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Update

Finance and Governance

New Sustainable Finance Package: Rules on Insurance Activity

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Among the range of measures covered in the new regulatory package on Sustainable Finance, approved on April 2021, there are important rules on the activity of insurers.

In this regard, the European Commission has adopted two delegated acts that aim to include sustainability in its procedures and in its investment advice to clients.

Firstly, the **Commission Delegated Regulation** on insurance activity amending **Delegated Regulation (EU) 2015/35** regarding the integration of sustainability risks in the governance of insurance and reinsurance undertakings.

What's new in this topic?

- The Regulation clarifies and gives concrete definitions of sustainability risk, sustainability factors, and sustainability preferences.
- Insurance and reinsurance undertakings are required to take sustainability risks into account in their risk management, through their identification and assessment, and in the actuarial function, namely in the assessment of the uncertainty associated with the estimates made in the calculation of technical provisions.
- In view of the Commission's ambitions to ensure that climate and environmental risks are managed and integrated into the financial system, and the importance of remuneration policies to ensure that staff of insurance and reinsurance undertakings effectively manage the risks identified by their risk-management system, those remuneration policies should contain information on how they take into account the integration of sustainability risks into the risk-management system.
- The prudent person principle in Article 132 of Solvency II requires insurance and reinsurance undertakings to invest only in assets whose risks they can properly identify, measure, monitor, manage, control and report. In order to ensure that climate and environmental risks are effectively managed by insurance and reinsurance undertakings, the application of the prudent person principle should take into account sustainability risks and insurance and reinsurance undertakings should take into account in their investment process the

sustainability preferences of their clients, as taken into account in the product approval process.

The **second Commission Delegated Regulation amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359** as regards the integration of sustainability factors, risks and preferences into the product supervision and governance requirements for insurance undertakings and insurance distributors, and into the conduct of business and investment advice rules for insurance-based investment products.

How does this change manifest itself?

- Information on investment objectives typically focuses on the customer's risk-taking preferences, risk profile and financial objectives. In this Regulation, insurance intermediaries and insurance undertakings distributing insurance-based investment products are advised to take sustainability factors more adequately and systematically into account in their selection process. To assist in the recommendation of a product, suitability assessments should now invoke sustainability issues, including questions on customer preferences in this regard.
- The sustainability factors of insurance-based investment products should be presented in a transparent manner that allows insurance intermediaries and insurance undertakings to engage in a dialogue with their customers or potential customers in order to obtain a sufficiently detailed understanding of the sustainability preferences of each customer.
- The product approval process should identify at a sufficiently detailed level, for each insurance product, the target market and customer group compatible with that product, taking into account not only the characteristics, risk profile, complexity and nature of the insurance product, but also the related sustainability factors.
- The Regulation clarifies that a general statement that an insurance product has a sustainability-related profile is not sufficient. Instead, insurance companies and intermediaries developing the insurance product must determine the group of customers with specific sustainability preferences to whom they want to distribute the insurance product, taking into account the specific sustainability-related objectives at stake.
- The law aims to ensure that financial instruments that include any significant element related to sustainability are eligible for recommendation to clients or potential clients who express clear preferences in this regard. To this end, it is recommended that products be classified in advance and grouped according to the proportion invested in economic activities that are considered sustainable from an environmental point of view, the proportion of sustainable investments or consideration of the main negative impacts, namely through the categorization of the main negative impacts or the types of commitments made and qualitative or quantitative indicators.
- In line with the obligation to conduct distribution activities in accordance with the best interests of clients, recommendations made to clients and potential clients should reflect both the financial objectives and any sustainability preferences expressed by those clients. It is therefore necessary to clarify that the inclusion of sustainability factors in the advice process should not lead to mis-selling or misrepresentations that insurance-based investment products meet clients' sustainability preferences if this is not the case.

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- Seeking to avoid "greenwashing," in particular the practice of securing an unfair competitive advantage by recommending an insurance-based investment product as environmentally friendly or sustainable when in fact it does not meet basic environmental or other sustainability-related standards, insurance intermediaries and insurance undertakings that distribute insurance-based investment products should refrain from recommending such products as meeting individual sustainability preferences if they are not consistent with those preferences.
- Therefore, and to prevent such practices from occurring, insurance intermediaries and insurance undertakings providing advice on insurance-based investment products should first assess the other investment objectives and individual circumstances of a customer or potential customer before investigating the customer's possible sustainability preferences.
- In cases where no insurance-based investment product matches the customer's or potential customer's preferences regarding sustainability and the customer or potential customer decides to adjust his preferences, the insurance intermediary or insurance undertaking shall keep records of the customer's decision, including the reason for it.
- In order to maintain a high level of investor protection, when identifying the types of conflicts of interest whose existence may damage the interests of a client or potential client, insurance intermediaries and insurance undertakings distributing insurance-based investment products should include all conflicts that may arise from the integration of the sustainability preferences of a given client.

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