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Solvency II review: improving rules for insurers to build a sustainable future

ShareAction, Better Finance, the German Association of the Insured BdV , Urgewald and WWF European Policy Office all have the interests of European financial services users at heart, and work towards a more sustainable global financial system. As such, we advocate for financial rules that safeguard against risks and ensure financial stability, consumer protection and a liveable planet.

Solvency II, the legislative framework for EU insurers, is currently under review. Solvency II, introduced in 2016, laid the foundations for a harmonised, sound, and robust prudential framework for insurance firms in the EU. It is based on the risk profile of each individual insurance company, while ensuring overall comparability, transparency and competitiveness.

We agree with the Commission that the insurance sector should play a role in achieving the targets of the European Green Deal. This is **why we call on the European Parliament and Council to make essential improvements to Solvency II**, which will secure a sustainable future for insurers – and for society at large.

Assessing and managing sustainability risks

If we want insurers to adequately consider **sustainability risks**, including climate risks, **sustainability expertise** should be expected at Board level for all insurers, and insurers' **risk management systems** should explicitly cover the sustainability risks to which they are exposed.

To assess climate risks early on, insurers should run thorough **climate change scenario analyses**. National competent authorities should also carry out regular **stress tests** of environmental, social and governance risks.

More broadly, insurers and their supervisors should seek to align with the world-leading sustainability standards that are currently available or being developed by e.g. the Network for Greening the Financial System or the European Financial Reporting Advisory Group.

Importantly, under Solvency II insurers should adopt a **transition plan** covering underwriting and investment, with implementing actions and specific science-based short-, medium- and long-term targets, including **absolute emission reduction targets** for attributable greenhouse gas emissions for 2025 and 2030.

Transition plans should be more than written promises: they should be integrated within insurers' underwriting and investment strategy and decision-making; and responsibility for their implementation should lie at the highest level of the insurance company.

Build up capacity to deal with losses linked to sustainability risks

Climate change is one of the biggest threats (among geopolitical duress, terrorism, and others) we currently face, and the transition and physical risks associated with it are increasingly visible. Severe weather events are already having financial repercussions for insurers. In the first half of 2022 alone, global insured losses due to climate-change related catastrophes were estimated at USD 35 billion – **22 per cent above the average for the past ten years**, according to the latest ECB Financial Stability Review. Climate change will also directly affect the value of certain assets as we transition away from a carbon-intensive economy, in a context where increasing costs deriving from Covid-19 are already impacting the (re)insurance industry.

Solvency II is a risk-based framework and should remain so. This is why emerging risks must be reflected into the prudential framework. In other words, **capital requirements** must factor in the full risk of investments in environmentally harmful and risky activities.

Insurance companies that invest in highly risky assets (e.g. fossil fuel assets, but also crypto assets, as well as certain social- and environment-linked assets that may be just as risky) must have enough capital to absorb losses arising from the materialisation of those risks. Adopting the One for One capital rule will safeguard **financial stability**, thereby ensuring that taxpayers and governments do not need to bail out insurers.

In addition, increasing capital requirements will have a **deterring effect** with wider benefits for all: the costs associated with higher capital requirements mean insurers will be disincentivised to invest in those risky activities, including many that are detrimental to the objective of a climate-neutral continent. As the European Economic and Social Committee stated, 'sustainability goals must not be jeopardised by insufficient capital requirements that artificially turn highly polluting activities into profitable investments'.

Besides amendments specifying that sustainability risks (in particular risks related to the fossil fuel sector) must be incorporated in the calculation of technical provisions within Solvency II, we also support **EIOPA's mandate,** as proposed in the initial Commission proposal, to report on the risk profiles of broader categories of assets and insurance liabilities that are environmentally and/or socially harmful, and to consider a **dedicated prudential treatment** for these assets and liabilities.

Finally, we want to emphasise that **preventing greenwashing** practices remains of utmost importance. Sustainable investments should be subjected to the same risk assessment procedures as any other investment by insurers. In other words, 'green' or other assets deemed socially or politically desirable should not benefit from a preferential prudential treatment that would not be risk-based.

Mitigating and reducing negative impacts

As the latest EU sustainable finance strategy reiterated, and a recent UN PRI report highlighted, **double materiality** must be streamlined across EU financial regulation. Indeed, considering financially material risks is not enough; insurers must also assess, and reduce where possible, any adverse impact that their underwriting and investment activities have on people and planet.

First, insurers' risk management systems should explicitly cover the **principal adverse impacts** of the insurance or reinsurance undertaking on sustainability factors and (might) rule out adverse coverage.

Second, all insurers should have a robust **stewardship policy** in place, so that they actively engage with investee companies (escalating where necessary) to influence their behaviour with a view to achieve positive overarching sustainability outcomes.

Indeed, ShareAction's research showed that only a small minority of insurers have robust stewardship strategies to ensure their engagement with clients and investee companies is sufficiently ambitious. General transparency on stewardship activities is also poor, with less than a third of surveyed insurers publishing any information at all.

Transparency and accountability with regards to sustainability

Accountability is key to making sustainability commitments and policies work in practice, in a context where insurers' voluntary initiatives fail to deliver the necessary results. We therefore recommend linking **remuneration** to concrete sustainability outcomes.

Transparency is fundamental to Solvency II, and it is especially important to share sustainability information with policyholders, who have a direct interest in how their insurance company is doing. Disclosure via the **Solvency and Financial Condition Report** (SFCR) should also include relevant sustainability information. All SFCRs should be easily and freely accessible – including in terms of language and presentation – online.

The above expectations and requirements can be enshrined into EU law via amendments to Solvency II. We count on EU policymakers to make Solvency II fit for purpose, so that European insurers play their part in achieving the goals of the Paris Agreement, the European Green Deal and European Climate Law.

BF BETTER FINANCE
The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the public interest nongovernmental organisation advocating and defending the interests of European citizens as financial services users at the European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users.

BUND DER VERSICHERTEN
Offensiv für Versicherte

Bund der Versicherten e.V., the German Association of Insured, is a consumer protection association aimed at safeguarding the interests of the insured, mainly via general information and advice for its members on insurance and pensions, and via activities and measures to control and ensure the compliance of insurers with the economic and legislative order. It was created in 1982 and has around 45,000 members.

urgewald

Urgewald is a German non-profit environmental and human rights organization. For 30 years, Urgewald has been fighting against environmental destruction and for the rights of people harmed by corporate profit interests.

WWF

WWF European Policy Office helps shape EU policies that impact on the European and global environment.

Our mission is to stop the degradation of the planet's natural environment and to build a future in which humans live in harmony with nature, by:

- conserving the world's biological diversity
- ensuring that the use of renewable natural resources is sustainable; and
- promoting the reduction of pollution and wasteful consumption