September 2017

Questionnaire by the High-Level Expert Group on sustainable finance interim report

Question 1: From your constituency's point of view, what is the most important issue that needs to be addressed to move towards sustainable finance? (sustainable finance being understood as improving the contribution of finance to long-term sustainable and inclusive growth, as well as strengthening financial stability by considering material environmental, social and governance factors)

For insurers, the specific regulatory area that needs to be addressed is the Solvency II framework, which, as the draft HLEG report highlights, creates unnecessary barriers to investing in long-term assets.

Equally important, a clear and detailed framework, including a taxonomy for sustainable finance, is needed, to allow for a proper and consistent identification of sustainable investment assets and projects across member states. This would help increase attractiveness of these assets and potentially support more investment. When developing such a framework, the EU should join efforts with other jurisdictions in view of developing global standards/taxonomies on sustainable finance, that would ultimately be able to ensure comparability of sustainable assets across the globe and foster cross-border investment.

In addition:

- The following area are equally part of sustainable finance and should be recognised as such: climate change, social aspects, governance.
- A sustainable finance framework would constitute the basis for market-driven standards, labels and metrics, and will ultimately help facilitate reviews and impact assessments.
- The European Union should envisage a consistent, comprehensive and coordinated EU sustainability strategy that:
  - is linked to the EU commitments and related financing needs eg COP21, the UN's Sustainable Development Goals (SDGs)
  - connects the dots between energy, climate, transport, technology, education, etc
  - outlines all the critical policies required to achieve the agenda and creates a predictable and stable path for policy action
  - outlines how policy and other actions at national, municipal and local level contribute to the agenda
- A taxonomy for sustainable finance should be carefully designed, also with input from market players, to prevent a situation where a too detailed taxonomy would in fact act as a disincentive and prevent innovation.
- European policymakers should investigate how best practices on use of subsidies and tax policies applied to support sustainable finance could be extended across EU member states. This could help accelerate the growth in this asset class and enhance cross-border investment.
- Enhance supply of sustainable finance by, for example, strengthening climate-related objectives (eg there appears to be broad agreement at policymakers' level that at least 40% of EFSI 2.0 financing aims to contribute to climate action).
- EU policymakers should increase emphasis on supporting and enhancing financial literacy around sustainable finance across member states.
- Policymakers should avoid artificial and/or economically unjustified investment incentives that could lead to asset bubbles. Instead, the EC focus should be on removing investment disincentives and/or inappropriate investment frameworks.

The following questions cover selected areas that are addressed in the recommendations (chapter VI) of the interim report, which the expert group considers to be crucial and would appreciate your feedback on:

Develop a classification system for sustainable assets and financial products

Question 2: What do you think such an EU taxonomy for sustainable assets and financial products should include?

European (re)insurers would very much welcome an EU taxonomy for sustainable assets and financial products. 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.

Establish a European standard and label for green bonds and other sustainable assets

Question 3: What considerations should the EU keep in mind when establishing a European standard and label for green bonds and other sustainable assets? How can the EU ensure high-quality standards and labels that avoid misuse/green-washing?

Insurance Europe reiterates its support for an **European taxonomy and related standards regarding sustainable finance**, and including green assets. Regarding the issue of labels, Insurance Europe strongly believes in market-led labels, which would ultimately be based on the EU taxonomy.

The development of such a taxonomy should be informed by already existing global/European frameworks, such as the Green Bond Principles that are at the core of the international green bond market. In order to help investors' assessment of green products, detailed standardised disclosures templates could be envisaged. Standardisation would not only help investment assessment, but also enhance comparability between investments.

In addition, Insurance Europe supports **European standards for responsible investors**, which could assess, for example, how well fund managers integrate sustainability issues into their activities. Such a standard should be voluntary and auditable via eg third party certification.

Create "Sustainable Infrastructure Europe" to channel finance into sustainable projects

Question 4: What key services do you think an entity like "Sustainable Infrastructure Europe" should provide, more specifically in terms of advisory services and connecting public authorities with private investors?

Insurance Europe supports the creation of such an entity. It further believes that:

- It could be envisaged to achieve objectives similar to those of the European Investment Advisor Hub (EIAH) and the EIPP (European Investment Project Portal).
- It could be set up within the EIB, who already has relevant experience and expertise.
- It should act as a connector between public authorities and the private sector.
- It should facilitate a platform on which investors have an overview of all investments across Europe that will have received a "sustainability" label
- It should facilitate provision of advice to market players wishing to issue/structure sustainable investment products.
- It should aim to foster private investment and should not engage in financing of sustainable projects for which market financing is available.

Mismatched time horizons and short-termism versus long-term orientation

Question 5: It is frequently stated that the inherent short-termism in finance, especially financial markets, represents a distraction from, or even obstacle to, a long-term orientation in economic decision-making, including investments that are essential for sustainability. Do you agree with this statement*?

- (•) Yes
- ( ) No
- ( ) Don't know / no opinion / not relevant

***Question 5.1:** If you agree with this statement, which sectors of the economy and financial system are particularly affected by the 'mismatch of time horizons'? What are possible measures to resolve or attenuate this conflict?

Insurance Europe agrees that, due to a number of factors, financial markets are generally short term. The insurance industry is however different, because the nature of long-term liabilities both requires and allows insurers to take a long-term view.

In fact, the insurance industry is the largest European institutional investors. Investing is not at the core of the insurance business model, but it 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 the insurers have contractual obligations. Insurers should therefore not be "forced" to invest long-term, and should 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, 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.

Governance of the investment and analyst community

Question 6: What key levers do you think the EU could use to best align the investment and analyst community with long-term sustainability considerations in the real economy?

The insurance industry has over recent years increasingly reflected sustainability elements (such as ESG criteria) in its investment decision making. Representatives from the industry have, on a number of occasions, publicly indicated willingness and interest to increase their investment in long-term/sustainable assets. At the same time, the following three areas have been raised by the industry as limiting the ability for more investment – and these should be carefully investigated by European policymakers in their planning for achieving strategic objectives in the area of sustainable finance:

1. **Regulation**: a number of regulatory developments, including Solvency II and EMIR, have been indicated by the industry in recent years as disincentivising long-term investment and being inappropriately calibrated to allow the industry to play its role as long-term investor at full potential. Work is needed by policymakers to assess regulatory developments against the objectives of sustainability.
2. **Supply of appropriate assets**: the industry has over recent years raised concerns on the limited supply of long-term assets such as infrastructure. Insurance Europe has welcomed actions by the European Commission in this area as part of the Juncker Investment Plan – and believes that these efforts should continue with a view of creating a credible pipeline of long-term suitable assets that insurers can invest in.
3. **Financial education**: EU policymakers should increase emphasis on supporting and enhancing financial literacy around sustainable finance across member states. This would help support the objectives of sustainability across the spectrum of investors, ie from the level of individuals saving and making investment choices for retirement, to the level of institutional investors managing assets for the benefit and in the interest of their ultimate beneficiaries.

In addition, the EU can support development of best practice by encouraging knowledge building and information sharing centers (eg similar to the EIAH).

A strong pipeline of sustainable projects for investment

Question 7: How can the EU best create a strong and visible pipeline of sustainable investment projects ready for investment at scale?

Insurance Europe very much supports recognition that a credible pipeline of long-term sustainable assets is needed. When supporting this pipeline, the Commission should envisage to:

- Clearly define standards for sustainability (see answer to question 1).
- Create visibility of the pipeline (via eg the "Sustainable Infrastructure Europe" entity).
- Create EU support for sustainable investments that need such support to enhance their attractiveness to private investors. When doing this, ensure that any risks of crowding-out private investment is minimized/eliminated.
- Avoid risks of asset bubbles via "artificial" incentives.
- Ensure a high level of political/long-term engagement in sustainability, for example by harmonising a preferential treatment of sustainable assets across member states, by a clear political commitment to a general 'polluters pay' principle to internalize externalities. This will help diminish political risk embedded in the assets.
- Encourage transparency in line with the recommendations of the FSB on climate-related financial disclosures.
- Build on already existing platforms such as TEN-T, EIPP.

Integrating sustainability and long-term perspectives into credit ratings

Question 8: What are some of the most effective ways to encourage credit rating agencies to take into consideration ESG factors and/or long-term risk factors*?

Please choose 1 option from the list below:

- ○ Create a European credit rating agency designed to track long-term sustainability risks
- ◉ Require all credit rating agencies to disclose whether and how they consider TCFD-related information in their credit ratings YES
- ○ Require all credit rating agencies to include ESG factors as part of their rating
- ○ All of the above
- ○ Other

***Question 8.1:** Please specify what other ways you would deem most effective in encouraging credit rating agencies to take into consideration ESG and/or long-term risk factors.

As noted above, a commitment by European policymakers to long-term sustainability should also be reflected in the design and calibration of European policies. Insurance Europe believes that the Commission should first assess the extent to which ESG considerations are already reflected in the work of CRAs. In fact, Insurance Europe believes that over recent years the market has created pressure on CRAs to increasingly reflect such considerations in their analysis. In many cases, where ESG and climate related aspects are financially relevant, CRAs will have already taken these aspects into account in their assessments. Should the Commission conclude that the current approaches do not satisfy sustainability objectives, it should, at the minimum, require CRAs to disclose the extent to which sustainability factors (as these will be described in future EU standards) are taken into account or not.

Role of banks

Question 9: What would be the best way to involve banks more strongly on sustainability, particularly through long-term lending and project finance?

No comments.

Role of insurers

Question 10: What would be the best way to involve insurers more strongly on sustainability, particularly through long-term investment?

Insurers are already significant long-term investors in the European economy, with assets totalling almost €10tn and approximately 60% of EU GDP. Insurers have a natural capacity to invest long-term, which is given by the nature and profile of their liabilities. Such investments often support low carbon economies and include both debt-like and equity-like products. The key issue that needs to be addressed is to ensure that the industry is able to maintain and grow their existing long-term investment appetite.

Insurance Europe suggests the following three key areas for the Commission to take action on:

1. Design of a taxonomy framework to help the clear identification of sustainable assets
2. Appropriate design and calibration of regulation for long-term investors such as insurers
3. Political support for an appropriate supply of long-term suitable assets

As previously highlighted, a EU taxonomy on sustainable assets would be very much welcome.

It is also important that European and national policymakers support the creation of credible pipelines on long-term sustainable assets, and also consider offering public support whenever this is needed to increase attractiveness of such assets for private investors.

Regarding regulation, it should be stressed that the industry supports the risk-based nature of regulations such as Solvency II and does not believe that prudential regulation should be used to provide artificial *incentives* to long-term investment. On the contrary, investigations should focus on identifying and removing *disincentives*, by appropriately designing and calibrating regulation that appropriately recognises and measures the actual risks faced. Solvency II is — and should remain — a risk-based framework, but more work is needed to ensure that the risks are correctly identified and measured.

Unfortunately, regulations are sometimes designed in a way that does not recognise insurers' ability to invest long-term and creates unnecessary disincentives. For example, Solvency II treats insurers like traders and wrongly assumes that insurers are always and fully exposed to the market volatility of assets. This flawed assumption leads to exaggeration of liabilities, artificial volatility and excessive and unnecessarily high capital requirements, which ultimately disincentivise investments.

Besides Solvency II and as the HLEG draft report rightly identifies, the impact of IRFS 9 on the level and on the volatility of reported profits should also be considered as a major regulatory obstacle for equity investment.

Social dimensions

Question 11: What do you think should be the priority when mobilising private capital for social dimensions of sustainable development?

The appropriate design and calibration of investors' regulatory rules should be a priority for EU policymakers.

The social dimension of sustainability is very important and should be appropriately reflected in the EC work, next to other areas such as climate change. In fact, over recent years a number of member states have created investment opportunities for the private sector, aimed at supporting social and/or climate change objectives.

When assessing these investment opportunities, insurers have identified that regulation, and in particular Solvency II, can be disincentivising. A few examples include:

- Unnecessarily high capital requirements applied to investments in infrastructure such as hospitals, schools, often with embedded government guarantees. Solvency II doesn't appropriately recognise the government guarantee and therefore measures risks on these assets as any other corporate risk. Implicitly, from a return/risk perspective, these assets are not attractive to insurers.
- Unnecessarily high capital requirements applied to real estate. A report published in March 2017 by MSCI and INREV shows that an appropriate capital requirement for European real estate investments would be between 12 and 15% rather than 25%. Notwithstanding this, in countries such as Austria, insurers are large investors in a separate category of real estate, so-called affordable housing, whose essential features are state-regulated. These investments translate into a relief to municipal budgets and promote social stability and solidarity against the background of increasing rents and lack of living space. Unfortunately, these investments are treated in Solvency II as if insurers were trading them. This flawed trading assumption leads to an overly high and unnecessary capital requirement, which is an investment disincentive.

Other

Question 12: Do you have any comments on the policy recommendations or policy areas mentioned in the Interim Report but not mentioned in this survey?

Insurance Europe would like to make the following comments on the **recommendations**:

- Regarding the establishment of **principles of fiduciary duty (recommendation 3)**: Insurance Europe would welcome confirmation that sustainability objectives should be considered as part of the fiduciary duty if they are financially relevant and have a direct impact on the risk-return profiles of investment assets.
- Any initiatives targeting **financial and/or non-financial disclosures (recommendation 4)** in relation to sustainability should aim to first identify already existing relevant reporting requirements and avoid overlap and inefficiencies created by new requirements. In fact, insurers are already faced with various requirements in this area, including the EU non-financial reporting requirements in financial reports. The EU should aim to consolidate the range of reporting initiatives as far as possible. This should be done in a way that avoids information overload, while recognising that reporting has to be done in a meaningful, standardised way and not artificially expanded. While Insurance Europe recognises the benefits of climate-related information and disclosures, which can enable analysis by all stakeholders and thus promote a better understanding of climate change-related risks, the voluntary nature of the disclosures must be preserved, not least due to the lack of data and developed measurement methodologies. In addition, any reporting recommendations should acknowledge the sensitive nature of the required information and should therefore not pose threats to competitive advantages stemming from superior investment/underwriting strategies.
- **Positioning by the ESAs on sustainability issues (recommendation 7)** should be done in a coherent and consistent way, with a joint approach, which recognises the nature of the market players and their business models, as well as the risk-based nature of prudential rules.

Regarding the **policy area for discussion** on the **role of insurance companies and their treatment under Solvency II**, Insurance Europe would like to re-emphasise the fact that regulation can, and does create investment disincentives especially in the area of long-term investment and this concern should be carefully looked into.

Solvency II remains a key regulatory challenge for insurers, as it wrongly assumes that insurers act like traders and are fully exposed to market volatility, thus forcing them to hold unnecessarily high capital. This is particularly true for long-term assets. While Solvency II is and should remain risk-based, more effort should be put into assessing if the risks are appropriately identified and measured and, if the answer is no, swift action should be taken to remedy this. One straightforward way in which the Commission could address outstanding Solvency II issues would be by simply raising and answering the following questions:

- *To what extent does Solvency II recognise that insurers are often not exposed to short-term volatility in market movements, especially in the case of long-term assets?*
- *Is the current Solvency II assumption that insurers would be forced to sell their entire portfolio at a huge loss in a time of stress reasonable and backed by evidence?*
- *Would addressing these points have a material impact on the willingness and ability of the industry to invest long-term, including in sustainable finance?*

Answering such questions would make perfect sense in the context of assessing the barriers to and risks facing long-term investment in Europe.

Question 13: In your view, is there any other area that the expert group should cover in their work?

The following issues could be further emphasised in the report:

- The importance of looking at sustainability from a global perspective. The EU approach to sustainability is in fact a direct consequence of the EU commitments to global initiatives on sustainability, climate change and growth. The EU should remain engaged on these issues in a global context, and take the opportunity to be a leader and promoter of relevant policy initiatives at international level. This would support a level playing field with other jurisdictions.
- The pricing environmental externalities in an economically viable way should be further supported by actions aimed at, for example, discontinuing fossil fuel subsidies.