they took note of the input received. EIOPA proposes to integrate sustainability risks in:

- the risk management and the actuarial functions of the insurance undertakings
- companies’ investment practice, via amendments to the prudent person principle
- ORSA related assessments

There appears to have been strong support from BoS members for EIOPA's proposals, so one can conclude that European supervisors are largely supportive of enhancing Solvency II sustainability-related provisions. This adds to the strong support for such changes that both the Commission and Parliament have indicated.

The secretariat does not believe that it is helpful, nor achievable to oppose all changes to Solvency II requirements. Therefore, care needs to be taken to focus only on objecting elements for which there is evidence/clear explanation as to why they are unnecessary and of the problems they trigger.

Members are invited to provide *initial views on which proposals of EIOPA's Draft Technical Advice on the changes to delegated acts under Solvency II and IDD risk creating the most unjustified/problematic burdens?*

On **pillar I** – Following the EC [call for opinion](#), in late August, with a deadline of 30 September 2019, EIOPA has a clear mandate to look into concrete quantitative areas such as:

- Capital incentives/disincentives for sustainable investments
- Reflection of sustainability in companies' internal models design
- Calibration of natcat capital requirements and the extent to which these reflect sustainability/climate change
- Calculation of BEL and the extent to which these capture sustainability

This risks being a backdoor for EIOPA to add further levels of quantitative conservativeness to the framework, including potential increases in capital in the standard formula and requirements for internal models. Certain EP amendments proposed in the ESA review already provide an indication of some of the potential changes in Solvency II, as they target including references to "sustainability" across main definitions/examples of risks.

Insurance Europe expects EIOPA to start its Pillar I work next year. The secretariat has not yet developed specific positions except on the issue of green/brown capital adjustment factors aimed at incentivising/disincentivising investments – Insurance Europe is against capital charges that are not based on the actual underlying economics and risks. Since green investments can be both high and low risk such adjustments do not seem justified. However, in its lobbying for improving the treatment of long-term business which is economically justified, the secretariat does make the link to sustainable investment because removing unnecessary barriers would help sustainable investment too (as it is typically long-term).

Next steps

EC proposal on disclosures

- Trialogue discussions to commence next year, and pressure by the EC may support adoption of the regulation during this Commission mandate.

EC proposal on taxonomy for sustainable finance

- The EP ECON Committee is expected to vote on the draft report in February, while the Council has made very little progress. This file will likely be closed under the next Commission.

EC proposal on low carbon benchmarks

- Trialogue discussions to commence next year, and this regulation might be adopted during this Commission.

EIOPA work on Pillar II in Solvency II:

- The final EIOPA advice will be delivered by April 2019 and will be integrated in Solvency II Delegated Regulation already in 2019.

EIOPA work on Pillar I in Solvency II:

- This work is currently taking place at the level of EIOPA and its members, and the final opinion will be incorporated in the Solvency II 2020 review.