FERMA's response to Consultation Paper on Technical Advice on the integration of sustainability risks and factors in the delegated acts under Solvency II and IDD

Introduction

FERMA welcomes the inclusion of sustainability risks into insurance prudential regulations like Solvency II and IDD. The insurance industry is the largest institutional investor and certainly a driving force in the shift towards a sustainable economy. Insurance undertakings are playing a crucial role in the European economy in securing the business operations of thousands of organisations.

At the same time, it is of utmost importance to recognise that businesses are in the process of transitioning to sustainable practice. As this transition is ongoing, we believe if these proposed changes are implemented too hastily, it could have an acute impact on businesses who are yet to complete this process. Businesses must be given time to adapt their operations and facilitate these changes.

Before the completion of the future EU classification system of sustainable activities (the taxonomy) and the establishment of common European definitions that will clarify what constitutes a "sustainable activity", considerable work remains to be done to specify how the "inclusion of sustainability risks" will work in practice and what the practical consequences could be for corporate insurance offerings in Europe. Therefore, EIOPA has a key role in assessing the consequences of considering sustainability risks in EU prudential regulations and how it can be best implemented.

Therefore, FERMA raises the attention of EIOPA to the following points below and calls on the European insurance authority to pro-actively work with all stakeholders to overcome the sustainability challenges for the insurance community.

Q3: Do you agree with the proposed reference on the tasks of the risk management function?

Q4: 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?

1. **<u>Proportionality should remain central for smaller and less complex insurers</u>**
   - We welcome the mention of the need for a consideration of the proportionality principle when ensuring that insurance undertakings have sufficient understanding of sustainability risks on point 41.
   - Indeed, small and less complex insurance entities must comply with all requirements but should be allowed to simplify their approach in the way they fulfil them.
   - This is because, without posing a higher risk to global financial stability, compliance and regulatory costs for smaller insurance entities are high relative to their size. There is always a minimum in absolute value for compliance costs; irrespective of a company's size, which can be particularly detrimental to small entities.
   - Proportionality is also crucial for supervisory authorities as it can allow them to use their limited resources more effectively and focus on what is relevant for the regulation (focus on more risky companies, critical risk areas in an industry segment, customer protection, etc.).

2. **<u>A transition period is needed to acquire the necessary skills and knowledge to identify, assess and manage ESG risks</u>**
   - The EIOPA consultation paper mentions a gap in the necessary skills and knowledge to identify, measure and manage sustainability risks.
     - *Point 40 and 41: The assessment of sustainability risks requires deep knowledge of the undertaking's business, the external environment and the interaction between both. For such purpose, relevant knowledge may include a wide range of different areas such as ecology, law, sociology, financial markets, among others / risk managers and asset managers should be able to understand what "sustainability risks" means while being able to use relevant internal/external data*
     - *Point 55: lack of experience and ESG skills among institutional investors and asset managers*
   - We believe it is a fundamental issue because the prudent person principle relies on the fact that an insurance undertaking will only invest in assets and instruments *whose risks can be properly identified, measured, monitored, managed, controlled and reported (point 49).*
   - Therefore, a transition period is needed to ensure that the internal capacities are sufficient to produce reliable data on sustainability.
   - We recommend EIOPA engage with the risk management community with regards to the methods in which these risks can be identified and measured through quantitative and qualitative methods.
   - We also point out that the ESG skills shortage is a particular barrier for small insurance entities and thus we highlight the need for proportionality and a simplified approach for such organisations in the application of these changes.

Q5: Do you agree with the proposed new article for the integration of sustainability risks into the prudent person principle?

Q6: Do you agree with the proposed amendment of the article for the actuarial function?

1. **Need for a careful assessment of impacts on price and product diversity**
   - As recalled in the consultation paper, Solvency II does not regulate the pricing of insurance contracts (point 68).
   - However, if the opinion of the actuarial function on the overall underwriting policy includes sustainability risks affecting the policyholders and their claims, the materiality of ESG elements to be used in an actuarial analysis will be a crucial element for the credibility of the opinion.
   - Additionally, we are concerned about the impact these proposals will have upon the design of insurance related products and the offers that clients receive in terms of price and product.
   - Furthermore, if the inclusion of sustainability risk results in an increased cost to insurance organisations, we are concerned about the process of passing this cost onto insurance purchasers.
   - Materiality of ESG elements relates to the ongoing challenge to price externalities, i.e. to quantify and monetise sustainability risks.
   - It is necessary to evaluate how the proposed changes could affect the terms under which an insurance contract is offered.

2. **Impact on insurability**

   - Following announcements from a few (re)insurers that they will no longer insure companies with certain carbon footprints – we are concerned the insurability of companies who are yet to have undergone the transition to sustainable practice may be further affected.

   - If threats to insurability materialise – it is likely businesses will explore the use of captive insurance to ensure their practices are underwritten. Resultantly, we are concerned about the impact that these proposals will have upon the use of captives.

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