ShareAction»

ShareAction's feedback on the European Commission's Solvency II Directive review proposal[1]

ShareAction welcomes the Commission's efforts to integrate sustainability considerations in the review of the legislative framework for European (re)insurers, Solvency II. However, more ambitious regulatory changes are needed to allow the European insurance sector to face mounting sustainability risks and play a positive role in the transition to a greener economy, in view of achieving the EU's sustainability ambitions.

Risk management

The Commission's proposed requirement for insurers to conduct climate change scenario analysis is a step in the right direction, although it has shortcomings:

- There should be a provision for extreme warming and disorderly transition scenario, as recommended by the Network for Greening the Financial System (NGFS)[2]
- The scenario analysis should be disclosed to allow external stakeholders to assess insurers' positions and progress. (See the Task Force on Climate-related Financial Disclosures' (TCFD) intention to improve public data on climate-related risks and opportunities[3])
- The scenario analysis should not be limited to climate change risks, but should encompass wider environmental risks.

Double materiality

The proposal only considers how climate change risks affect insurers but overlooks the impact that insurers' activities have on planet and societies ('double materiality'). Although such impact will be disclosed by most insurers under the Sustainable Finance Disclosure Regulation and Corporate Sustainability Reporting Directive, the former contains loopholes (Member States can exempt smaller insurers) and the latter is still under discussion, so there is no guarantee as to what insurers it will ultimately cover. Thus, Solvency II should include the obligation for all insurers to assess and regularly report on the sustainability impact of their investing and underwriting activities, as well as the obligation to implement strategies aimed at reducing negative impacts. Solvency II should also detail the supervisory process and powers, especially for cases when undertakings fail to comply with the regulation.

Prudent Person Principle

Although the April 2021 Delegated Act (applicable from August 2022) provides that, in relation to the Prudent Person Principle, insurers shall *"take into account the potential long-term impact of their investment strategy and decisions on sustainability factors"* and that *"where relevant, that strategy and those decisions … shall reflect the sustainability preferences of its customers",* this remains too general. EIOPA or the Commission should provide guidance on how this should be done, and insurers should also be required to take steps to mitigate their negative impact.

Sustainable practices

Given that shareholder engagement is key to investor impact, Solvency II should require insurers to implement responsible stewardship practices, i.e. to influence the strategy of the firms in which they invest to steer them towards more sustainable practices.

In addition, insurers should be required to consider sustainability risks and impacts in their underwriting policies, practices (including in the development and pricing of insurance products) and reporting.

Capital requirements

Insurers' capital requirements do not reflect climate change risks; they provide problematic incentives to invest in and insure climate change inducing activities. This goes against the risk-based nature of Solvency II and the EU's objectives to direct more capital towards sustainable activities and, crucially, *away* from harmful activities. The Commission missed an opportunity to show leadership by updating pillar 1 rules in line with climate change risks. We encourage EIOPA to adopt a precautionary approach when exploring a dedicated prudential treatment of exposures related to environmentally and/or socially harmful activities, and to treat fossil fuel related assets as the riskiest type of assets.