Principles for Responsible Investment

CONSULTATION RESPONSE

EIOPA CONSULTATION PAPER ON TECHNICAL ADVICE ON THE INTEGRATION OF SUSTAINABILITY RISKS AND FACTORS IN THE DELEGATED ACTS UNDER SOLVENCY II AND IDD

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INTRODUCTION

ABOUT THE PRI

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 2200 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US $83 trillion in assets under management. Of these, 1096 are based in Europe.

The PRI works with policy makers, regulators, investors and stakeholders to improve the sustainability of the financial system and address systemic market risks through policy change. The PRI has experience of responsible investment public policy reform in multiple markets, including the UK, Europe, US and China.

THE PRI VIEW: INVESTOR DUTIES AND SUSTAINABILITY

The PRI strongly supports action by EU institutions to clarify the relationship between investor duties and sustainability. Since 2005[1], a growing body of evidence has demonstrated that failure to consider these issues in investment practice is a failure of investor's duties (often referred to as 'fiduciary duties'). This was echoed in the 2016 consultation on long-term sustainable investment[2] and the 2017 consultation on the Capital Markets Union mid-term review[3], as well as the recommendations of the High Level Expert Group on Sustainable Finance (HLEG).

The PRI was an observer to the HLEG and contributed to the recommendations on reforming investor duties, governance and risk management. The HLEG analysis identified several critical dimensions to clarify:

- Key investment activities, including investment strategy, risk management, asset allocation, governance and stewardship should integrate a broad range of value-drivers including sustainability factors.
- There should be greater alignment with the time horizon of the end beneficiary or policy-holder.
- Investors should proactively seek to understand the sustainability interests and preferences of their clients, members or beneficiaries and disclose whether, and how, these have been taken into account.
- Stewardship is an essential element in fulfilling investor duties.

However, investors are not yet systematically integrating these issues. The PRI finds that ambiguity around investor duties has been a key barrier and therefore strongly welcomes the legal clarity proposed in EIOPA's draft technical advice.

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[1] UNEP FI and Freshfields Bruckhaus Deringer, A legal framework for the integration of environmental, social and governance issues in institutional investment, 2005, PRI, UNEP FI and The Generation Foundation, Fiduciary Duty in the 21st Century.

[2] This concluded that 'the large majority of contributors, in particular institutional investors and NGOs, argued that fiduciary duty, that is, the duty of investors and asset managers to act in the best interest of the beneficiary (future pensioners) or the client (retail or institutional investors) was not clear enough and could therefore be used as an excuse for not considering ESG matters in investment decisions'

[3] This proposed 'clarification that fiduciary duties of asset owners and asset managers includes integrating environmental, social and governance (ESG) considerations into decisionmaking'

RESPONSE TO DETAILED QUESTIONS

The PRI's core competency is in activities relating to institutional investment and is therefore responding to relevant parts of section 2: Technical advice on delegated acts under Solvency II.

2.1 ORGANISATIONAL REQUIREMENTS

Draft Technical Advice
Policy proposals for organisational requirements Solvency II Delegated Regulation to be amended as follows:
Article 269
(1) "The risk management function shall include all of the following tasks:
(a) assisting the administrative, management or supervisory body and other functions in the effective operation of the risk management system;
(b) monitoring the risk management system;
(c) monitoring the general risk profile of the undertaking as a whole;
(d) detailed reporting on risk exposures and advising the administrative, management or supervisory body on risk management matters, including in relation to strategic affairs such as corporate strategy, mergers and acquisitions and major projects and investments;
(e) identifying and assessing emerging risks **and sustainability risks.**"

Questions to stakeholders

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

Yes. The PRI agrees with the EIOPA view that risks originating from sustainability factors, should be considered within the existing mandate of the administrative, management or supervisory body (AMSB) and key functions. However, we find that this is not yet systematic. Our analysis demonstrates that the lack of regulatory clarity, rather than the novelty of these risks, is a critical barrier to more systematic integration. To that effect, we welcome the introduction of specific language in Article 269 to remove ambiguity and draw attention to the need to assess these risks, in combination with the introduction of the new article in the Solvency II Delegated Regulation on the prudent person principle.

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?

Yes. The PRI recommends that disclosure requirements of the delegated regulation are also updated to require disclosure on the integration of sustainability issues into governance and risk management. This will be critical to ensure that regulators, beneficiaries and policy-holders have adequate information and can understand and assess the insurer's practices.

In addition, the PRI supports EIOPA's proposal to provide additional guidance on aligning remuneration strategy with sustainability objectives. Amendments in both of these areas should complement and support the requirements in Solvency II and also align with emerging proposals on [disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341.]

The PRI also supports providing additional guidance to support the evaluation of "fit and proper" requirements, in line with recommendation 7 of the [High Level Expert Group on Sustainable Finance]. This guidance should make clear that fit and proper tests should include an assessment of the individual and collective ability of the members of governing bodies to address sustainability risks and opportunities, to understand the stakeholder context and to take account of clients' sustainability preferences.

2.2 OPERATING CONDITIONS

Draft Technical Advice Policy proposals on operating conditions - New article in the Solvency II Delegated Regulation, Chapter IX, new Section 6: Section 6 Investments Article 275bis Integration of sustainability risks in the prudent person principle. "1. Within the prudent person principle, insurance and reinsurance undertakings shall take into account sustainability risks when assessing the security, quality, liquidity, and profitability of the portfolio as a whole. 2. Insurance and reinsurance undertakings shall take into account the potential long term impact of investment decisions on sustainability factors and, where relevant, reflect the environmental, social and governance preferences of policyholders and beneficiaries." - New recital in the Solvency II Delegated Regulation: "(xx) Insurance undertakings should reflect the environmental, social and governance preferences of policyholders and beneficiaries in their investment portfolio where these preferences are relevant for the product oversight and governance arrangements according to Directive 2016/97 and Commission Delegated Regulation 2017/2358, as indicated by the use of the terms "where relevant, reflect the environmental, social and governance preferences of policyholders and beneficiaries " in this Regulation."

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

The PRI supports the creation of the new article in the Solvency II delegated regulation. We believe that introducing this language is necessary to provide legal clarity and to draw attention to issues which are often neglected in investment practice.

The PRI was an observer to the HLEG and contributed to the recommendations on reforming investor duties, governance and risk management. The HLEG analysis identified several critical dimensions to clarify:

- Key investment activities, including investment strategy, risk management, asset allocation, governance and stewardship should integrate a broad range of value-drivers including sustainability factors.
- There should be greater alignment with the time horizon of the end beneficiary or policy-holder.
- Investors should proactively seek to understand the sustainability interests and preferences of their clients, members or beneficiaries.
- Stewardship is an essential element in fulfilling investor duties.

With regards to the draft technical advice, the PRI therefore recommend the following changes:

- Paragraph 1 should explicitly reference the need to align with the time horizon of the beneficiaries or policy-holders and the term "sustainability risks" should be replaced with "sustainability risks and opportunities" to better reflect the benefits of integrating sustainability issues within the investment process.
- The intent of paragraph 2 is to encourage stewardship in line with beneficiary preferences, and to positively influence corporate practice on sustainability. We therefore recommend that paragraph 2 state explicitly that investors should work to understand the sustainability preferences of their beneficiaries and policy-holders, and be active owners to encourage companies to progress towards sustainable economic activities. Investors should also disclose if, and how, the preferences of their beneficiaries and policy-holders have been taken into account.

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

Actuarial issues are not in scope for the PRI.

2.3 RISK MANAGEMENT

Draft Technical Advice

Policy proposals for risk management Solvency II Delegated Regulation to be amended as follows:

Article 260 Risk management areas

"1. The areas referred to in Article 44(2) of Directive 2009/138/EC shall include all of the following policies:

(a) Underwriting and reserving:

(i) actions to be taken by the insurance or reinsurance undertaking to assess and manage the risk of loss or of adverse change in the values of insurance and reinsurance liabilities, resulting from inadequate pricing and provisioning assumptions **due to internal or external factors, including sustainability risks;**

(…)

(c) Investment risk management:

(…)

(vi) actions to be taken by the insurance or reinsurance undertaking to ensure that sustainability risks relating to the investment portfolio are properly identified, assessed and managed.

(…)

1.a The policies on the areas referred to in paragraph 1 shall include, where appropriate, consideration of sustainability risks.

Article 262 Overall solvency needs

"1. The assessment of an insurance or reinsurance undertaking's overall solvency needs, referred to in Article 45(1)(a) of Directive 2009/138/EC shall be forward looking and include all of the following elements:

(a) risks the undertaking is or could be exposed to, including operational risks, taking into account potential future changes in its risk profile, due to:

i. the undertaking's business strategy,

ii. the economic and financial environment, or

iii. the effect of sustainability risks, **including climate change;** (…)

Q7: Do you agree with the proposed reference to sustainability risks under the investment as well as the underwriting and reserving risk management policy?

The PRI agrees with the need to amend the investment risk elements to clarify that sustainability risks should be included. Underwriting and reserving risk are outside our scope.

Q8: Do you agree that other risk management policies may include reference to sustainability risks?

Not in scope for PRI.

Q9: Do you agree with the proposed requirement to include consideration of the effect of sustainability risks in the overall solvency needs assessment of the undertakings'' ORSA?

Yes. As above, we consider an explicit reference to sustainability to be a necessary and useful addition. The PRI has developed tools and guidance to support investors to respond to risks such as climate change. Of particular relevance is PACTA, an online tool for analysing exposure to climate transition risk in energy intensive sectors, developed with 2 Degrees Investing Initiative. We would welcome the opportunity to share more detail on this and other initiatives.