Position Paper

Insurance Europe comments on the European Commission proposal for a regulation on the establishment of a framework to facilitate sustainable investment

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Summary

Insurance Europe welcomes the opportunity to provide comments on the European Commission proposal for a regulation on the establishment of a framework to facilitate sustainable investment.

With more than €10tn of assets under management, the insurance industry is the largest institutional investor in Europe. As a result of their business model, insurers invest their assets with a long-term perspective. Several considerations affect insurers' investment decisions and **sustainability is already a key factor** for insurers. This includes sustainable investment strategies, but also sustainable approaches based on stewardship and engagement to contributing to sustainability. The increasing number of insurance companies voluntarily committing to sustainability objectives confirms that a transition towards sustainability is already taking place.

Insurance Europe welcomed the recommendations of the EC High-Level Expert Group report and the subsequent Action Plan on Financing Sustainable Growth. The insurance industry supports the EU efforts to make the European economy greener and more resilient in line with the CMU project goals. Since **sustainability has different meanings** to investors across markets, Insurance Europe believes that reaching a **shared understanding of sustainability** must be the key priority of the EC. In this context, the EC proposal on the framework (ie taxonomy) is therefore a very positive step.

With respect to the EC proposal, Insurance Europe particularly welcomes that:

- The classification system considers the **degree of sustainability at the level of economic activities** and includes all economic sectors in its scope**,** therefore leaving room for various investment strategies and instruments in line with investors' heterogeneous sustainability preferences.
- The proposal provides the foundation for **harmonisation at national and EU level** with respect to standards and labelling schemes for green financial products, which would ultimately lead to increased comparability and transparency and a level playing field in the EU.
- Private sector experts will be part of the **Platform on sustainable finance** and will be able to contribute to the development and the monitoring of the framework.

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- The **review clause** envisages regular evaluation of the criteria considered in the framework, which would allow to keep it functional and updated over time.

However, the industry believes that a unified EU classification system should:

- Look at sustainability in a holistic sense and **include in its scope all environmental, social and governance (ESG) factors** contributing to sustainable investments, in recognition of the implicit connection of these components.
- Be **prioritised** over other actions in the Action Plan and its timeline should be accelerated to include all ESG components in its scope.
- Be comprehensive and sufficiently advanced before being used as basis of regulatory requirements on sustainability. Regulatory requirements related to the classification system should therefore remain **voluntary until all aspects of the taxonomy are sufficiently developed**. This would promote a smoother operationalisation of the taxonomy and ensure a more mature definition of sustainability is in place for insurers to properly adjust their product development and offering.
- Be **internationally coordinated given the global investment universe of institutional investors**. Consistent, transparent and broadly accepted definitions and terminologies increase and support the development of a shared understanding of sustainability across jurisdictions.

The industry also stresses the need to consider the **specificities and varying maturity levels of national markets** with respect to sustainability. Specifically, the demand for sustainable investments across investors should be encouraged while allowing for market development and innovation. Additionally, **the sustainability evaluation** should be able to reference the transitional process to sustainability and to encourage long-term investments for firms willing to adopt more sustainable business models. The sector also encourages the EC to ensure that the right framework is in place for **determining the degree of sustainability of economic activities in a neutral and transparent manner** as to ensure standardisation and comparability in the market and to save costs for investors.

From an investment perspective, sustainability and long-termism are strongly linked. As insurers follow a long-term business model, they have the potential to **redirect capital flows to greener activities**, which is also one of the 3 objectives of the EC Action Plan on sustainable finance.

However, insurers' willingness to increasingly invest in sustainable projects is limited by a number of constraints. Specifically, the industry urges the implementation of measures addressing the:

- inadequate supply of sustainable investment assets, without prejudice to quality and security requirements
- existing barriers to long-term investments in the Solvency II regime
- failure of the current regime to differentiate between capital treatment of more/less sustainable investments based on long-term risks

Detailed comments

Insurance Europe provides below detailed comments on the proposed regulation and the taxonomy facilitating sustainable investments.

Inclusion of all ESG factors in the taxonomy scope

Insurance Europe supports a **holistic approach** encompassing sustainability issues in a broad sense. In line with the very definition of sustainable finance, which refers to environmental, social and governance (ESG) considerations in investment decision-making, the industry believes that **all ESG factors contributing to sustainable investments should be embedded in the taxonomy.**

When it comes to investment decisions, the environmental, social and governance components are implicitly connected and mutually interdependent, so they should all be integrated in the taxonomy scope. Concentrating only on the environmental component, even if temporarily, might result in **a misallocation of capital and a financing disadvantage for investments targeting the "S" and "G" dimensions.** As a remedy, the insurance industry encourages the EC to include a social and governance component at an earlier stage of the development of the taxonomy than currently envisaged in the EC proposal.

The application of a taxonomy that only considers the "E" component might bear a **risk of crowding out sustainable investments** focused on "S" and "G" aspects, meaning that such investments might not be made in an appropriate volume until economic activities are defined more precisely later according to these aspects. A **voluntary application** of the regulatory requirements related to framework could help mitigate this risk until the development of the screening technical criteria and the inclusion of all the ESG factors in the taxonomy scope.

Degree of sustainability of an investment — Article 1(1)

Insurance Europe welcomes the choice of considering sustainability at the **level of economic activities**, rather than directly at investments level. A sustainability assessment capturing **the degrees of sustainability** will allow to accommodate various investment strategies within the insurance industry (eg exclusion investing, norm-based screening, engagement and voting, ESG integration in investment analysis and best-in-class or positive screening) and to properly evaluate a wide range of financial instruments and investment projects (eg housing, social infrastructure, projects in renewable energy and biodiversity preservation). Additionally, the degree of environmental sustainability should be determined in a **neutral and transparent** manner to allow:

- standardisation and comparability in the market
- cost savings and lower administrative burdens

The insurance sector also encourages the adoption of a coherent, flexible and manageable classification system, that does not represent a market barrier to pursuing investment strategies regarding ESG issues. In this respect, a dynamic approach with minimum standards would be crucial to **encourage the transition towards greener activities**, while recognising the function of stewardship and active ownership tools to promote sustainability.

Measures by Member States — Article 1(2) and Article 4(1)

Insurance Europe stresses the need to take into account the **specificities and maturity levels of national markets when developing harmonised standards and labelling schemes** that stimulate comparability of investments and cross-border transactions, not limited to European markets. Already established market features and existing differences in investors' preferences should be acknowledged and respected in the criteria for labels or other standards. In this respect, the industry believes that flexible arrangements have the potential to stimulate the **appetite for sustainable investments for more investors**, while allowing for market innovation.

Market participants offering sustainable financial products — Article 1(2) and Article 4(2)

Insurance Europe welcomes the inclusion of the **offering of financial products defined as environmentally sustainable** in the proposal. This has the potential to create a level playing field for financial market participants.

The **disclosures** regarding the environmental sustainability of a financial product referred to in Article 4(2) might enhance comparison of investments from a "green" perspective. However, the insurance industry notes that these requirements should be **coherent and proportionate**, so as not to penalise small and medium-sized companies with less investing capacity and resources. Insurance Europe also recommends clarifying how these obligations relate to those covered in Article 5 of the EC proposal on disclosures.[1]

In this respect, Insurance Europe is concerned that disclosures related to the criteria for environmentally sustainable activities might introduce **competitive distortions at product offering level**, deterring insurers, particularly smaller or less-resourced ones, from competing in the market for sustainable products. Specifically, insurers offering life products with a guarantee are at a **competitive disadvantage compared with other financial market participants offering fund-like products**. For guarantee products, the prudent person principle (Art 132 of the Solvency II Directive[2]) indirectly requires the insurer to invest in a broad mix of products (eg corporate bonds, covered bonds, government bonds, equities, real estate, mortgages, infrastructure, etc) for which the degrees of environmental sustainability will need to be determined. However, achieving a high sustainability degree for this complex mix of products would be challenging considering the currently limited supply of sustainable assets. Therefore, green insurance products linked to a guarantee will not be able to successfully compete on environmental grounds against other financing products that can easily achieve full environmental sustainability. In this context, financial stability issues connected with ESG assessment and related disclosures for some assets, eg government bonds, should also be considered thoroughly.

Environmental objectives — Articles 5-13

The insurance sector supports the **environmental objectives** listed in Article 5, including the definition of how economic activities contribute to them as specified in Article 6-11. Overall, the industry believes that they are aligned with the commonly-accepted understanding of which activities qualify as environmentally sustainable.

The **minimum safeguards** proposed in Article 12 are also welcomed, as the inclusion of the ILO conventions is imperative to ensure social resilience in the transition towards a more sustainable economy. These safeguards refer more to the social component of sustainability than to the environmental one, which displays the natural link between the different sustainability aspects.

Requirements for technical screening criteria — Article 14

The insurance sector welcomes the EC proposal's recognition of the need to develop specific technical screening criteria for each environmental objective. Looking at the requirements as defined in Article 14, Insurance Europe supports technical criteria that:

- are based on conclusive scientific evidence.
- comprehensively assess the economic activities, including products and services provided.
- cover all relevant economic activities and grant them equal treatment, provided same contribution levels.
- consider markets impacts on liquidity, stranded assets and other distortions.

However, Insurance Europe believes that the technical screening criteria should also:

- prevent the creation of unnecessary barriers to sustainable investments.
- allow for market developments and related innovation, beyond ongoing development at national and EU level.

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[1] COM/2018/354 final
[2] Directive 2009/138/EC

- incorporate a long-term perspective in the sustainability evaluation in order to:
  - facilitate long-term investments for firms willing to move towards more sustainable practices.
  - explicitly consider gradual transition from non-sustainable to sustainable activities, eg with respect to scientific and technological developments.
  - take into account that for certain investments (like investment in small private enterprises) less or no ESG data is available for technical screening, or the cost of obtaining this data is currently excessive compared to its benefits.

Platform on Sustainable Finance — Article 15

Insurance Europe particularly welcomes the establishment of a Platform on sustainable finance as an essential channel to promptly inform the taxonomy and monitor related key developments. The insurance sector strongly supports the **composition of this EC expert group** as described in Article 15(1).

In general, Insurance Europe appreciates the recognition of the need for flexibility and collaboration in the development of the taxonomy. In this respect, the possibility for relevant stakeholders to provide input as foreseen in Article 4(2) would allow the development of a more coherent and robust taxonomy, endorsed by financial market participants.

Insurance Europe also notes that, given their long-term business model, insurers can only change their portfolio gradually, respecting asset-liability-management requirements over a certain time horizon. As a result, a **stable governance structure** that encourages communication and cooperation is crucial for insurers. This will guarantee a smooth operationalisation of the taxonomy, supportive of long-term investments both in terms of attractiveness and financial stability.

Review clause — Article 17

The insurance sector welcomes how the review clause tries to tackle these issues, notably the evaluation of the:

- development of the technical screening criteria as per Article 17(a)
- criteria for environmental sustainability of economic activities as per Article 17(b)

While the industry welcomes a periodic 3-year evaluation report, the review should also allow for more frequent reviews as appropriate and in line with an evaluation of the Platform of Sustainable Finance, as foreseen in Article 15(f).

With respect to Article 17(c), the insurance industry strongly encourages the Commission to extend the scope of the proposed Regulation to social and governance aspects of sustainable finance. Investments related to the "S" and "G" factors are already of significant importance to insurers in a number of EU countries. However, there is a lack of appropriate supply of such assets. Action by the EC aimed at including social and governance objectives in the taxonomy would not only help address the gap in supply, but would support a transition to a sustainable future in a comprehensive manner. Therefore, paragraph 17(c) should be replaced with an explicit and unconditional commitment to **extending the scope of the proposed Regulation to social and governance objectives**, as soon as possible.

Regarding Article 17(d), Insurance Europe believes that a proper compliance mechanism should not impose costly verification requirements that might negatively impact financial investment returns and affect investors' preferences for sustainable investments. The industry highlights that such compliance requirements should be flexible and proportionate, also aligning or being part of the current applicable requirements and standards.

Timing and sequencing of application — Article 18

Considering the phased application of the framework as envisaged in Article 18, the insurance industry believes that binding regulatory measures based on the regulation should apply **only once the framework has been**

completed to include the social and governance components and all six environmental objectives, provided that suitable technical screening criteria are in place. Applying the taxonomy once all its components are completed would fully allow market players to develop familiarity, buy-in and expertise with sustainability concepts. Such application of the framework would ensure proportionality is considered, notably various maturity levels of market players across national markets as well as their various investment capacities and sizes.

A uniform, coherent and common understanding within the EU of what is meant by sustainability will be key to boosting the EU´s sustainability agenda. Specifically, the framework should be comprehensive and sufficiently advanced before being used as the basis for compulsory, sustainability-related, regulatory requirements. This would enable insurers and reinsurers to properly adjust their **product development and offering**, without being exposed to unnecessary uncertainty or risk. In this respect, the insurance industry notes some inconsistencies in the application dates as currently foreseen. While Article 4(4) stipulates July 2020 as the date of entry into force of a delegated act on information disclosures for the environmental sustainability of financial products, the framework will apply only from December 2021 and 2022 for those environmental objectives referred in point (4) and (5), and (3) and (6) respectively.

Since **sustainability has different meanings** to investors across markets, reaching a common understanding of what is sustainable must be the key priority of the EC. Consequently, Insurance Europe believes that the development of all components of the taxonomy should be sufficiently advanced before implementing binding measures. Specifically:

- the development of **a taxonomy for all ESG components needs to be prioritised** and the timeline to include all sustainability factors needs to be accelerated.
- regulatory requirements on sustainability that are related to the sustainability classification should be **voluntary** until all aspects of the classification system are sufficiently mature.

Insurance Europe notes that the first set of legislative proposals implementing the Action Plan on sustainable finance sets out requirements and obligations that explicitly refer to all ESG factors, namely reporting, transparency requirements and pre-contractual disclosure obligations on sustainable investments, as well as obligations at the level of the suitability test of the delegated acts of the IDD and MIFID II.

The link to prudential regulation (Solvency II)

The insurance industry supports prudential **rules that measure and capture actual risks and are not based on artificial incentives/disincentives to investing**.

The industry has over recent years highlighted a number of concerns regarding the design and calibration of long-term business and investment in Solvency II. While such concerns should be a priority in the 2018 and 2020 Solvency II reviews, the industry believes that the taxonomy should not be used as a base for building artificial investment incentives and/or disincentives. Prudential regulation should not attempt to artificially support green or penalize brown assets via adjusted capital requirements. Any changes in capital requirements should be based on compelling evidence regarding the risk profile of a given asset class. Contributing to the goals of sustainability should not contradict the risk-based nature of investment and underwriting decisions.