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ESG in the insurance sector – Integrating sustainability into the Solvency II and IDD frameworks

Two major delegated acts will come into force that integrate sustainability risks and factors into insurance undertakings' risks management, rules of conduct and product governance obligations.

On 2 August 2022, two major delegated acts **[1]** will come into force that integrate sustainability risks and factors into insurance undertakings' risk management, rules of conduct and product governance obligations.

I. Integrating sustainability risks into the risk management of insurance and reinsurance undertakings

1. Who is concerned?

All insurance and reinsurance undertakings, regardless of their activities.

2. Key changes

The Solvency II framework has been amended to take into account the impact that sustainability risks may have on the risk profiles of insurance and reinsurance undertakings.

In particular, insurance and reinsurance undertakings will now be required:

- to integrate sustainability risks into their overall system of governance, notably by:
  - including sustainability risks in their risk management system;
  - including sustainability risk oversight in the risk management function's duties;
  - taking sustainability risks into account in their assessment of the undertaking's overall solvency needs;
  - including sustainability risks in the actuarial function's opinion on their underwriting policy;
  - integrating sustainability risks into their remuneration policy;

- to integrate sustainability considerations into the prudent person principle, notably by:
  - including sustainability risks in the assessment of their investment risks;
  - ensuring that their investment strategy and decisions take into account:
    - the impact of the strategy and decisions on sustainability factors;
    - clients' sustainability preferences.

3. Practical impacts

Tackling these new rules has a series of practical impacts, requiring insurance and reinsurance undertakings to inter alia:

- review and adapt their overall system of governance, which includes:
  - o the composition, roles and responsibilities of the board of directors, both collectively and individually;
  - o the roles and responsibilities of the internal control functions;
  - o the roles and responsibilities of the actuarial function;

- train their key function holders and relevant employees in the new concepts and their implications;

- adapt their internal policies, procedures and processes.

II. Integrating sustainability factors, risks and preferences into product governance and rules of conduct

The IDD framework has been amended to integrate sustainability considerations into insurance undertakings' product governance processes and suitability assessments.

1. Integrating sustainability into product governance

1.1. Who is concerned?

All insurance undertakings that manufacture and/or distribute insurance products.

1.2. Key changes

Relevant insurance undertakings will now be asked to address three key sets of requirements for:

- embedding sustainability objectives and factors into the definition of their target markets;
- integrating their clients' sustainability objectives into the product approval and testing process;
- ensuring that the staff involved in product development have the necessary competences, knowledge and expertise to understand clients' sustainability objectives.

1.3. Practical impacts

Abiding by the new rules is no mean feat. In particular, it requires insurance undertakings to:

- review their entire product governance set-up to ensure that each step of the product development, approval and testing processes considers both the product's impact on sustainability factors and clients' sustainability objectives;
- ensure that the staff involved in these processes are properly trained to understand and implement the relevant sustainability considerations.

2. Integrating sustainability into the suitability assessment

2.1. Who is concerned?

Insurance undertakings (and intermediaries) that advise on insurance-based investment products.

2.2. Key changes

Relevant insurance undertakings will be required to consider their clients' sustainability preferences in suitability assessments.
Sustainability preferences are a (potential) client's choices on whether, and to what extent, any of the following financial instruments will be integrated into their investment portfolio:

- products that pursue, fully or in part, sustainable investments in economic activities that qualify as environmentally sustainable under Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088 (the "EU Taxonomy").
  These are investments that (i) substantially contribute to one or more of the six environmental objectives defined in the EU Taxonomy, (ii) must not significantly harm any other environmental objective, (iii) comply with technical screening criteria established by the European Commission and (iv) comply with minimum social and labour standards.

- products that pursue, fully or in part, sustainable investments pursuant to Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

These are investments in an economic activity that (i) pursues an environmental or a social objective, provided (ii) that the relevant investments do not significantly harm any other objective and (iii) that such investments comply with minimum social and labour standards.

• products that consider principal adverse impacts on sustainability factors.
Such products try to limit or exclude negative impacts of investments and activities on environmental, social and governance matters.

2.3. Practical impacts

Tackling these new rules requires insurance undertakings to adopt a series of practical measures, including in particular:

• training to enable staff to understand and distinguish the relevant investment products and educate clients on the new concepts;
• review and update of the product development, approval and testing processes;
• review and categorisation of products;
• review and update of policies, procedures, processes and contractual documentation;
• adapting internal record-keeping arrangements.

>> To read the Commission Delegated Regulation (EU) 2021/1256 of 21 April 2021 amending Delegated Regulation (EU) 2015/35 as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings, **click here_**

>> To read the Commission Delegated Regulation (EU) 2021/1257 of 21 April 2021 amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as regards the integration of sustainability factors, risks and preferences into the product oversight and governance requirements for insurance undertakings and insurance distributors and into the rules on conduct of business and investment advice for insurance-based investment products, **click here_**

If you need more information, please contact us.

[1] Commission Delegated Regulation (EU) 2021/1256 of 21 April 2021 amending Delegated Regulation (EU) 2015/35 as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings;

Commission Delegated Regulation (EU) 2021/1257 of 21 April 2021 amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as regards the integration of sustainability factors, risks and preferences into the product oversight and governance requirements for insurance undertakings and insurance distributors and into the rules on conduct of business and investment advice for insurance-based investment products.

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