insurance europe

Position Paper

Insurance Europe's comments on EC consultation on institutional investors' and asset managers' duties regarding sustainability

Our reference:	ECO-LTI-18-003		
Referring to:	Institutional investors and asset managers' duties regarding sustainability		
Related documents:	Institutional investors and asset managers' duties regarding sustainability		
Contact person:	ECOFIN Team	E-mail:	ecofin@insuranceeurope.eu
Pages:	7	Transparency Register ID no.:	33213703459-54

Summary

Insurance Europe welcomes the opportunity to provide comments to the EC work on fiduciary duties regarding sustainability.

The insurance industry is the **largest European institutional investors**, with more than €10tn of assets under management. Most of insurers' assets cover long-term liabilities, and are therefore invested with a long-term view. The industry very much welcomes the EC's objectives of achieving an increasingly efficient allocation of capital, as well as sustainable and inclusive growth.

The insurance industry has, already years ago, started to **consider and incorporate ESG factors in** its **business models and investment strategies**, and a number of insurers across Europe have increasingly taken (public) commitments to sustainability goals. Such commitments were largely not triggered by regulation, but rather based on companies' own-initiatives. It is expected that, over time, and given the strong political drive for the EU sustainability and growth agenda, the coverage of sustainability objectives will be widespread across the industry.

However, it is equally important to acknowledge that there are a number of **challenges and barriers to the identification, measurement and assessment of sustainability/ESG factors**, including the often-limited availability, quality and consistency of ESG data, which is viewed as a significant constraint. Similarly, in particular for smaller entities, the build-up of resources and expertise can be considered as a barrier to enhanced engagement in sustainability issues.

From an insurance perspective, it is key to note that **investing in a responsible/sustainable way** is not only about investing in certain assets, but can also be translated into a strategy that can be implemented in relation to all assets. From this perspective, it is important for the industry that a clear and detailed framework, including

Insurance Europe aisbl
Rue Montoyer 51, B-1000 Brussels
Tel: +32 2 894 30 00 • Fax: +32 2 894 30 01
E-mail : info@insuranceeurope.eu
www.insuranceeurope.eu

© Reproduction in whole or in part of the content of this document and the communication thereof are made with the consent of Insurance Europe, must be clearly attributed to Insurance Europe and must include the date of the Insurance Europe document.

a **taxonomy for sustainable finance**, and metrics to measure ESG impact, is developed at European and international level.

Equally important and related to the above is the issue of an **adequate supply of sustainable assets**. An increased supply of appropriate assets that meet not only sustainability criteria but also quality and security requirements, is key to an increased involvement by large as well as small and medium-sized insurers in sustainable investing.

Regarding the **fiduciary duty** of the industry towards its policyholders, ie the duties of care, loyalty and prudence, Insurance Europe notes that this is in fact an existing key element of the Solvency II framework, reflected in the **prudent person principle**. Insurers have the obligation to invest in *"the best interest of all policyholders and beneficiaries"*[1]. In addition, the Solvency II prudent person principle requires that all assets are invested in a manner that ensures security, quality, liquidity and profitability of the portfolio, and in line with the nature and duration of insurance liabilities. There is therefore no need for additional fiduciary duty requirements for insurers.

Similarly, regarding the **identification of material exposure to sustainability factors**, Insurance Europe notes that, wehere exposure to sustainability factors is assessed as being material for an investment instrument, Solvency II already provides that insurers assume individual responsibility and take appropriate actions. In fact, a key element of the Solvency II framework is an undertaking's Own Risk and Solvency Assessment (ORSA), which foresees that insurers *"shall have in place processes which are proportionate to the nature, scale and complexity of the risks inherent in its business and which enable it to properly identify and assess the risks it faces in the short and long term and to which it is or could be exposed."*[2] There is therefore no need for further binding requirements for insurers on the methods and processes that undertakings follow where material exposure to sustainability factors is identified.

With respect to the **feasibility and benefit of consulting policyholders on sustainable investment issues**, Insurance Europe notes that it may be inefficient and economically questionable for an undertaking, representing a broad customer base, to consult with each and every beneficiary. Insurance Europe notes that the key drivers of insurers' investments are represented by the profile of liabilities and the risk-return profile of available assets. Specific knowledge of a company's business, its product offerings and related liabilities are key in the investment decision making, and such information only resides within the insurance company who owns the business. It is therefore difficult to understand how the involvement of policyholders, who do not have such information, would bring any benefits to optimising investment decisions.

Insurance Europe looks forward to further engagement opportunities in this area.

[1] Art 132 of the Solvency II Directive
[2] Art 45 of the Solvency II Directive

insurance europe

Detailed comments

Insurance Europe would like to take the opportunity to provide comments on a selected number of relevant issues emerging from the questions in the EC consultation.

Insurers are key long-term investors in the European economy

The insurance industry is the largest European institutional investor, with more than €10tn of assets under management. Investing is not at the core of the insurance business model, but is a consequence of it. Insurers' investments are driven by the nature of their liabilities, the largest part of which are long-term and illiquid and therefore create the need for assets of similar profile.

While the profile of long-term assets will often match investment needs, insurers will not invest unless it makes sense from a risk/return perspective and the investment is in the interest of policyholders, towards whom insurers have contractual obligations. Insurers should therefore not be "forced" to invest long-term, and should equally not be disincentivised when they have the interest and ability to do so.

At the same time, while the industry has the ability and the intention to invest long-term, including in sustainable assets, it is often prevented or disincentivised to do so by regulations that are not appropriately designed and/or calibrated. Solvency II, EMIR and IFRS are examples of developments of recent years on which the industry has raised concerns regarding unintended consequences in the area of long-term investment.

Sustainability factors relevant for the insurance industry

The following areas are equally part of sustainable finance and should be recognised as such: climate change and other environmental factors, social aspects, governance.

The insurance industry has, already years ago, started to consider and incorporate ESG factors in its business models and investment strategies. It is worth noting that investing in a responsible/sustainable way is not only about investing in certain assets, but can also be translated into a strategy that can be implemented in relation to all assets. Concretely, two key approaches to this are worth noting: i) one is where undertakings integrate and work with ESG considerations as part of their *overall* investment strategy, and another is ii) when undertakings target specific assets that they consider to be sustainable. One does not exclude the other.

With regard to the first approach, where ESG factors are part of the overall investment strategy, a common starting point for many undertakings is often represented by public/government commitments and objectives at national/regional level. For example, international conventions ratified by a jurisdiction (eg UN international conventions regarding the environment, human rights, labour law, corruption and inhumane weapons), as well as guidelines supported by a jurisdiction (eg UN Global Compact, ILO, OECD guidelines for multinational companies) are often used as reference points by undertakings at jurisdictional level for their investment activities and sustainability objectives. Many undertakings also employ providers of ESG and corporate governance research and ratings to help them develop and implement their investment strategies. Examples of responsible investment approaches include negative and positive screening, as well as dialogue and engagement.

With regard to the second approach, relating to targeting specific sustainable assets, there is currently no European taxonomy of such investments. However, market-led initiatives, such as labels and standards, have helped insurers frame their policies with regards to sustainable investing.

The following types of investments represent examples that could meet ESG objectives:

- "Green"/environment friendly investments: represent an increasingly significant part of insurers' portfolios across member states. Such investments include, but are not limited to: renewable energies, energy efficiency, pollution management, waste management, biodiversity conservation, clean transportation.
- Social infrastructure: represents an area of investment interest for the insurance industry in a number of members states, such as Austria, Belgium, Denmark, France, Germany. Examples of assets that insurers invest in include: social housing and accommodation, public infrastructure such as schools, hospitals, prisons, theatres.

In order to improve identification of sustainable factors and assets, the insurance industry supports the development of a taxonomy for sustainable finance. An EU taxonomy should:

- Aim to cover sustainability issues in a broad sense, ie including but not limited to defining green assets/technologies.
- Prioritise a definition for "green" assets, on the basis of which "green" labels could be created (as either public or private initiatives).
- Be informed by already existing taxonomies, such as the Green Bond Principles, the Climate Standards, etc.
- Be developed at European level by European policymakers and with input from stakeholders, while being also discussed/raised by EU policymakers in relevant international fora.

Given the long-term horizon to finance a sustainable economy, investment needs will certainly evolve: green technologies move fast, social needs could change quickly, etc. Such a taxonomy should therefore be flexible and take into account ongoing scientific research. From this perspective, it could be useful to plan a regular review of the taxonomy.

Reflection of sustainability factors in insurers' investment decisions

Over recent years insurers across Europe have increasingly taken (public) commitments to sustainability goals.

A very concrete proof is the fact that a large number of European (re)insurers have to date signed the United Nations Principles for Responsible Investment (UN PRI), and these insurers manage in fact a significant part of the €10tn of assets of the sector. Other market players have developed their own internal policies on sustainability/ESG objectives, often inspired from market labels and standards.

It is important to note that commitments by the insurance industry to sustainability objectives were largely not triggered by regulation, but rather based on companies' own-initiatives. It is expected that, over time, and given the strong political drive for the EU sustainability and growth agenda, the coverage of sustainability objectives will be widespread across the industry.

It is however also important to note that there are a number of challenges and barriers to the recognition of ESG aspects that need be addressed. These include:

- The availability, quality and consistency of ESG data is viewed as a major constrain for considering ESG factors adequately. Often, the lack of adequate information to achieve an accurate assessment of the financial attractiveness of ESG investments is deemed as a key barrier to invest. From this perspective, both further studies on ESG impact from an investor/portfolio perspective and standards/definitions for ESG factors would be welcome.
- Costs triggered by the build-up of resources and specific expertise within undertakings, or by the provision of information from external agencies with ESG expertise, are often significant. In particular for smaller entities, this can be viewed as a burden and should be taken into account by policymakers when considering regulatory proposals.

Equally important and related to the above is the issue of an adequate supply of sustainable assets. An increased supply of appropriate assets that meet not only sustainability criteria but also quality and security requirements, is key to an increased involvement by large as well as small and medium-sized insurers in sustainable investing.

The challenges of identifying and modelling sustainability factors

As noted above, insurers already reflect and integrate, to a significant extent, sustainability factors in their investment decisions.

Integration of sustainability factors requires both:

1. Identification of *"what is sustainable"*

As highlighted previously in the paper, it is important to note that investing in a sustainable way is not only about investing in certain assets, but can also be translated into a strategy that can be implemented in relation to all assets. For example, investing in the listed equity of a company that has a traditional role in the low carbon economy can be deemed as a sustainable approach to investing, and it is not necessary that the listed equity itself is defined as a specific sustainable asset. It would in fact often be difficult to seek to identify sustainable investments at asset by asset level.

It is important for the industry that a clear and detailed framework, including a taxonomy for sustainable finance, and metrics to measure ESG impact, is developed at European and international level. This will allow for a proper and more consistent identification of sustainable investment assets and projects across jurisdictions, and will also help increase the attractiveness of sustainable assets and potentially support more investment.

A challenge worth noting is the case where insurers invest through asset managers and funds, when, as shown by the Solvency II look-through experience, it is materially more difficult to have access to detailed information on the underlying portfolio, at individual asset level.

2. Modelling, which is the ability to assess sensitivity of investments to ESG factors in a quantitative way, eg *"what is the change of an asset value with respect to the change of the "E" value, the "S", value or the "G" value"*. Insurers need time and flexibility to be able to build a strong model, consistent with the taxonomy for *"what is sustainable".*

Against the background of the diversity in the industry with very large as well as small companies and various levels of existing engagement in sustainability issues, insurers should be allowed to assume individual responsibility and discretion in deciding on the methods and processes on how to integrate financially relevant sustainability factors.

Areas relevant for sustainability factors in investment decision-making

Insurance Europe appreciates that all the areas identified by the Commission (ie governance, investment strategy, asset allocation, risk management) may be impacted following an undertaking decision to include sustainability considerations in its investment decision-making.

It should however be **noted that sustainability cannot in itself be a sole criterion for investment in the case of an insurance company.** There are in fact a number of elements that impact both the strategic and the tactical investment decisions, and investment decision-making cannot be reduced to a binary relationship between sustainability vs returns. Equally important, there is a significant difference to note between an investment strategy and the resulting asset allocation. Experience over recent years has shown that, in many

cases, the supply of specific/appropriate investment assets lagged behind insurers' commitments to invest. The clear example is infrastructure, where market supply remains scarce and below insurers' interest. From this perspective, it is important to note that in many cases the investment strategies of insurers will incorporate investment "targets" (by sector/asset class) which, depending on market availability of assets and their appropriateness for insurers' portfolios, may materialize or not.

Fiduciary duty in Solvency II

Fiduciary duty - the duties of care, loyalty and prudence - towards policyholders is a key element of the Solvency II framework, reflected in the **prudent person principle**. Insurers have the obligation to invest in *"the best interest of all policyholders and beneficiaries"*[3]. In addition, the Solvency II prudent person principle requires that all assets are invested in a manner that ensures security, quality, liquidity and profitability of the portfolio, and in line with the nature and duration of insurance liabilities. Concretely, this means that the prudent person principle already imposes fiduciary duty on insurers, by requiring sustainability to be one of the criteria that insurers identify as relevant in their investment and risk management assessments, if ESG aspects are deemed financially material, ie if they have an impact on the security, quality, liquidity and profitability of the portfolio as a whole.

Insurance Europe therefore believes that Solvency II already provides for a framework aimed at ensuring that sustainability factors are considered by insurers where material, as part of the prudent person principle that insurers need to comply with. Any envisaged work by the Commission should appropriately take into consideration the already existing Solvency II requirements and avoid overlaps/inconsistencies.

Consultation with and disclosure to policyholders of sustainability elements

Insurance Europe notes that it may be inefficient and economically questionable for an undertaking representing a broad customer base to consult with each and every policyholder.

Online surveys of customers could provide some information on their preferences. However, in practice, customers are generally only willing to accept surveys at the time of conclusion of contract. After that, customers are most of the time not willing to answer such surveys. Moreover, Insurance Europe notes that policyholders often lack the necessary expertise to be able to advise on a company's investment strategy and actions. In fact, the key drivers of insurers' investments are represented by the profile of liabilities and the risk-return profile of available assets. Specific knowledge of a company's business, its product offerings and related liabilities are key in the investment decision making, and such information only resides within the insurance company who owns the business. It is therefore difficult to understand how the involvement of policyholders, who do not have such information, would bring any benefits to optimising investment decisions.

Similarly, the sometimes poor quality of data and potential complexity in the process of assessing the sustainable nature of an investment can make it challenging to engage with policyholders on sustainability issues.

Regarding disclosure, Insurance Europe notes that issues related to sustainability and policyholder disclosures in the insurance sector have already been discussed in the context of Regulation (EU) No 1286/2014 (the **PRIIPs Regulation**). Article 8 (3) (c) of the PRIIPs Regulation requires a section of the Key Information Document (KID) entitled 'What is this product?' to outline the nature and main features of the PRIIP. Under point (ii) this shall include: *its objectives and the means for achieving them, in particular whether the objectives are achieved by means of direct or indirect exposure to the underlying investment assets, including a description of the underlying instruments or reference values, including a specification of the markets the PRIIP invests in,* ***including, where applicable, specific environmental or social objectives targeted by the product****, as*

[3] Art 132 of the Solvency II Directive

well as how the return is determined;". At this stage, the insurance industry is looking forward to the EC Delegated Act on this issue.

Identification of sustainability-related risks

Where exposure to sustainability factors is assessed as material for an investment instrument, Solvency II provides that insurers assume individual responsibility and appropriate actions. In fact, a key element of the Solvency II framework is an undertaking's Own Risk and Solvency Assessment (ORSA), which foresees that insurers *"shall have in place processes which are proportionate to the nature, scale and complexity of the risks inherent in its business and which enable it to properly identify and assess the risks it faces in the short and long term and to which it is or could be exposed."*[4] The ORSA framework already provides for the identification of relevant sustainability risks. There is therefore no need for further binding requirements for insurers on the methods and processes that undertakings follow where material exposure to sustainability factors is identified.

Insurance Europe is the European insurance and reinsurance federation. Through its 35 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of €1 200bn, directly employ over 940 000 people and invest over €10 100bn in the economy.

---

[4]Art 45 of the Solvency II Directive