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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.
Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents and EIOPA’s rules on public access to documents .
Contributions will be made available at the end of the public consultation period.

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*Name of your organisation

German Insurance Association

* 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
- ( ) Finland
- ( ) France
- (x) 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
- [x] Industry association
- [ ] Consumers' representative
- [ ] Other

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?

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;

a) No comment

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

b) One-off-costs for the implementation of the taxonomy; extensions of front/middle/back office and risk management systems as well as credit risk and capital market data systems by ESG data; process related amendments in the strategic asset allocation process, risk management process, reporting process.
Ongoing costs for delivery of ESG-relevant data (e.g. ongoing data on ESG-indices or ESG-ratings) and maintenance, updates and further development of systems, processes and products.
Perhaps lower revenues on investment because of restrictions to the asset selection, but in our view not yet quantifiable.

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

c) Perhaps lower volatility and – in the long run – less risk exposure with respect to reputational risk, stranded assets and ESG-risks, but in our view not yet quanitifiable.

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 of the possible changes are difficult to anticipate. However, on the basis of a survey conducted by the GDV the estimated implementation costs for the German insurance undertakings for the necessary changes caused by the IDD – without ESG-legislation – was overall 862 Mio. € one -off and 568 Mio. € ongoing costs per year. Out of that amount 319 Mio. € one-off costs for the implementation of adjusted advice processes and 68 Mio. € for the implementation of product oversight an governance processes (POG). Ongoing costs (on an annual basis) for advice processes are estimated with 79 Mio. € and POG with 19 Mio. €. This potential burden on providers and – ultimately – customers should be taken into account, when new distribution obligations are introduced. This includes especially the disclosure requirements on ESG and the additions to the rules on advice which are currently developed as separate legislative acts. Unnecessary cost drivers should be avoided. A prominent example would be an introduction of obligations on disclosure and advice before the underlying rules on a common taxonomy are finalized. In this case, providers would have to develop processes and criteria to comply with the obligations twice within a relatively short time. This would not be proportionate.

The potential costs of the legislation on sustainability may be greatly increased by liability risks arising from the lack of a common understanding of what exactly is sustainable and what is not. Discrepancies in the understanding to this regard may lead to contracts being declared as not valid by the civil courts at a later time. This risk is especially relevant with a view to future collective redress mechanisms. Therefore it is, in our view, essential that any obligations with regard to advice and customer information on ESG are preceded by the Regulation on taxonomy.

With respect to the timing of the new legislation on ESG considerations, we would like to stress that an insufficient transposition period for the market participants causes a substantial increase in the costs of implementation.

Furthermore, we would like to point out that there will be additional costs with regard to the mandatory integration of ESG considerations in the advisory process. Relevant costs are for example for the adaptation of the advisory and documentation process, especially the modification of advisory tools.

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?

- ◯ Yes
- ◉ No

Please give reasons for your answer:

Already now Article 44 of the Solvency II Directive requires the risk management function to identify and assess all risks to which the undertaking is or may be exposed. As sustainability risks materialize through well-established risk factors, which are covered by existing legislation, financial material sustainability risks are already taken into account in risk management, ORSA and decision processes of AMSB. That is why we do not regard it as necessary to make an explicit reference on the tasks of the risk management in relation to the identification of sustainability risks. We agree that sustainability risks should be considered in view of their impact of the undertaking's risk profile as part of the risk management process, however, we do not see the need for an explicit reference, as this could also result in the identification and assessment of sustainability risks being overemphasized as it is one of many existing risks which may be relevant in the long-term (similar to, for instance, demographic change or longevity risk).

Further, we would like to point out that we consider related risk management activities as a main task of the first line of defence (1st LoD). The main task of the risk management function as a second line function is to oversee the 1st LoD-activities as defined in the Delegated Acts.

However, if the Commission insists on the explicit integration of sustainability risks in the legal provisions, we consider the proposed reference as acceptable. Thereby, it is essential, that an assessment of materiality of sustainability risks allows sufficient flexibility for undertakings so that they could integrate sustainability risks in a proportionate manner without changing their internal organisation.

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, in our view there is no need to propose any other amendment to ensure the effectiveness and adequacy of sustainability risk integration.
We agree with EIOPA´s view that fitness requirements and the content of the remuneration policy do not need to be adapted on Level 2 as the delegated acts do not contain any specific organisational provisions for particular risk areas. We agree that further explicit reference to sustainability risks would not be coherent.
We regard it as appropriate and sufficient if – with particular consideration of the proportionality principle - undertakings are requested to ensure the necessary expertise.

Other than proposed by the European Commission EIOPA wants to apply the requirements to all undertakings (life and non-life). We believe this is not justified. Given, that sustainability risks mostly materialise long-term we believe that additional requirements should not be introduced for property & casualty insurers that generally have a significantly shorter duration on both the asset and the liability side compared to life insurers. In Germany the modified duration for assets of life insurers is 11 while it is only 6 for property & casualty insurers. Should property & casualty insurers nevertheless fall in the scope of additional requirements we suggest to at least introduce a threshold for small property & casualty undertakings so that small property & casualty undertakings are excluded from the scope.

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

- ( ) Yes
- (x) No

Please give reasons for your answer:

Generally, we support the principle-based approach of EIOPA towards integration of sustainability risks in Solvency II. However, regarding Art. 275bis(1) already now it is the task within the prudent person principle (ppp) to address sustainability risks in the assessment of investments, if they are financially relevant. Therefore, an explicit reference as part of the ppp is viewed as redundant. The ppp as defined in current legislation already requires to consider any factors that impact the security, quality, liquidity and profitability of the portfolio.
Should the Commission insist on the explicit integration of sustainability risks in the legal texts, we support the wording proposal made by EIOPA in Art. 275bis(1) but suggest to clarify the term as “financially relevant sustainability risks”.
In this respect, we view it positive, that EIPOA wants sustainability risks to be recognised within the existing ppp and not as another criterion alongside security, liquidity, profitability and quality. We agree that sustainability risks tend to materialise through the existing risk categories credit risk and property risk and that they can affect the existing investment principles.
The implications of the first part of Article 275bis(2), requiring undertakings “to take into account the potential long-term impacts of investment decisions on sustainability factors”, are not made sufficiently clear. As the proposal is worded, it may result in a contradiction to Article 133 of the Solvency II Directive. The requirement to consider the impact of investment allocations on general sustainability factors is much broader than the current ppp (that focuses on impacts of risks on the financial situation of the company) and may entail a contradiction to the requirement to act in the best interest of existing stakeholders of the company (including policyholders).
While regulation in other policy areas may appropriately address general issues of “stewardship” and of directing macroeconomic capital flows, it seems inappropriately placed in prudential insurance regulation that addresses financial interests of stakeholders of the regulated company over the term of their underlying commitments. We suggest not to address broader macro-economic policy issues in prudential regulation and recommend to delete this part.
We view the binary approach as easier, better manageable and less costly for all insurers due to the following reasons:
-Engagement (in direct as well as indirect investments via funds) is very costly. Especially for small and medium sized insurers the only way to perform engagement within their portfolios is to outsource the necessary engagement activities, which entails considerable costs.
-The question arises as to the added value. We do not believe it is possible to provide the evidence about the effects of engagement activities in a reasonable manner
-Engagement is generally more effective and manageable in equity portfolios than in bond portfolios. However, insurers are mainly bond investors. Engagement is almost impossible with government bonds. Covered bonds might be regulated by special law.
-Generally, the overall effectiveness of engagement policies conducted by small and medium sized companies is questionable.
-An obligatory stewardship approach would create further legislation in order to clarify what stewardship means, in which cases it is appropriate etc.
We would suggest to remove Art. 275bis(2) and the proposed new recital, since the objective of prudential regulation is the protection of customers’ financial interests resulting from direct contracts with the undertaking. It seems that the proposed addition is out of scope of prudential regulation. From a practical perspective it appears impossible to “take into account” all long-term impacts of investment decisions on sustainability factors. The ESG preferences of policyholders and beneficiaries are too heterogeneous to be taken into account in general account insurance business.
If a stewardship principle is nevertheless followed by EIOPA for all insurers we would suggest to provide small and medium-sized undertakings with more time to gain experience in dealing with ESG concepts before introducing the obligation to implement engagement concepts or to introduce a threshold for small companies. Finally the proportionality principle should be mentioned here explicitly.

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

- ○ Yes
- ● No

Please give reasons for your answer:

From a content perspective the underwriting processes in compliance with existing Solvency II legislation include the consideration of the impact of sustainability risk on the risk profile of the undertaking, as well as consideration of these risks in pricing and reserving. In contrast to the investment related sustainability issues, the Commission has not identified deficiencies in the considerations of sustainability risks in the underwriting process. In fact, as far as sustainability risks are relevant for certain insurance coverages, for example environmental liability insurance or natural catastrophe coverages, dedicated expertise exists contributing to pricing and reserving. There is a risk that additional explicit requirements for the actuarial function regarding the assessment of sustainability risks may be misinterpreted to signal additional reserving or additional risk capital needs, which in both cases is redundant.

So we don’t see any reason to include the liability side. As the models to calculate the best estimate are depending on long time data, undertakings are able to deal with changes and trends if there are any. This may lead to changes in prices, products or contracts if necessary, which is easy to do as contracts in non-life last mostly one year.

Art. 262 (1) (a) (iii)
As the actuarial function has to consider the whole underwriting policy we don’t see the need to extend the duties. In case there are any management rules concerning sustainability one can assume that these surely will be implemented. In so far we believe it to be sufficient to refer to the management.

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:

Art. 260 (1)(a)
In our view, a consideration of sustainability risks in the underwriting policy would not be appropriate.
While we support the consideration of sustainability aspects as part of all business processes, the proposed references introduce an element of redundancy. Where EIOPA suggests changes to the underwriting and reserving related sections of the delegated Solvency II regulation, these do not relate to areas where a deficiency had been identified by the EU Commission and are duplicating requirements already implied by the Solvency II directive and regulation.

On the liabilities side of non-life insurers, if there are effects of climate change they become clear year after year. So if there appear trends in time series of technical provisions showing claims expectations to rise, insurers normally react by means of premium adjustments or changing reinsurance programs, which is possible due to the short term contracts. The addition that sustainability risks must be taken into account in underwriting is therefore not necessary, because it is considered in the estimation and the way of handling risks anyway.

Art. 260 (1) (c) (vi)
The prudent person principle requires already today that financially relevant sustainability risks relating to the investment portfolio are taken into account. While we support the consideration of sustainability aspects as part of all business processes, the proposed reference introduces an element of redundancy, since where relevant, existing Solvency II legislation already requires sustainability risks to be considered in the risk management process. We would like to point out that with the requirement in paragraph (vi) that it must be ensured that sustainability risks in the investment portfolio are properly identified, assessed and managed it is suggested that quantification is possible in a meaningful way. On the investment side one would have to look at the business models of each individual investment in the status quo as well as the business strategy / transition. And even then it is not said that this has any significance for financial risks, since questions such as the valuation of assets are more decisive in the medium term (example Solarworld). Should the Commission insist on the explicit integration of sustainability risks in the legal texts, we acknowledge the wording of Art. 260 (1)(c)(vi) relating to investment risk management.

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

- ○ Yes
- ◉ No

Please give reasons for your answer:

Regarding Art. 260, new paragraph 1.a we welcome the inclusion of “where appropriate”, as this amendment allows for considering sustainability without putting too much focus on this specific risk at the expense of other risks. Provided, sustainability risks are financially relevant and material, we consider it to be acceptable if references to sustainability risks in risk management policies are made. However, we do not see a necessity to include sustainability risks into the risk governance / written policies as no deficiency had been identified by the EU-Commission in any other area but investment management. Therefore, if references to sustainability risks are made in risk management policies, it is important to strike the right balance of risk consideration in risk management practice and supervisory review.

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?

- ○ Yes
- ◉ No

Please give reasons for your answer:

The link between sustainability risks and the ORSA is critical in our view. We agree that the "effects of sustainability risks" on the risk profile should be taken only in account if these effects are financially relevant and material for the undertaking.

However, a compulsory analysis of sustainability risks would contradict the basic idea of a company-specific strategy and risk assessment. Therefore, it should be made clear that a measurement and quantification of the effects of sustainability risks should only be necessary if these effects are financially relevant and material for the undertaking's ORSA. If the effects are financially relevant and material, then it should be sufficient to evaluate the material sustainability risks in a qualitative way.

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:

As EIOPA already pointed out this is only one possible source of conflicts of interests (see page 42/43 of the draft technical advice). The delegated regulation already includes appropriate criteria for determining different types of conflicts of interest. Those criteria capture such conflicts of interest that might arise from taking into account sustainability considerations. We agree with EIOPA, that a reference only on ESG considerations could overemphasise and unbalance the legal drafting. We appreciate a high-level principle-based approach as suggested by EIOPA in Number 92. Hence we would prefer Option 7.1, introducing a reference to ESG into a new recital only. As EIOPA pointed out (page 42/43) this Recital could provide guidance on the application of the conflict of interest rules.

We also would like to draw attention to the fact that neither the IDD nor the delegated acts require insurance undertakings to offer insurance products considering ESG preferences. Hence insurance undertakings and insurance intermediaries should not be expected to include ESG considerations into their conflict of interest policy in general, but only where relevant. We would suggest adjusting the proposed recital slightly by introducing a "where relevant".

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:

We do not see potential conflicts of interest in this regard which would be particular to ESG.

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?

With regard to the European Commission's action plan on sustainable finance, we noticed that some of the proposed regulations might cause conflicts of interest. In particular, the proposal on disclosures on sustainable investments and sustainability risks may lead to these conflicts.

The IDD states that there should be no incentive to recommend a given product other than the best interest of the customer (Art. 17(3) IDD, Recital 46). The MiFID II sets similar requirements (Recital 56 and Article 23 (1)). In contrast, 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. However, remuneration polices which take account of ESG-considerations would likely be in breach of the conflicts of interest provisions in IDD and MiFID II.

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?

We believe 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.
These measures need to be a company specific decision appropriate to their size, organization and the nature, scale and complexity of their business, types of offered products as well as to the risk of damage the interest of the customer.

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 investments there is currently no common market standard or label. There is a wide range of different "Labels" like Dow Jones Sustainability Index (DJSI) or, ESG-Scorings by ESG-rating agencies like MSCI, Sustainalytics or ISS oekom. In addition, the PRI contain general guidelines, but these are principle based, similar to the Solvency II Prudent Person Principle. Concrete implementation differs between different companies since there is no common and compulsory standard available yet. For investments, which are not listed and not traded like infrastructure projects they might need internal audit processes. This fragmentation makes it difficult for customers to compare different products. For the insurance undertakings and insurance intermediaries it could lead to legal uncertainty and liability risks, inter alia, in the advice process caused by different understandings on what is a sustainable investment. Therefore any new distribution requirements – such as the disclosure obligations which are currently developed – should absolutely be preceded by the complete rules on taxonomy.

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:

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. The determinations made in relation to the target market are subsequently applied in the testing, distribution and monitoring of the product. While the numerous additions to Articles 4 to 11 proposed by EIOPA reflect this, a clarifying recital on this point would in our view be sufficient.

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:

The 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.

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?

- (x) Yes
- ( ) No

Please give reasons for your answer:

See our answer on question 15.

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