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SUSTAINABLE FINANCE

Green shoots of recovery

Insurers support the transition to a carbon-neutral, resource-efficient & more inclusive EU economy

Despite the huge challenges created by the COVID-19 pandemic, the insurance industry remains as committed as ever to the transition to a more sustainable economy and to tackling climate change.

Just over two years have passed since the launch of the ambitious Action Plan on Financing Sustainable Growth by the former European Commission of President Juncker. They have been two years of fast-paced regulatory developments focused on the financial sector, including insurance. The new Commission of President von der Leyen has confirmed the extremely high level of ambition of that 2018 Action Plan and a focus on tackling the increasing challenges posed by climate change.

A number of regulatory initiatives on sustainability have either already been launched under the European Green Deal or have been announced. There will also now be discussions on how to put sustainability at the centre of the EC's Recovery Plan for Europe to repair the economic and social damage resulting from the pandemic and lockdowns.

Two asks from the insurance industry

Insurance Europe supports the European Green Deal objective of making the EU a net-zero greenhouse gas emissions economy by 2050. The Green Deal can address two requests made by the insurance industry during the Juncker Commission:

- To have the responsibility for sustainability shared between all relevant sectors, and not just placed on financial services. Insurance is a key part of the economy, as it provides coverage for underlying risks and funding via its investments, but the industry can only become greener if the economy overall becomes greener. All sectors need to contribute to this transition, and insurers welcome that this is exactly what the Green Deal sets out to do.
- To increase actions to create new sustainable assets in which insurers can invest. The EU has identified a yearly investment gap of about €260bn that needs to be closed in order to achieve its 2030 climate and energy targets[1]. Insurers have significant potential to help fund the investments needed and are keen to do so, but currently there is an extremely limited number of such investments and projects. Steps need to be taken by other industries, national and local governments and the Commission so that there are far more transformational and sustainable projects in which to invest. More sustainable equity, debt and sovereign bonds are also required.

As institutional investors, many European insurers have started to apply environmental, social and governance (ESG) criteria to their investment strategies and to increase their targets for sustainable investment. Insurance Europe recently estimated that the European insurance industry planned to allocate over €140bn to sustainable investments by 2020.

1 Communication of the European Green Deal

Definitions & disclosures

The EC's 2018 Action Plan saw it pushing the sustainable finance agenda via legislation that would embed sustainability in all aspects of financial services companies: in investments, in governance, in prudential rules and in consumer disclosures.

The Action Plan launched work on a much-anticipated EU taxonomy on sustainable finance and it took the EU's co-legislators almost two years to finalise a Taxonomy Regulation. While still quick for EU legislation of a highly strategic nature, this reveals the differences between member states and between national realities, and hints at the challenges that lie ahead for Europe's green transition.

The insurance industry had long called for a common definition of sustainability, to avoid "green washing" and to create a common understanding of sustainable investing. During the development of the taxonomy, it stressed that the transformation of the economy from "brown" to "green" would need to be gradual and that all efforts put into this transition should acknowledge this. The taxonomy should therefore recognise the positive impact of activities to move, or enable moves, to carbon neutrality. For example, the benefits

of investing in a bond whose proceeds would be used to finance a company's energy-efficiency should be recognised.

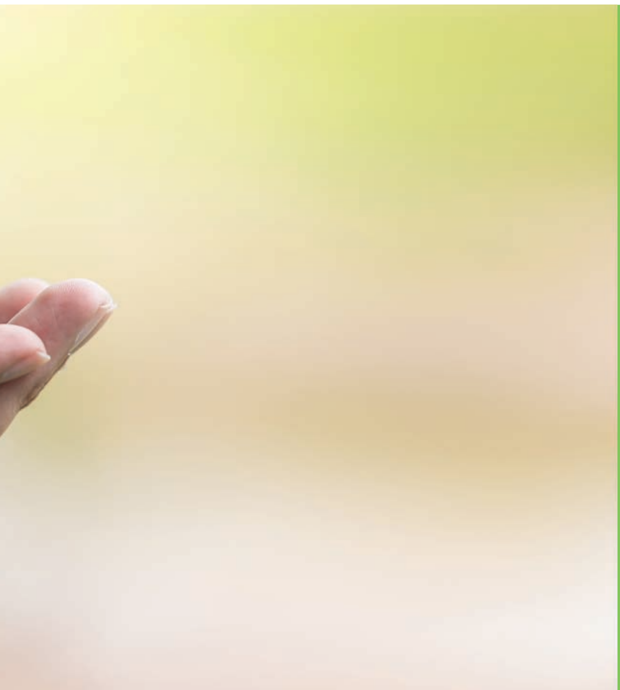
The EC Action Plan also resulted in an extensive Sustainable Finance Disclosures Regulation that requests the provision of various pieces of sustainability-related information on websites and to consumers. The insurance industry falls within the scope of this Regulation and so needs to comply with a number of new obligations.

Unfortunately, however, it has a number of implementation concerns and sees barriers that have not been addressed in the Regulation:

- The Regulation will require sustainability data for each actual and potential investment, yet reliable public ESG data is currently limited. It is therefore crucial to make it mandatory for companies to provide ESG information so that investors can manage sustainability risks, steer their portfolios towards the objectives of the European Green Deal and report on their investment portfolios in line with the Regulation. Indeed, ESG data should be made available through a centralised, electronic European register. This would aid comparability and lower costs, as well as helping data preparers by eliminating multiple requests for information.
- There is a significant risk of creating an overload and duplication of product information. While disclosures are beneficial for customers and the public, they should be needs-based and feasible. Providing too much information can have a detrimental impact on consumers and hamper their decision-making.
- The current timeline for implementing the Regulation is more than challenging and could create significant practical problems and liability risks for investors, as well as confusion for customers. Despite the urgent need to take action to promote a sustainable economy, the Level 2 measures should clarify and help determine how to deal with these challenges.

Looking ahead, a key workstream is the review of the EU's Non-Financial Reporting Directive (see box on p32), which is intended to make it mandatory for companies to report ESG data. In June 2020, Insurance Europe responded to the consultation on the Directive, strongly supporting this aim. In addition, the EC Renewed Sustainable Finance Strategy will enhance the integration of sustainability factors in business operations, while unveiling opportunities to finance sustainable investments.

The insurance industry will contribute to the work of the EC and EIOPA, seeking to address the concerns described earlier and to ensure any measures are proportionate and feasible.



No favourite colours in Solvency II

Europe's insurance regulatory framework, Solvency II, is — and should remain — risk-based. This means that any differences in the treatment of insurers' green and brown assets should be based on differences in their underlying risks, and that the insurance industry does not support artificial incentives or disincentives to hold assets on the basis of green or brown qualifications.

Instead of any green-supporting factor, the priority should be to make sure the 2020 Solvency II review results in focused changes that help insurers to play their key role in supporting investment to achieve carbon neutrality and economic growth in Europe, and that do not hinder them. Insurers are willing and able to contribute to sustainability goals, but Solvency II's capital requirements should not be used to promote them.

Sustainability & Solvency II

As part of its Action Plan, the EC also asked EIOPA to investigate what should or could be done in the Solvency II insurance regulatory framework to better reflect sustainability in areas such as the prudent person principle, companies' own risk solvency assessments (ORSAs), key organisational functions and capital requirements.

While the industry appreciates the need to assess the framework against sustainability considerations and agrees that insurers should assess their exposure to sustainability and climate change risks, Solvency II already requires all risks to be covered and therefore only small changes are needed. EIOPA itself acknowledges this and also that the assessment of the impact of climate change depends on the materiality of the risks and is subject to Solvency II's principle of proportionality.

On the ORSA, the insurance sector highlighted that the assessment should continue to reflect a company's own risk assessment and that any attempt at standardisation can undermine this.

Limited but vital improvements are needed to Solvency II to ensure the framework correctly measures insurance business and risks, in particular relating to long-term business and investments. The industry's interest in investing in long-term sustainable investment is strongly linked to its ability to continue to sell long-term products. Ensuring that the 2020 review of Solvency II reduces — and does not increase — unnecessary barriers to long-term products and investments is therefore key (see also Solvency II article on p23).

Sustainability at international level

Europe remains by far the most ambitious region in addressing climate change and supporting a sustainable financing of the economy. Nevertheless, a key milestone in sustainable finance came at international level with the establishment by the Financial Stability Board back in late 2015 of a Task Force on Climate-Related Financial Disclosures. This industry-led taskforce had the ambitious aim of creating voluntary, consistent, climate-related financial risk disclosures for use by companies in providing information to investors, insurers and other stakeholders.

The final recommendations were released in June 2017 and quickly became an international reference point for such disclosures. As a follow-up, the IAIS consulted on an issues paper on implementing the recommendations in December 2019 and released its final version in February 2020.

European insurers support the fact that the IAIS is considering implementing the recommendations through various Insurance

An EU Ecolabel for retail financial services?

The EC's 2018 Action Plan on Sustainable Finance observed that "the lack of labelled financial products may prevent investors directly channelling their funds into sustainable investments". To address this perceived problem, the Commission set its Joint Research Centre (JRC) the task of developing criteria to add financial products to its EU Ecolabel scheme, which is currently awarded primarily to consumer and household goods.

Insurance Europe has contributed to the JRC's consultations as it finalises the criteria for adoption by the EC in 2021. It has stressed that the criteria must pay due consideration to the fact that, in many countries, a large proportion of insurers' products are guarantee-based, in order to avoid any competitive disadvantage with the fund industry.

While the insurance industry supports the ambition behind the Ecolabel proposal, it believes the proposed criteria are unrealistically high, meaning that most products would not qualify. It has therefore called for better-calibrated criteria that would create a sufficiently large pool of eligible investments.

Core Principles (ICPs). It is worth making a comparison with Solvency II, where sustainability risks are being explicitly embedded in the prudential framework to facilitate the identification and management of all material risks by insurance companies. Similarly, introducing clarifications on how sustainability can be integrated explicitly in interpreting the IAIS ICPs will help strengthen the integration of material sustainability risks in insurers' operations in a consistent and efficient manner. In addition, this could be an effective way of ensuring minimum standards globally, which is an objective supported by the European industry.

From this perspective, it is helpful that the IAIS is taking a coordinated approach across jurisdictions, which reflects the global nature of insurers' operations and especially the cross-border nature of climate risks. Coherent policymaking across jurisdictions will avoid duplicative or contradictory standards, while contributing to an understanding of sustainability risks and strengthening the overall stability of the financial system.

Global data gap

A key issue emerging in the global discussions is the availability of data on the sustainability profile of each entity, from the perspective of both a company's performance and the external environmental and social impact of its activities. As mentioned earlier, sustainability-related information is a prerequisite for insurers to be able to perform sustainable investing and underwriting activities, and to produce robust and efficient disclosures, but quality sustainability data is currently lacking.

In general, regulatory support is needed to enhance the quantity and quality of ESG data available worldwide. Even within Europe there are significant interactions between various pieces of EU regulation that need to be addressed for consistency; at international level, the issue only becomes more complicated and solutions will take time. It is important to acknowledge the scale of the challenge and take this into account in any assessment of progress on sustainability disclosures.

Looking ahead, the European industry will continue to bring to the IAIS its extensive knowledge in the area of sustainable finance and use the recent regulatory discussions in Europe to contribute to the even more challenging international ones.

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