Sustainability regulations in the insurance sector

8 February 2022

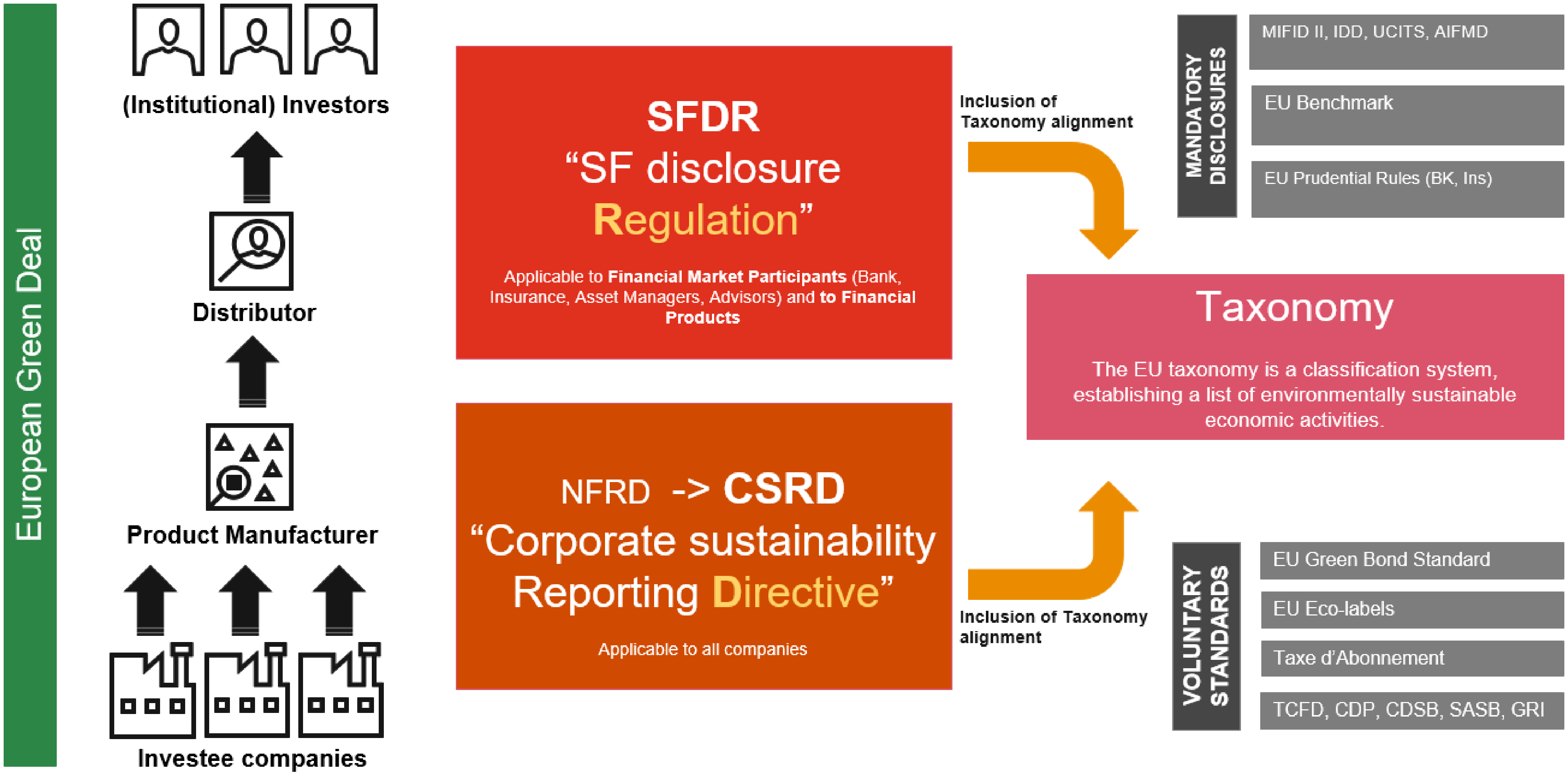
Hosted by pwc

Content

Recap on the Regulatory landscape
Four essential pillars

SFDR	Taxonomy	DA *MiFID/IDD UCITS/AIFM*	CSRD
Disclosure - financial products	Framework - define environmentally sustainable activities	Requirements - distributors, managers	Disclosure - corporates

Recap on the Regulatory landscape
An interconnected world…



Recap on the Regulatory timeline

The dynamic regulatory development for the insurance industry continues in 2022 and beyond…

2021 · 2022 · 2023 · 2024

10/03/2021
Main application date of **SFDR Level 1**

Solvency 2

4/21: EIOPA Opinion on integration of scenario analysis into ORSA

07/21

i. Consultation on QRT extension
ii. Methodology on ESG in the SII standard formula, report on ESG in nonlife underwriting and pricing

1 January 2022

- **Taxonomy:** Application date of technical screening criteria for the env'l objectives: (i) Climate change mitigation & (ii) Climate change adaptation
- **Taxonomy:** Alignment reporting – at product & entity level

Q1 2022

- **CSRD**: Expected Publication of EC Proposal

01/05/2022

- **EET** enters into force (planned)
- **Q2 2022 Taxonomy** : DA TSC env. goalsl 3-6

Q2/3 2022

Application date of:

- **MiFID II** amendments
  - i. Suitability: 02/08/22
  - ii. Target market: 22/11/22
- **UCITS** / **AIFMD** amendments
- **IDD** amendments (DAs)
- **Solvency II** amendments (DAs) incl. start of monitoring in ORSA.

31 December 2022

- **SFDR:** Application Level 2(RTS)
- **SFDR:** Go-live PAI at product level
- **SFDR:** End of 1st reference period (1/1/2022 – 31/12/2022) for PAI at entity level
- **Taxonomy:** 1st reporting deadline (climate change objectives)

January 2023

- **01/01 Taxonomy:** Application date of technical screening criteria for the remaining environmental objectives: (iii) water and marine resources, (iv) Circular economy, (v) Pollution prevention, (vi) biodiversity
- **Solvency 2 :** Application of extended SII QRTs

CSRD

30/06/2023

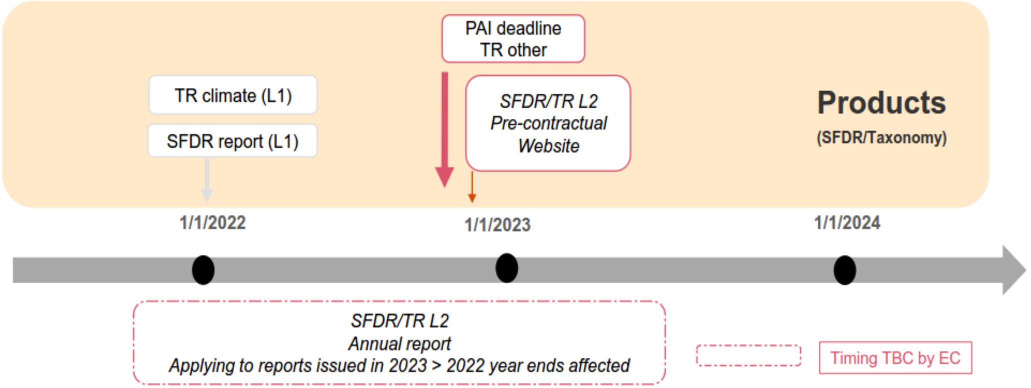
- **SFDR:** 1st PAI reporting at entity level to be published

01 January 2024

- **Taxonomy:** Quantitative taxonomy alignment reporting (entity level – reporting period 2023)

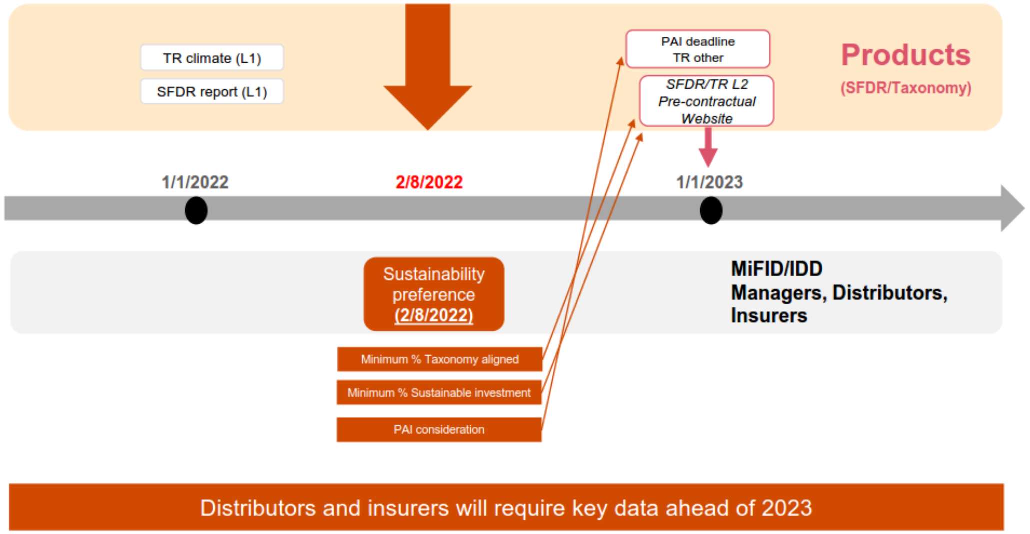
And a few sympathetic challenges…

L2 postponed to 1 January 2023



Capture of information starts 1 January 2022 !

But information required for MiFID/IDD in August



What to expect in the next months…in a nutshell…

- **Finalization of SFDR RTS**
- **Continuation of Environmental Taxonomy work (TSC of objectives 3 to 6)**
- **Extension of Taxonomy?**
- **Social Taxonomy?**
- **Non-financial reporting from companies (CSRD, EFRAG, ISSB…)**
- **EU Eco-label**
- **New initiatives stemming from the new Sustainable Finance Action Plan**

COMMISSARIAT AUX ASSURANCES

A few recent matters of interest…

Regulatory update 1/2: Draft report of JURI on CSRD & Complementary Delegated Act

CSRD JURI draft report

EU COM legislative proposal (Apr 2021) foresees:

- CSRD to become effective on 1 Jan 2024 (for FY2023)
- Exemption for subsidiaries if a subsidiary and its subsidiary undertakings are included in the consolidated management report of a parent undertaking

The draft report of the EP's Legal Affairs (JURI) committee (Nov 2021) proposes:

- A 1-year delay of the application date to 1 Jan 2025 (for FY2024)
- To eliminate the subsidiary exemption (the EP committee EMPL supports this view)

Next steps:

- Several meetings in Jan 2022 aiming at reaching a compromise text
- The JURI final report is expected to be adopted by mid-March

EU Taxonomy Complementary Delegated Act

Through Article 10(2), the Taxonomy permits certain transitional activities in gas and nuclear sectors to be classified as environmentally sustainable.

Nuclear activities and fossil gas activities to be included in the Taxonomy

1. Pre-commercial stages of advanced nuclear technologies with minimal waste from the fuel cycle
2. Construction and operation of new nuclear power plants (third generation or higher) for electricity or heat production, including hydrogen production
3. Electricity generation from nuclear energy in existing plants
4. Electricity generation from fossil gas
5. Combined heat or cold and electricity generation from fossil gas (cogeneration)
6. Heat or cold generation from fossil gas in a district heating and cooling system

The supplementary Delegated Act will go through the following process:

Formal adoption later in January 2022 → 4-month scrutiny period - Objection requires qualified majority (72% - 20 MS) → 2-month extension period → Application after scrutiny period

A few recent matters of interest…

EU COM Art. 8 TR FAQs

- On 20 December 2021, the EU COM published an FAQs document on Art. 8 Taxonomy Regulation. In addition, the Platform on Sustainable Finance published its considerations on voluntary information as part of Taxonomy-eligibility reporting.
- Even though the FAQs clarify several issues, there is still a lot of room for interpretation, which has the potential to limit the comparability of the KPIs across the insurance sector.

Selected key elements of the FAQs with high importance for insurers	
Q4	**Mixed groups** shall report consolidated Taxonomy information based on the type of undertaking of the parent of the group. They are free to provide additional voluntary Taxonomy information when considered relevant to gain an understanding of taxonomy eligibility.
Q 12	In the case where an underlying undertaking has not yet disclosed its taxonomy eligibility, which will be the case for FY21, a financial undertaking may choose to estimate the proportion of eligibility of economic activities (e.g., by using the NACE approach). This is considered a voluntary disclosure in the FAQ.
Q 13	Financial undertakings shall **'look through**' their portfolios of investments and assets to assess those investee undertakings that are the ultimate beneficiary and their taxonomy aligned activities for the purpose of the disclosures required by the Art. 8 TR Delegated Act.
Q 16	For the underwriting of non-life insurance activities to be counted eligible, the insurance line of business **must contain a policy** (i.e., the insurance policy as agreed with the customer) **with terms related to the treatment of 'climate perils'** in view of Appendix A to Annex II to the Climate DA.
Q 18	Reinsurance companies should seek to obtain information on the LoB of the ceded insurance business in time for the eligibility reporting. In the absence of information to perform the assessment, reinsurers could use estimates to report eligibility information on a voluntary basis, and separately from the required eligibility disclosures in accordance with the Art. 8 TR Delegated Act.
Q 19	Clarification that life insurance does not qualify as a Taxonomy eligible activity as determined by the Climate Delegated Act and that it relates to non-life insurance consisting of the underwriting of climate-related perils and reinsurance only. Activities of life insurers are covered by the investment KPI.

Estimates and proxies

- **are not allowed** to be used **for the mandatory reporting** under Art. 8 TR. Yet, entities may disclose additional information on a voluntary basis, separately from the Art. 8 disclosures and clearly identified as estimates/proxies.
- There must be a **clear distinction** between the mandatory KPIs and additional voluntary disclosures.

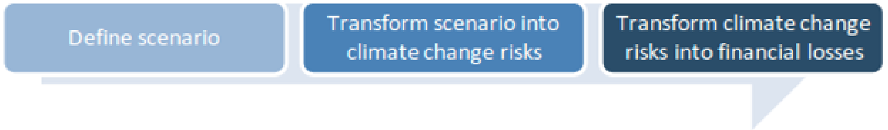
Voluntary disclosures should be prepared on the basis that they do not contradict or misrepresent the mandatory information reported pursuant to the Disclosures Delegated Act and it **should not be given more prominence** than the mandatory disclosures. Where an undertaking includes voluntary disclosures, this disclosure should be accompanied by supporting detail setting out the basis for this disclosure and methods used for its preparation along with a clear explanation of how it differs from mandatory reporting (see explanatory notes for Q18 of the FAQs).

https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-taxonomy-article-8-report-eligible-activities-assets-faq_en.pdf

A few recent matters of interest…

Consultation issued 10 December 2021

- Forward-looking management of physical and transition risks;
- Detailed and practical basis for implementation of sustainable finance ambitions in practice;
- Concrete case studies for materiality assessment of climate change scenarios included in the consultation. Help design the steps for the materiality assessment and to run climate change scenarios;
- Improve the comparability of reported information.



ATLEAST **two long-term climate scenarios** should be considered :

- a global temperature increase remaining **below 2°C**, ideally 1.5°C, in line with the EU commitments;
- a global temperature increase **exceeds 2°C.**

Define high-level scenario **needs**

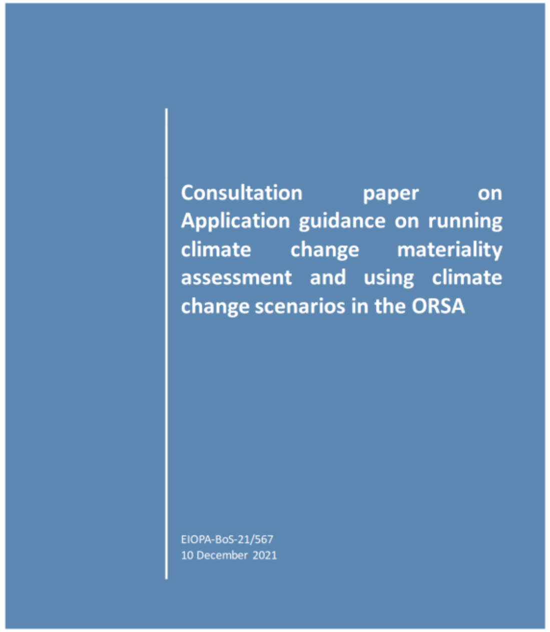
Define the needed scenario **parameters**

Choose the scenario **ambition**

Choose the scenario **speed**

Conclusions

- Granularity of data;
- Availability of tools;
- Finding the right tools/data for the right analysis;
- Predefined parameters versus own parameters.


Consultation paper on Application guidance on running climate change materiality assessment and using climate change scenarios in the ORSA

EIOPA-BoS-21/567
10 December 2021

Appendices

SFDR – a look in the rearview mirror…

2021 · 01 · 02 · 03 · 04 · 05 · 06 · 07 · 08 · 09 · 10 · 11 · 12 · 1 January 2022

02 – 2 February 2021

Draft RTS released

03 – 10 March

Application date of SFDR level 1 disclosures:

- Pre contractual
- Website

04 – ESA's Public Hearing

- Single rule book for SFDR and Taxonomy for product level disclosures

05 – Consultation closed

Consultation on the ESA's Taxonomy-related product disclosures closed (combined SFDR and Taxonomy RTS for product disclosures

07 – Delay to application of RTS and Responses to Q&A

- Level 2 delayed to July 2022
- Commission responds to ESA's questions

10 – Update to RTS

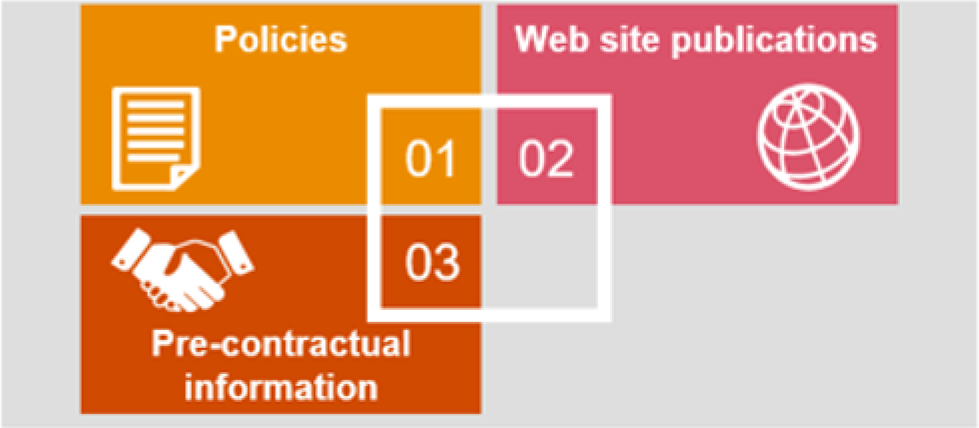
Updated RTS published final report as it relates to Taxonomy related product disclosures

11 – Deferral of level 2 SFDR reporting obligations

Application date deferred to 1 January 2023 with PAI disclosures by 30 June 2023

SFDR – a look in the rear-view mirror…

1 Disclosure requirements at **management level**

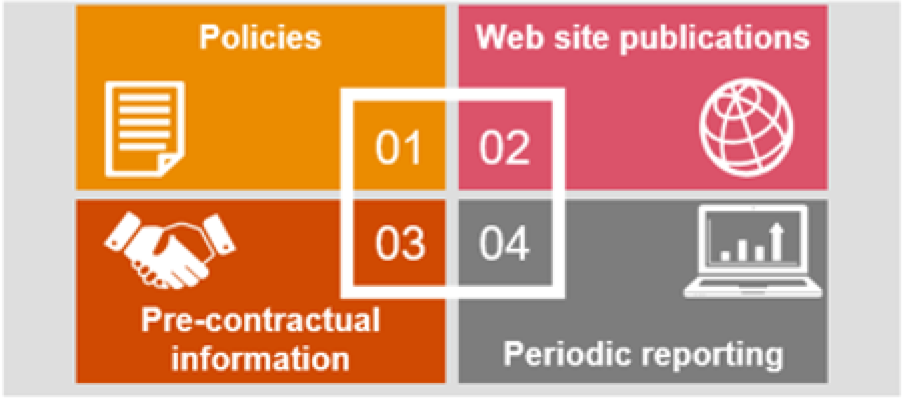


01
- Implementation of **sustainability risk policies.**
- Enhancement of **governance policies.**
- Enhancement of **remuneration policies.**

02
- **Sustainability risk policy.**
- **Statement on adverse sustainable impact considerations.**
- **Information on integration of sustainability risk in remuneration policy.**

03
- Information on the **integration of sustainability risks in investment decision.**
- Explanation of the **impact of sustainability risks on the return** of financial instruments offered.
- Explanation of the **absence of sustainability risks.**

2 Disclosure requirements at **product level**



01
- Enhancement of **product policies.**

02
- Enhanced product information.

03
- Explanation of the **absence of sustainability risks.**
- Specific information on **products promoting ESG-characteristics or following an ESG objective.**

04
- Annual Information on specific ESG factors fostered by a financial product.

Taxonomy – a look in the rear-view mirror…

2021 · 01 · 02 · 03 · 04 · 05 · 06 · 07 · 08 · 09 · 10 · 11 · 12 · 1 January 2022

ESMA, EBA and EIOPA issue guidance
On the KPIs and methodology for disclosure of environmentally sustainable activities by financial institutions

Climate Delegated Act Published
Publication of the delegated act on the technical criteria for the first 2 environmental criteria

Draft Delegated Act
Advice on the content and the presentation of the information to be reported

EU Taxonomy Compass and formal adoption of Delegated Act
The EU publishes a taxonomy spreadsheet for mapping economic activities against the technical criteria

Proposal for Social taxonomy and extension of Environmental taxonomy
In addition to the social taxonomy, a proposed extension to the environmental taxonomy to define 'significantly harmful' and 'no significant impact' activities

Draft Criteria for remaining Environmental taxonomy
Draft criteria for remaining 4 environmental categories - water, circular economy, pollution and biodiversity were published

Article 8 Delegated Act published
Delegated Act supplementing Article 8 of the Taxonomy regulation published in the Official Journal

Taxonomy (“Classification system”) – The Essentials (1/3)

RELEVANT FOR	Entity level	Bank
		Insurance
		Asset Managers
	Product level	Financial products

The EU taxonomy is a classification system, establishing a list of environmentally (and social) sustainable economic activities.

An economic activity is sustainable when…

ENVIRONMENTAL OBJECTIVES

1. **Climate change mitigation**
2. **Climate change adaptation**
3. **Sustainable use and protection of water and marine resources**
4. **Transition to a circular economy, including waste prevention and increasing the uptake of secondary raw materials**
5. **Pollution prevention and control**
6. **Protection of biodiversity and healthy ecosystems, and restoration of degraded ecosystems**

SOCIAL OBJECTIVES

1. **Respect for Human Rights**
2. **Governance**
3. **Promote Adequate Living Conditions for all**

https://ec.europa.eu/sustainable-finance-taxonomy/

TIMING

PHASE 1
- Technical details out
- Reporting as from January 2022

PHASE 2
- Technical details NOT out
- Reporting as from January 2023

PHASE 3
- Technical details NOT out
- Reporting TBD

Classification process

For an economic activity to be considered **environmental sustainable**, it has to comply with *four different conditions:*

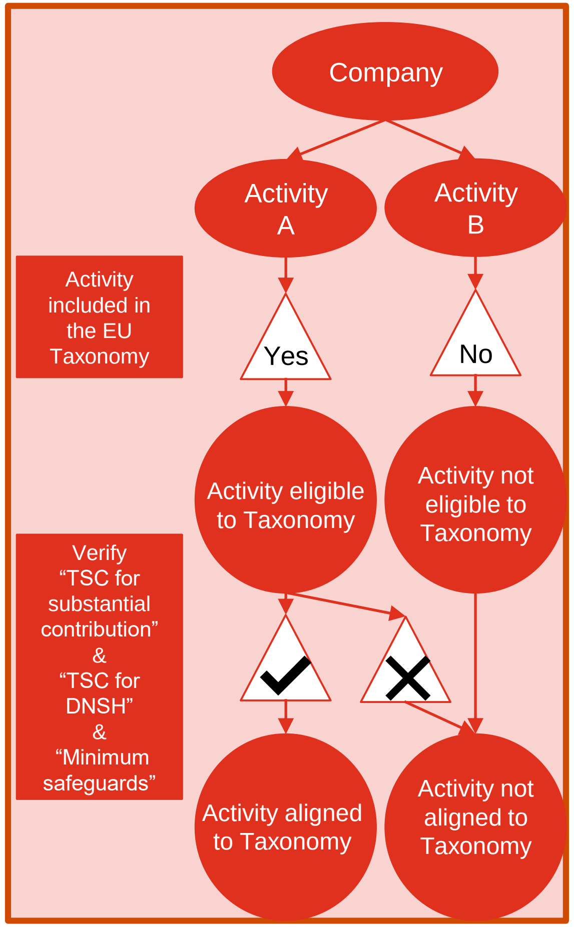
1. Make a **substantial contribution** to one of the 6 environmental objectives;

2. Comply with the **technical screening criteria (“TSC”)** of the main objective;

3. **Do not significantly harm (“DNSH”)** to the other 5;

4. **Meet minimum safeguards** (OECD guidelines on multinational enterprises and the UN Guiding Principles).

The mechanism to classify economic activities as **social sustainable** is currently being developed by the European Commission.

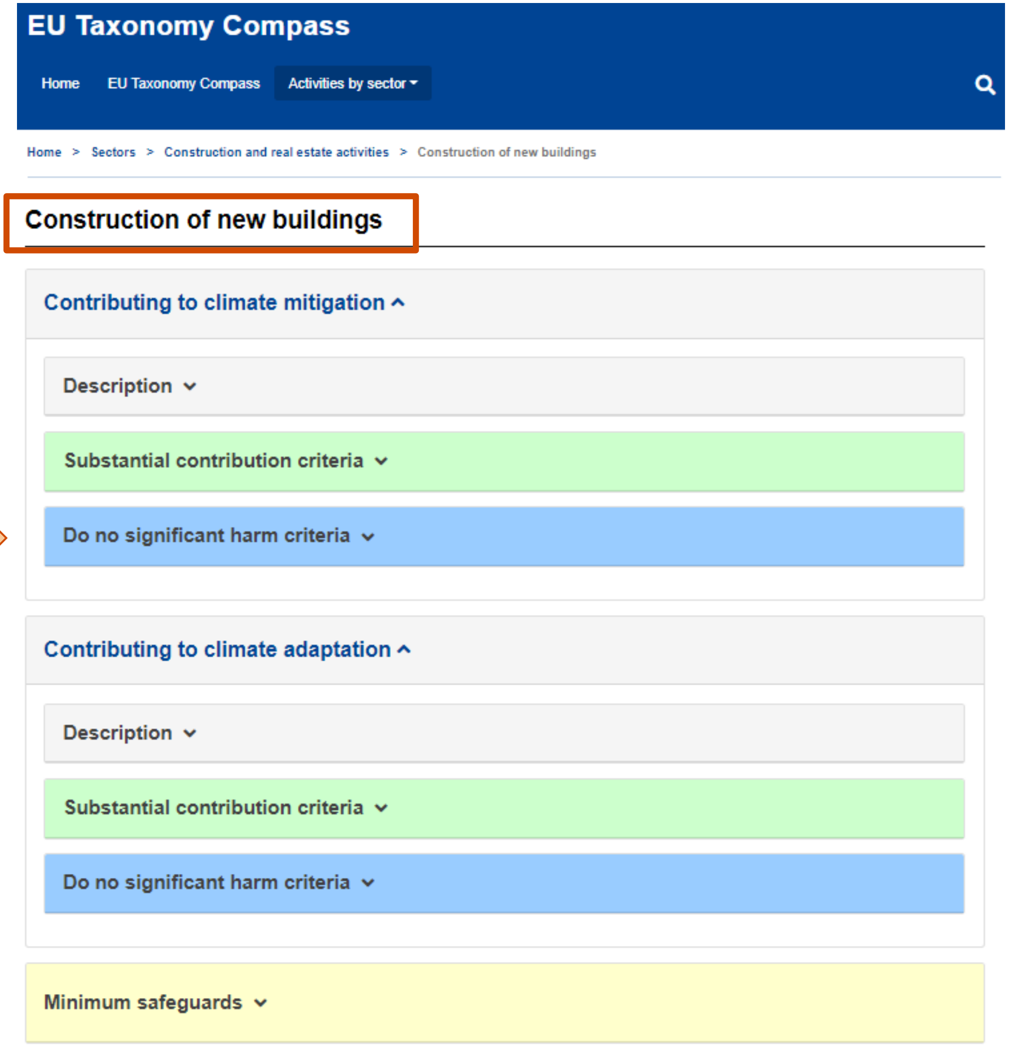


Taxonomy (“Classification system”) – The Essentials (2/3)

RELEVANT FOR	Entity level	Bank	Product level	Financial products
		Insurance		
		Asset Managers		

13 sectors with more than hundred activities included in the delegated climate act

Sector	1 Mitigation		2 Adaptation
1. Agriculture and forestry	✓		✓
2. Environmental protection and restoration activities	✓		✓
3. Manufacturing	✓		✓
4. Energy	✓		✓
5. Water supply, sewerage, waste management and remediation	✓		✓
6. Transport	✓		✓
7. Construction and real estate activities	✓		✓
Construction of new buildings	✓		✓
Renovation of existing buildings	✓	T	✓
Installation, maintenance and repair of energy efficiency equipment	✓	E	✓
Installation, maintenance and repair of charging stations for electric vehicles in buildings (and parking spaces attached to buildings)	✓	E	✓
Installation, maintenance and repair of instruments and devices for measuring, regulation and controlling energy performance of buildings	✓	E	✓
Acquisition and ownership of building	✓		✓
8. Information and communication	✓		✓
9. Professional, scientific and technical activities	✓		✓
10. Finance and insurance activities			✓
11. Education			✓
12. Human health and social activities			✓
13. Arts, entertainment and recreation			✓



https://ec.europa.eu/sustainable-finance-taxonomy/

Taxonomy ("Classification system") – The Essentials (3/3)

RELEVANT FOR: Entity level – Bank, Insurance, Asset Managers; Product level – Financial products

KPIs

Turnover

Capital Expenditure "CAPEX"
Assets intended to benefit the organization for more than one year

Operational Expenditure "OPEX"
Ongoing expenses to run day-to-day business

Sovereign exposures

Separated disclosure as country not-taxonomy aligned

Short positions

Netted for Taxonomy

Derivatives

Not addressed

Activities

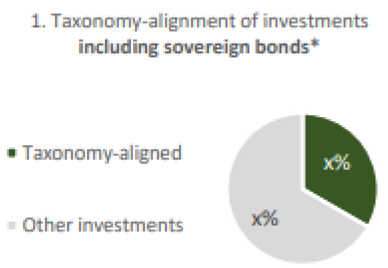
Enabling activities directly enable other activities to make a substantial contribution to an environmental objective

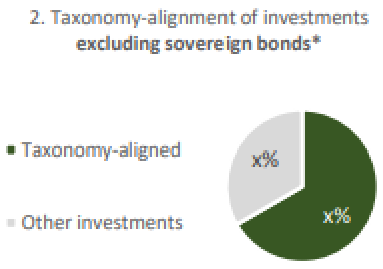
Transitional activities are activities for which low-carbon alternatives are not yet available and that have greenhouse gas emission levels corresponding to the best performance.

Pre-contractual disclosures

Investments in non-financial companies	Investments in financial companies
Turnover KPI by default	Turnover KPI by default CAPEX or OPEX where this may be more appropriate given the features of the financial product

The same KPI must be used for all investments in the pre-contractual disclosure

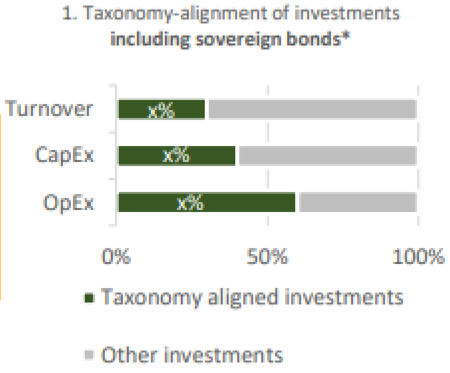


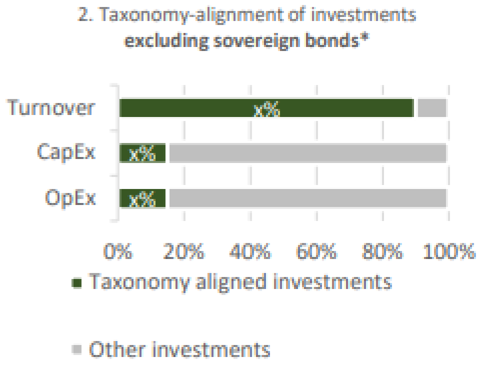


Periodic Reporting disclosures

All investments

All three KPIs





DNSH as per SFDR

The DNSH requirement for a sustainable investment under SFDR is assessed by reference to the adverse impact indicators (PAI) in Annex I of the SFDR RTS.

DNSH as per Taxonomy

The DNSH requirement is prescribed under the Taxonomy technical screening criteria of the assessed activity.

Sustainable investments as per Taxonomy

Sustainable investments as per SFDR

Non-sustainable investments as per SFDR

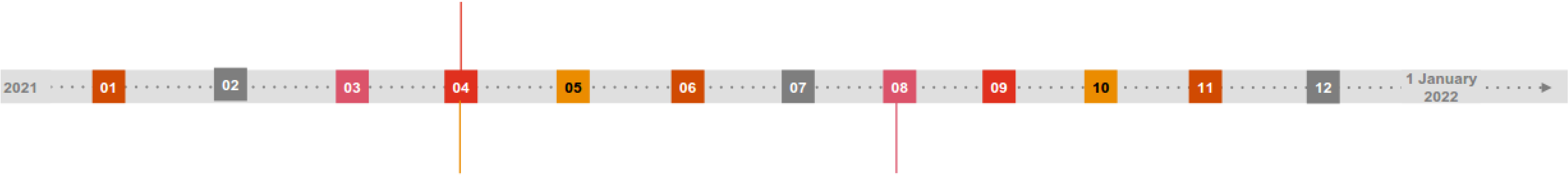
Audited by a Third Party

Disclosed in the template

CSRD – a look in the rear-view mirror…

Delegated Acts

The 6 delegated acts on fiduciary duties, investment and insurance advice released as part of the Sustainable Finance package



Corporate Sustainability Reporting Directive draft published.

Delegated Acts

MiFID, AIFMD, UCITS, IDD and Solvency II published in the Official Journal

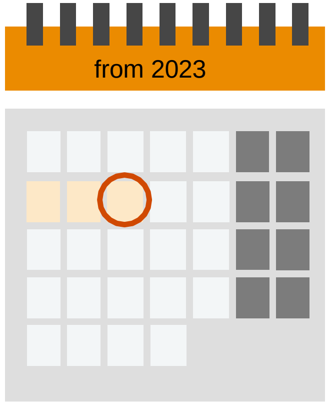
Corporate Sustainability Reporting Directive (CSRD)

Proposal at a glance

Main changes

Who?	Significant **extension of the scope** of sustainability reporting
What?	• **Expanding the content** of sustainability reports • EU will create own reporting **standards** • **Double materiality** clearly defined
Where?	Sustainability report mandatory component of the (consolidated) **management report**
How?	**Electronic format** and **tagging** of sustainability reports mandatory
Responsibility?	Responsibility of management and governance and **new role of the audit committee**
Enforcement?	Clear responsibilities for **preparation, oversight and enforcement**
Audit?	**Mandatory audit** of sustainability reports with **limited assurance**

Application intended for reporting periods starting on or after 1.1.**2023**



Warning:

The full information on timings of the CSRD is subject to change as member countries are still discussing.

Disclosures requirements and comparison versus NFRD

NFRD
Business model
Description of the policies pursued, including due diligence processes implemented
Outcome of these policies
Principal risks
Non-financial key performance indicators

	CSRD
1	brief description of the **business model and strategy**
2	**targets** related to sustainability matters set by the undertaking and progress made towards achieving those targets
3	role of the **administrative, management and supervisory bodies**
4	**policies** in relation to sustainability matters
5	**principal risks** and management of those risks
6	**indicators** relevant to disclose information referred to in points 1 to 5
7	**intangibles**: intellectual, human, social and relationship capital
8	**process carried out** to identify the information included in the management report

The key proposals include a massive broadening of scope of the NFRD from 11,600 to approximately 49,000 entities in the EU including foreign subsidiaries. Companies coming under the CSRD would be:

All companies listed on EU-regulated markets

- including companies incorporated outside the EU but listed on an EU-regulated market.
- exception: micro-entities

1

Large companies not listed

large companies defined as exceeding at least two of the following at the balance sheet date:

- balance sheet total: €20m
- net turnover: €40m
- average number of employees during financial year: 250

2

- **Subsidiaries/subgroups** that are EU-listed or have a large presence in the EU (but parent company is outside the EU) are also in scope.
- In addition, all EU parent companies of large groups should prepare **sustainability reporting at group level**.

3

Exceptions

- SMEs may use separate sustainability reporting standards for SMEs and do not have to start reporting until three years after the effective date (i.e. 1 January 2026)
- **Possibility to exempt subsidiaries/subgroups** if
  - they are included in the consolidated management report of their parent company and
  - the consolidated management report is drawn up under regulation that is considered equivalent to the manner required by the sustainability reporting standards.

Scope – Illustrative examples

Company name	Criteria (2 out of 3 min)	Structure	In scope
Lux subsidiary owned by a Germany Group	✔	Subsidiary of EU Group	Yes at Germany level
Lux subsidiary with headquarter in USA	✔	Subsidiary of Non EU Group	Yes at Luxembourg level
Lux subsidiary of headquarter in Switzerland	✔	Subsidiary of Non EU Group	Yes at Luxembourg level until further FINMA requirements