# 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

Actuarial Association of Europe (AAE)

* Your name

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*

Response to this survey to be treated as confidential

- (x) No
- ( ) Yes

*

Your member state

- ( ) Austria
- ( ) Belgium
- ( ) Bulgaria
- ( ) Croatia
- ( ) Cyprus
- ( ) Czech Republic
- ( ) Denmark
- ( ) Estonia
- (x) Finland
- ( ) France
- ( ) 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*

Professional association representing actuaries

**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 part 1/2 to the consultation (5000 characters maximum):

The Actuarial Association of Europe (AAE) welcomes the opportunity to provide comments to this sustainability consultation on Solvency II and IDD. The AAE is of the opinion that matters related to sustainability are highly important and that the underlying insurance legislation should acknowledge and even encourage insurers to change their business practices to a more sustainable direction.

The consultation stays on a principles-based level on what is required from insurers, which seems to be a good approach to start. The AAE is of the opinion that insurers (and pension funds) should be incentivised to make sustainable, carbon neutral/negative investments, but accepts that a detailed plan of how to introduce any green supporting factors may not yet be at the stage of development to implement at this time. Insurers, in particular life insurers, and pension funds may be the only pools of capital today that could fund the economic reorientation required. Also, the revised timeframes in the IPCC 2018 report set an ambitious path for this change having the year 2030 as the new target. Any change in the legislation should encourage starting rapid actions but not force this course. Care in this area would also help to avoid unwanted transition risk.

EIOPA highlights in the paper (par. 39 to 41) the importance for insurers to understand deeply what sustainability means and what risks it brings to them. However, the paper struggles to properly define sustainability (par. 10 to 17) and refers to several other documents where it is defined in different ways. This might leave insurers in a difficult position if they are forced to bring the concept of sustainability into their business practice but are at the same time left wondering what sustainability actually means and what kind of information can be used to understand it.

For instance, the consultation paper refers to the EC's proposal (Par. 14) which leaves the concept unclear. While this may be appropriate for a regulation setting broad standards, EIOPA must simultaneously offer, through different avenues, detailed standards of what might be considered. More depth would be needed in defining the list of factors. For example:

a. The Intergovernmental Panel on Climate Change (IPCC) Summary for Policy Makers (https://www.ipcc.ch/site/assets/uploads/2018/02/WG1AR5_SPM_FINAL.pdf) offers environmental variables that can be used. Some of the following can be subdivided.

I. Climate Systems;

II. Atmospheric Temperature;
III. Ocean heat content;
IV. Cryosphere (snow and ice cover);
V. Sea Level;
VI. Carbon and other biogeochemical concentrations.
b. The IPCC Technical Summary (https://www.ipcc.ch/site/assets/uploads/2018/02/WG1AR5_TS_FINAL.pdf) provides more details that can be used. For example, the CO2 measures have components such as cement, gas, oil, coal, and also details Other Well-Mixed Greenhouse Gases (CH4, N2O, Halocarbons).

It might be helpful to define sustainability in the regulations for example by using the following components:
a) Two components specific risk to the insurer/ a pension fund entity:
a. Risk to asset returns and valuations
b. Risk to liabilities, either on balance sheet or implied,
b) One component for "Stewardship",
a. Risks to the society /globe outside of the insurer / pension fund.
c) Systemic risk as the industry might be sequencing their actions similarly. This risk might also be partly covered in the other components too.

As the proposed amendments to the Technical Advice are quite vague, it is not always clear what is expected from (re)insurers and in particular from the Actuarial Function.

Answer specifically to question 1:

The benefits to the insurance community and the globe could be enormous, if the regulations manage to bring enough incentives for a more sustainable way of doing the business and if those actions can start rapidly.

Including monitoring and analysis of ESG risks into the overall risk management framework (governance, key functions, written policies, ORSA) seems to be a reasonable goal and would definitely increase the awareness in the industry. Indeed, many entities have already begun integrating sustainability considerations in their risk management. Generalizing this to the whole market would probably contribute to make it more resilient for a limited cost.

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?

General comments part 2/2 to the consultation (5000 characters maximum):

In paragraph 4 the paper sets out the aims of the Commission which are sensible. It would however help if the paper gave some concrete examples of how these can be applied in practice by (re)insurers. For instance:

a. Capital Flows / Transparency

I. Insurers to publicise their investment strategy regarding sustainability, so as to allow customers to refer to this criterion when choosing their insurer;

II. Insurers to offer sustainable investment options for products with a customer driven investment choice (e.g. mutual funds).

b. Financial Risks to be considered by Risk Management Function / Actuarial Function

I. Risk of poor asset performance where insurers invest long term in unsustainable investments

II. Risk of increasing frequency/severity of climate related events;

III. Risks of increasing cost of reinsurance/or lack of reinsurance for climate related events;

IV. Risks attaching to alternative risk transfer/mitigation mechanisms when applied to climate related risks – e.g. Cat Bonds.

c. Societal risk: increasing levels of un-insurability for some customers (e.g. flood-prone customers).

Par. 13 refers to Recital 58 which cites the relevance of ESG factors. This recital however explicitly allows that a statement clarifying lack of consideration of ESG factors is sufficient to satisfy requirements. This creates a “safe harbour” for not doing anything. While this may be a practical solution initially until ESG analysis and regulations are developed further, EIOPA should make VERY clear that ESG standards will evolve and that insurers methods must also evolve. Otherwise, these regulations may become a check box exercise not in the spirit of ESG, creating a toothless regulation.

Much focus is now being given to sustainable investments. Even though this might be the most important single aspect to cover, the viewpoint should be holistic on how the insurance business might change because of the environmental and societal changes. This would help the AMSB and the independent functions fulfil tasks given to them in a better manner even though the definitions of sustainability are somewhat vague.

EIOPA should also note that the International Actuarial Association is integrating ESG risks into its Risk Book by the end of 2019. Both IAA and AAE have also actuarial standards and actuarial notes on several aspect relating to actuarial work and might be able to bring clarification to what is required from actuaries for any new tasks also, for example those related to sustainability.

Answer specifically to question 2:

Creating the awareness amongst policyholders and new customers buying insurance services on how sustainability has been taken into account in the offering is a welcome development. Furthermore, this is not just for unit linked products. When the awareness increases there will also be more demand for insurance products taking into account the different aspects on sustainability (e.g. carbon footprint). This can be seen as one of the starting points to the progress which itself includes a lot of benefits.

The cost side can be seen as an aspect which obviously each insurer needs to take into account before implementing actions. In the future, differential pricing for products may become the norm in insurance practice where there is a difference in return/risk expectations for ESG investments.

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?

- (x) Yes
- ( ) No

Please give reasons for your answer:

Further, it should be clarified that Sustainability has 3 aspects: Assets, Insurance, Stewardship. Accordingly, consideration must be given to each aspect: the insurer's assets, the insurer's liabilities, and the impact local and global societies and environments.

**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?

The AAE feels it may be best to accept reference to practices that are being established elsewhere, while expounding general principles. As an example, we can imagine an upper and lower level to the RMF as described by the TCFD in Figure 2 of https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190110-sustainable-finance-teg-report-climate-related-disclosures_en.pdf :

- Upper level: strategy on climate (risks/opportunities, their impact and the undertaking resilience) with a clear involvement of the board
- Lower level: internal control on metrics and targets

**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:

The sentence "where relevant, reflect the environmental, social and governance preferences of policyholders and beneficiaries" seems to be a difficult task for insurers.

Even if insurers knew their policyholders' ESG preferences, which may well not be the case, it may be difficult to take these preferences into account in the investment process.

As there is lack of awareness of what sustainability means, what risks it keeps inside, on the taxonomy, etc., there might be a serious risk of non-compliance with the regulation if too strictly defined.

Additionally, for many products (for example generic euro funds or non-life portfolios), aligning asset allocation with expected policyholders ESG preferences may be highly impractical. For Unit-linked funds, the policyholders' preferences might be more easily available, at least for new sales. Should EIOPA wish to keep this objective, it would be necessary to specify clearly which market lines would be concerned.

Regarding the inclusion of the "where relevant", this wording might lead to interpretation and to de facto different rules between actors and countries. This risk might be need to handled by supervisory practices or guidance.

To require Sustainability in PPP “before the industry knows what sustainability risk actually means” could be a step that risks making the requirement meaningless, especially if the policyholder preferences are there. When insurers are forced to make their own interpretation on sustainability this might lead, in the worst cases, to some definitions and usages, which are far from the common definitions (UN, IPCC etc.) or even to green washing activities.

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

- (x) Yes
- ( ) No

Please give reasons for your answer:

The Actuarial Function (AF) needs to have a holistic view of both current and emerging risks, which are both requirements that already exist in the legislation. If sustainability needs to be separately mentioned, then certain aspects might need to be covered also:
• The ALM aspect on sustainability where the AF can provide good input, e.g. if the actuarial analysis indicates that the environment is becoming uninsurable in the long run, this should be fed into the strategical investment analysis (e.g. can one invest into an undertaking that would not fill the sustainable UW criteria?).
• With insurance risk, it might be good to talk of engagement (as in PPP), i.e. advice to policyholders on how to become more sustainable. Here the AF surely can be in a position to provide good insight for that work.
• The impact of sustainability risks on the actuarial function may vary between market lines, e.g.:
o They would be typically stronger for non-life entities since climate change might impact materially underwriting and reinsurance (via increased natural events risks for example)
o Regarding savings insurance, ESG risks are more related to the asset side and thus outside of the actuarial function perimeter
• The proposed modification might need to specify that the actuarial function should assess the impact of sustainability risks “where relevant to the insurers’ activities”.
• The regulation should state unequivocally the inclusion of non-policy sustainability risks in the technical provisions due to any source, e.g. arising from reinsurance policy or transfers via capital markets.
• Adding sustainability risks might nevertheless cause some difficulties as long as there is no clear view on the kind of risk covered by the sustainability risk. While climate change is already broadly discussed, social and governmental risks remain vague. To consider these e.g. in underwriting policy assigns a task to the actuarial function that might cause a challenge to the function holder.

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

- (x) Yes
- ( ) No

Please give reasons for your answer:

Different company policies need to specify an insurer’s position and its limits towards the major risks categories. In this context, the inclusion of sustainability risks appears appropriate. If sustainability risks need to be considered in the decision making, this might happen without legislation since it might already be common among insurers.

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

- (x) Yes
- ( ) No

Please give reasons for your answer:

Yes the AAE agrees, for instance reinsurance and risk mitigation and operational risks. The same argument as in Q7 exists on what is needed in the legislation and what might happen naturally.

**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:

The way sustainability related matters might change the business might be difficult to quantify or even assess qualitatively, as there is a clear lack of awareness of what sustainability actually means

Since the ORSA analysis must take into consideration all major risk areas, whether or not they are included in the standard formula, sustainability risks should be assessed one way or the other.

Currently, there seem to be very few reliable approaches to quantify these even though there is a lot of development already (e.g. UN PRI). In this context, entities should be allowed at first to either perform only qualitative analyses of those risks or very simplified qualitative ones. (See Paragraph 2 of General

Comments.) Entities should be careful not to double-count a sustainability risk that could have already been assessed through the market risk module. Any quantification will also need models that include sustainability related risks and the model needs also parametrization and expert judgment so it might be a difficult task to integrate into the overall solvency needs assessment.

**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:

**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 (selected)

Please give reasons for your answer:

It is unclear what is meant by "Conflicts of interest". "Fiduciary duty", which would be taking best care of the interests of the asset owner, might be one place where such issues might arise as it is often reduced to the idea of looking only at the return and (financial) risk. If asset owners generally have sustainability in mind, then taking account of this should be a fiduciary duty. Therefore, it seems that taking sustainability into account should not lead to conflicts of interest.

Sustainability should be taken into account when distributing products and clients should be made aware (even when they do not want to be!) to what extent what they are buying is sustainable or not. Furthermore, if one does not know the preferences of the client it should be assumed that the client favours sustainability (i.e. the default option should be on the sustainability side when the client does not explicitly say otherwise).

**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?

**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?

**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.

**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:

**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:

**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:

## Contact

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