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Integration of sustainability risks and factors in EU insurance regulation – The state of play

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Abstract

In this paper, the state of play regarding the integration of sustainability risks and factors in EU insurance regulation is discussed. The chapter describes briefly the broader context of the European Green Deal, EU Sustainable Finance Action Plan and Sustainable Finance Strategy, and the impact of these initiatives on insurance undertakings, ranging from disclosures requirements to substantive quantitative and qualitative requirements in the Solvency II framework. The main focus of the chapter is on the amendments to the Solvency II Delegated Regulation, relating to the integration of sustainability risks in the governance of insurance and reinsurance undertakings. Looking ahead, the chapter also reflects on potential future amendments to the Solvency II Directive, regarding the prudential treatment of sustainability risks by insurance and reinsurance undertakings. The chapter concludes with some final remarks.

Key words: sustainability, sustainability risks, Solvency II, risk management, prudent person principle

1. INTRODUCTION

1.1. Broader EU context[1]

On 11 December 2019 the European Commission launched the European Green Deal and announced that it had reset its commitment to tackling climate and environmental-related challenges, such as the warming of the atmosphere and changing climate, loss of species on the planet and destruction and pollution of oceans and

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[1] Some parts of this chapter have been derived from and will be discussed more elaborately by the author in Chapter 23, titled '*Integration of sustainability risks and sustainability factors into insurance regulation*' of the Cambridge Handbook of EU Sustainable Finance Regulation, edited by M. Siri, K. Alexander and M. Gargantini (forthcoming).

forests (European Commission, 2019). In the context of the European Green Deal, the European Commission reiterates that the private sector is key to financing the green transition. Long-term signals are needed to direct financial and capital flows to green investment and to avoid stranded assets. Prior to the launch of the Green Deal, the European Commission had already, in 2018, published an initial Sustainable Finance Action Plan, primarily focused on the role of the financial sector in the green transition (European Commission, 2018).

In the context of the European Green Deal, the Commission announced that it would present a renewed sustainable finance strategy in the third quarter of 2020. With some delay, the renewed sustainable finance strategy was published by the European Commission on July 6, 2021 (European Commission, 2021a).

1.2. What does this mean for EU insurance undertakings?

As is the case for other parts of the financial sector, the Sustainable Finance Action Plan and Sustainable Finance Strategy assume an important role for insurance undertakings[2] in the green transition and consequently a significant number of initiatives in the plans is either specifically targeted at insurance undertakings or financial undertakings more generally, or will apply to insurance undertakings, as part of regulatory initiatives applicable to undertakings more generally (such as relating to corporate disclosures,[3] or to value chain due diligence obligations.)[4] This puts the financial sector, including insurance undertakings, at the center of the sustainable development plans of the European Commission, as presented through the European Green Deal.

1.3. What kind of requirements are being introduced for insurance undertakings?

Partly, the rules are aimed at a better (or more explicit) assessment of sustainability risks by insurance undertakings, which are, for instance, translated into amendments to sector-specific requirements for insurance and reinsurance undertakings, e.g. in the EU Solvency II framework. These amendments relate primarily to the requirements for the internal organization, the risk management and governance system of insurance and reinsurance undertakings.

For another part, additional requirements are being introduced, targeted at improving the information that undertakings, including insurance undertakings, provide publicly about sustainability risks they are facing (outside-in) and on the influence they can exert, through their activities, on sustainability factors (inside-out). At the same time, an improvement of sustainability information provided by companies, including by insurance undertakings, serve insurance undertakings as well,

[2] In this chapter, for readability purposes, reference is made only to insurance undertakings, while the Solvency II obligations generally apply to both insurance and reinsurance undertakings.

[3] Through the CSRD and article 8 of the EU Taxonomy Regulation.

[4] Through the future Corporate Sustainability Due Diligence Directive (European Commission, 2022) and through reporting requirements on the value chain and value chain due diligence process in the CSRD.

as this should allow them to better assess sustainability risks and sustainability factors, including in their asset portfolio and should allow them to develop (more) sustainable insurance products and to take into account sustainability preferences that their customers might have. These requirements do not only apply to insurance undertakings, but generally these requirements will also apply to them. In particular, reference can be made to the requirements of the EU Non-Financial Reporting Directive (NFRD), that will be replaced in the coming years by the Corporate Sustainability Reporting Directive (CSRD)) and the disclosure requirements under article 8 of the EU Taxonomy Regulation, that currently apply to companies that are currently subject to the NFRD and will become subject to the CSRD. Apart from these corporate disclosure requirements, which are triggered legally by the fact that many EU insurance undertakings qualify as public interest entities (Directive 2013/34/EU, art. 2(1)) and consequently are in scope of the EU Accounting Directive,[5] disclosure requirements are also introduced for financial market participants, which may include insurance undertakings as well, based on the EU Sustainable Finance Disclosure Regulation (SFDR) (Regulation /EU/ 2019/2088).

This chapter focuses on the integration of sustainability risks and sustainability factors in EU insurance regulation. An important element of the broader European Commission's initiative on sustainable development is to put sustainability considerations at the heart of the financial system. The intention is to support the European economy into a greener, more resilient and circular system in line with the European Green Deal objectives. In its Action Plan 'Financing Sustainable Growth' the European Commission announced its intention to clarify the integration of sustainability in so-called fiduciary duties in sectoral legislation (European Commission, 2018). The objective of the European Commission is to direct financial and capital flows to green investment and to avoid stranded assets (European Commission, 2021a), which could be facilitated if sustainability is more clearly integrated in such duties of financial undertakings.

2. RELEVANT CONCEPTS

2.1. Sustainability risks and sustainability factors

When reference is made in this chapter to sustainability risks and to sustainability factors, the definitions correspond to the definitions used in the Solvency II Delegated Regulation, which in turn refer to the definitions in the SFDR. Consequently, 'sustainability risk' means an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment. 'Sustainability factors' mean environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters. Roughly, sustainability risks are risks that the insurance undertaking is exposed to

[5] Directive 2013/34/EU. This directive has been amended by the NFRD (Directive 2014/95/EU) and CSRD (Directive (EU) 2022/2464) and consequently, non-financial and sustainability reporting requirements for public interest entities have been introduced through the framework of the Accounting Directive.

(*outside-in*), sustainability factors relate to the impact the insurance undertaking, through its activities, might have (*inside-out*).

2.2. Fiduciary duties

In its Action Plan on Financing Sustainable Growth, the European Commission observes that several pieces of EU legislation, including Solvency II, require institutional investors and asset managers to act in the best interest of their end-investors/beneficiaries and labels this duty as 'fiduciary duty.' However, according to the European Commission, current rules to consider sustainability risks and factors in the investment decision process are neither sufficiently clear nor consistent across sectors. In the context of insurance supervision, it is important to stress in this context that the main purpose of insurance regulation and supervision is the protection of policyholders and beneficiaries. Other objectives are financial stability and fair and stable markets. These objectives should also be taken into account, but should not undermine the main objective (Directive 2009/138/EC, Recital 25). This is discussed below in more detail in the context of the prudent person principle, in paragraph 3.3 below.

3. INTEGRATION OF SUSTAINABILITY IN THE SOLVENCY II FRAMEWORK

3.1. Amendments to the Solvency II Delegated Regulation

As part of the EU Action Plan, the integration of sustainability risks and factors in EU insurance regulation is being addressed in the Solvency II Delegated Regulation. A number of amendments to the existing provisions have entered into effect as per August 2, 2022. Rather than creating new obligations for insurance undertakings, the amendments mainly specify already existing obligations to take into account sustainability risks, as risks an insurer could be exposed to, in specific parts of the Solvency II framework. Specifically, insurance undertakings are obliged to:

- Reflect sustainability risks in their risk management, including in the Own Risk and Solvency Assessment;
- Incorporate the identification and assessment of sustainability risks in the tasks of the risk management function, which is one of the key functions identified in the Solvency II framework;
- Require the actuarial function to take into account sustainability risks in the assessment of uncertainty associated with estimates made in the calculation of technical provisions;
- Ensure that the remuneration policy of the insurer provides information on how the insurer takes into account sustainability risks in the risk management system;
- Take into account sustainability risks in the application of the prudent person principle.

In addition, insurance undertakings shall take into account the potential long-term impact of their investment strategy and decisions on sustainability factors and, where relevant, that strategy and those decisions shall reflect the sustainability preferences of its customers, taken into account in the product approval process referred to in article 4 of Commission Delegated Regulation (EU) 2017/2358. The reference to the long-term impact of the investment strategy and decisions on sustainability factors deserves some further elaboration. According to the technical advice, provided by EIOPA to the European Commission in the context of the amendments to the Solvency II Delegated Regulation, EIOPA considers it prudentially relevant to require insurance undertakings to take into account the impact of their investment on sustainability factors. EIOPA considers that the resilience of the real economy, and the stability of the financial system, fuelled by integrating sustainability considerations in the investment strategy and decisions, has the potential to impact on the risk-return characteristics of a portfolio, as other factors (EIOPA, 2019a, 23). However, this does not mean, according to EIOPA, that insurance undertakings are required to make sustainable investments or to invest with impact, or to accept lower risk-adjusted returns (EIOPA, 2019a, 23). EIOPA suggests that the consideration of sustainability factors can also be achieved through the adoption of a stewardship approach, by exercising voting rights for equity holdings, but also by implementing or adapting investment strategies e.g. for best-in-class investments or exclusions (EIOPA, 2019a, 23).

The amendments to the Solvency II Delegated Regulation are limited to amendments to that specific regulation. The Solvency II Directive itself is not amended. Possible future changes to the Solvency II Directive are discussed in paragraph 3.4.

3.2. Reflection of sustainability risks in the ORSA

In its Opinion to the European Commission on Sustainability in Solvency II, EIOPA acknowledges that the medium to long-term impacts of climate change cannot fully be captured in the Solvency II capital requirements which are designed to reflect the risks that undertakings are exposed to over a one-year time horizon. However, EIOPA does not consider that this time horizon should be changed, but rather complementary tools such as scenario analysis and stress testing would be more appropriate to capture impacts of climate change. Scenarios analysis will allow undertakings to consider the impact of sustainability risks beyond the one-year time horizon or where timing is unpredictable. Such analysis should be embedded in the undertakings' risk management, governance and ORSA. This should enable undertakings to identify and assess the climate change-related risks they would be exposed to in a forward-looking manner and inform business planning and strategy. Stress testing at national or European level could also contribute to identify risks over a longer-term horizon (EIOPA, 2019b, 4.40–4.42).

The amendments to the Delegated Regulation include amendments to the provision on the calculation of the overall solvency needs of the insurance undertaking (Commission Delegated Regulation (EU) 2015/35, art. 260). Article 269 (1a) of the Solvency II Delegated Regulation provides that emerging risks and sustainability risks, identified by the risk management function, form part of the risks referred to in article 269 (1) point a of the Solvency II Delegated Regulation. This provision specifies the requirement in article 45(1) a of the Solvency II Directive for insurance undertakings to conduct an 'own risk and solvency assessment' (ORSA).

The ORSA is an assessment of the overall solvency needs of the insurance undertaking, taking into account its specific risk profile, approved risk tolerance limits and its business strategy. The Solvency II legislator has considered it important that insurance and reinsurance undertakings not only calculate their capital requirements in accordance with Solvency II requirements, but also regularly assess their own risk profile, independent from the assumptions according to which the capital requirements are being calculated and to identify any significant divergences between their own assessment and the capital requirements. The outcome of this regular process can lead to measures to be taken by the insurer, either from a capital perspective or a risk management perspective.

It is important to note that the ORSA does not serve to calculate or to recalculate the capital requirements of the insurance undertaking. If the outcome of the ORSA process leads to the conclusion that - for instance – the risk profile of the insurance undertaking deviates from the assumptions underlying the calculation of the capital requirements, the supervisory authorities can – temporarily – impose a capital add-on and require the insurance undertaking to e.g. change its risk profile or recalculate its capital requirements, possibly through the use of a full or partial internal model, should the standard calculation in the Solvency II Directive insufficiently capture the risks, embedded in the specific risk profile of the insurance undertaking.

In April 2021, EIOPA published an Opinion on the supervision of the use of climate change risk scenarios in ORSA (EIOPA, 2022a). The Opinion sets out supervisory expectations on the integration of the use of climate change scenarios by insurance undertakings in their Own Risk and Solvency Assessment ORSA. According to EIOPA, insurance and reinsurance undertakings will be impacted by climate change-related physical and transition risks. Therefore, EIOPA believes it is important to encourage a forward-looking management of these risks, also in the long term. EIOPA observes in its opinion that currently only a small minority of undertakings assess climate change risk using scenario analysis in the ORSA. Moreover, where undertakings perform a quantitative analysis of climate change risk, most assessments take a short-term perspective.

As follow-up on this Opinion, EIOPA published, on August 2, 2022, additional application guidance on climate change materiality assessments and climate change scenarios in the ORSA (EIOPA, 2022a). While the EIOPA Opinion sets out supervisory expectations on the use of climate change scenarios in the ORSA, the application guidance is positioned by EIOPA as optional guidance for insurance undertakings, and as an initial aid for undertakings to conduct climate change scenario analysis. Additionally, it should support in particular small and mid-sized insurance undertakings and enhance comparability of reported information. The application guidance is not intended to be a supervisory convergence tool.[6] The application guidance discusses various elements that

[6] In the meaning of article 29 of the Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC.

should be considered by insurance undertakings: conducting a materiality assessment, running climate change scenarios on the basis of the materiality assessment (i.e. for material risks) and transforming climate change scenarios into climate change risks.

3.3. Prudent person principle

In accordance with article 132 (1) of the Solvency II Directive, member states shall ensure that insurance and reinsurance undertakings invest all their assets in accordance with the prudent person principle. Insurance companies are required to maintain assets of sufficient quality to cover their overall financial requirements. All investments held by insurance companies should be managed in accordance with the prudent person principle (Directive 2009/138/EC, Recital 71). With respect to the whole portfolio of assets, insurers shall only invest in assets and instruments whose risks it can properly identify, measure, monitor, manage, control and report, and appropriately take into account in the assessment of its overall solvency needs, performed as part of the ORSA. Article 135(1) of the Solvency II Directive provides that the European Commission may adopt delegated acts, specifying certain aspects of the prudent person principle:

• The identification, measurement, monitoring and managing of risks arising from investments (Directive 2009/138/EC, article 135/1/a), and

• the identification, measurement, monitoring and managing of risks arising from derivatives, assets not admitted to regulated markets, excessive reliance on particular assets, issuers, groups of undertakings or on specific geographical areas and excessive accumulation of risks in the portfolio as a whole and excessive concentration of risks on the same issuer or group to which the issuer belongs.

Recently, the European Commission has adopted a first delegated regulation on the basis of the mandate in article 135 (1) of the Solvency II Directive, as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings (Commission Delegated Regulation (EU) 2021/1256). This delegated regulation became effective from August 2, 2022 (Commission Delegated Regulation (EU) 2021/1256, art. 2). A technical advice of EIOPA, that has been taken into account by the European Commission in the development of this delegated regulation, provides some background on these amendments. According to EIOPA, it has become clear, over the past years, that sustainability risks and in particular climate-change risks will affect insurance and reinsurance undertakings. EIOPA finds that there is a lack of evidence that undertakings across Europe effectively and consistently consider sustainability risks in their investment strategy, which can, according to EIOPA, be explained by a lack of a clear taxonomy of sustainable ("green") / non-sustainable ("brown") investments, a lack of reliability and comparability on ESG information, a lack of experience and ESG skills among institutional investors and asset managers, or the impact on costs and risk-adjusted performance (EIOPA, 2019a, paras 102–106). This seems to be addressed over time by the implementation of the EU Taxonomy Regulation, as well as more generally the evolution of sustainable finance that should allow insurance and reinsurance undertakings over time to assess these risks. EIOPA acknowledges that the prudent person principle already allows for sustainability risks to be taken into account, in analogy with other risks. However, EIOPA did recommend changes to the relevant Solvency II provision, as the principle as stated in the Solvency II Directive did not require explicitly undertakings to consider these risks.

In its technical advice, EIOPA indicated that it had considered to include an additional requirement to the prudent person principle, requiring insurance and reinsurance undertakings to consider the sustainability of their investment portfolio, in addition to the assessment of the security, quality, liquidity, and profitability of the investment portfolio. Instead, EIOPA has opted to include the requirement to consider sustainability risks when assessing their investment portfolio. Where sustainability risks materialise, they can affect the security and/or the quality and/or the liquidity and/or the profitability of the investment portfolio.

The Solvency II Delegated Regulation not only requires undertakings to take into account sustainability risks, but additionally requires undertakings to assess the potential long-term impact of their investments on sustainability factors. This might give the impression that, through this requirement, insurance and reinsurance undertakings may be required to invest in sustainable investments. However, this is not necessarily the case. EIOPA indicates that it strongly believes that the transition towards a sustainable economy cannot be achieved by simply implementing a binary approach between sustainable investments and non-sustainable investment (EIOPA, 2019a, para 110). The European Commission has followed EIOPA's technical advice to include such a requirement in the Solvency II Delegated Regulation.[7] The wording in the Solvency II Delegated Regulation is more prescriptive than the requirement in the IORP II Directive, that reads as follows: "within the prudent person rule, Member States shall allow IORPs to take into account the potential long-term impact of investment decisions on environmental, social, and governance factors" (Directive (EU) 2016/2341, art. 19/1/b). For insurance and reinsurance undertakings, EIOPA favours a compulsory requirement to support a European effort of (re)industry towards a resilient and inclusive economy. By addressing both sides of the investment, the impact of the investments and the impact on the investments, a sustainable investment cycle would be implemented (EIOPA, 2019a, para 113). EIOPA considers that this approach has the potential to impact on the risk-return characteristics of a portfolio, as other factors.

In addition to the requirement to take into account the long-term impact of the investment strategy on sustainability factors, insurance undertakings need to take into account sustainability preferences of its customers that are taken into account in the product approval process (Commission Delegated Regulation (EU) 2015/35, art. 275a(2)). Through this requirement, a link is made between the amendments to the Insurance Distribution Directive, that integrate sustainability in the product oversight and approval process (Commission Delegated Regulation (EU) 2021/1257) and the prudent person principle. The purpose of these requirements is that undertakings in their risk management and investment strategy and decisions consequently implement the commitments made to policyholders and beneficiaries on ESG characteristics of a specific product.

[7] See paragraph 5.1, in which is described how EIOPA suggests such an approach can be shaped.

3.4. Amendments to the Solvency II Directive

3.4.1. Introduction

On September 22, 2021, the European Commission has published a legislative proposal to amend the Solvency II Directive. The 2009 Solvency II Directive itself contained several mandates for the European Commission to review key elements of the directive. In addition, beyond these mandates, the European Commission has reflected more broadly on the lessons learned since the entry into force of the Solvency II Directive. In this context, the European Commission has also assessed whether the insurance sector could contribute to the EU's political priorities, including the climate and environmental targets under the European Green Deal. On sustainability, the European Commission has considered an EIOPA Opinion published in September 2019 on Sustainability within Solvency II. This has resulted in the addition to the European Commission's legislative proposal an obligation to conduct long-term climate scenario analysis. The European Commission indicated that it may consider, at a later stage, extending this obligation to other environmental risks. In addition, the proposal contains a mandate to conduct further work to assess the suitability of the existing Solvency II capital requirements for green assets (European Commission, 2021a).[8]

It remains to be seen what the final version of the text will entail.[9] Meanwhile, EIOPA has recently initiated work, motivated by the proposed mandate in the Commission Proposal[10] in the form of a discussion paper on the prudential treatment of sustainability risks (EIOPA, 2022b).

3.4.2. Climate change scenario analysis

As mentioned, the European Commission proposes to introduce, as part of the risk management obligations of insurers, an obligation to assess whether it has any material exposure to climate change risks and demonstrate the materiality of its exposure in the own risk-and solvency assessment. Where the insurance undertaking has material exposure to climate risk, it shall specify at least two long-term climate change scenarios, including the following:

- A long-term climate change scenario whereby the global temperature increase remains below two degrees Celsius; and
- A long-term climate change scenario whereby the global temperature increase is equal to or higher than two degrees Celsius.

[8] Paragraph 91 introduces the new Article 304a with two mandates to EIOPA as regards sustainability risks. EIOPA is mandated to explore by 2023 a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental and/or social objectives and to review regularly the scope and the calibration of parameters of the standard formula pertaining to natural catastrophe risk.

[9] As of early December 2022, the European Parliament had not yet adopted a final report, ahead of the trialogue-negotiations, which are expected to commence shortly after that probably in early 2023.

[10] Article 304a of the Solvency II 2020 Review Commission Proposal COM (2021) 581 final (European Commission, 2021b).

Such scenario-analyses should be repeated periodically, with intervals no longer than three years. The scenarios would be reviewed periodically, at least every three years, and updated where necessary. The question, whether or not this amendment will be adopted in the Solvency II Directive, appears to a large extent academic. Climate change risk can have a material impact on insurers and given the potential impact, EIOPA already now expects that insurance undertakings integrate these risks in their ORSA (EIOPA, 2021). Furthermore, the recent amendments to the Solvency II Delegated Regulation already include an obligation to take into account emerging risks and sustainability risks in the assessment of the overall solvency needs of the insurance undertaking. Moreover, EIOPA has recently published an extensive document, setting out application guidance on running a climate change materiality assessment and using climate change scenarios in the ORSA. In addition, some national competent authorities have also published expectations with respect to the assessment by insurers of sustainability risks in the ORSA (Dutch Central Bank, 2022). The main challenge, as also highlighted by EIOPA, is to reconcile the very long-term dynamics of climate change with the operational ability to assess the impact of related risks based on the insurers' current business model and to reconcile the potential long-term impact of climate-change risk on the insurance undertaking with the usual time-horizon that is being used by insurance undertaking to conduct an ORSA, which is usually a period of 3 to 5 years. As indicated above, the overall solvency needs in accordance with the ORSA process are assessed by an insurance undertaking in accordance with a different, longer time horizon than the time horizon on which the capital requirements for the insurance undertaking are being calculated.

3.4.3. Potential amendment of solvency capital requirements to take into account sustainability risk

The key focus of the amendments to the Solvency II framework in relation to sustainability has been on explicitly embedding sustainability risk in the risk management system and system of governance more generally, with a clear focus on the ORSA. In addition, the provisions on the prudent person principle have been amended to better reflect both sustainability risks and sustainability factors. So far, the capital requirements have not been reviewed. According to the proposal of the European Commission, EIOPA would be mandated to assess if a dedicated prudential treatment would be justified of exposures related to assets or activities substantially with environmental or social objectives or which are substantially with harm to these objectives.[11] EIOPA would, in consultation with the ESRB, have to assess what effect such a dedicated treatment would have on the protection of policyholders and the financial stability in the European Union. EIOPA should submit a report on its findings to the European Commission by June 28, 2023. While the follow-up of this work will formally be based on a mandate that is foreseen in the Solvency II Directive, but not yet adopted, EIOPA has already taken this work into account in its strategy and work programme

[11] Article 304a of the Solvency II 2020 Review Commission Proposal (European Commission, 2021b).

for the coming years.[12] In addition, as mentioned in paragraph 5.4, EIOPA published on November 29, 2022, ahead of a formal mandate in the Solvency II Directive,[13] a discussion paper on the prudential treatment of sustainability risks (EIOPA, 2022b).[14] In this paper, EIOPA proposes to focus its activities in this area on three areas:[15] "Firstly, as a risk-based environmental objective for insurance undertakings' investment activities, EIOPA proposes to study the link between climate change-related transition risks and prudential risks, since data availability seems to be most advanced in this regard. Secondly, in terms of the underwriting activities of insurance undertakings, EIOPA proposes to focus on climate change adaptation in terms of climate-related risk prevention. As climate change is substantially raising physical risk exposures, climate change adaptation can be considered as a risk-based environmental objective of outstanding importance to increase the resilience of the society and economy against climate change. Finally, given the stage of the public debate on the appropriate definition of social objectives and social risks, EIOPA aims as regards social aspects to provide an initial analysis of the corresponding Pillar II and III requirements under Solvency II and to identify potential areas for further analysis, as well as to initiate discussions on the appropriate prudential consideration" (EIOPA, 2022b, para 7).

In addition, EIOPA announced further publications are to be expected, that are either directly or partly related to prudential treatment of sustainability risks, on the following themes (EIOPA, 2022d):

– the macro-prudential impact of the protection gap;

– "impact underwriting": whether adaptation measures can help in increasing the supply of insurance;

– the reassessment of the natural catastrophe risk capital charges;

– and an analysis of the drivers of demand for property insurance.

4. FINAL REMARKS

This chapter focused on the integration of sustainability risks and factors in the Solvency II framework, with an emphasis on the amendments to the Solvency II Delegated Regulation, that took effect on 2 August 2022. While the Solvency II framework generally seems to be capable of taking into account all relevant risks that insurance companies are exposed, regardless of the nature of the risks, sustainability risks do merit specific attention. Insurance undertakings are, by the very nature of the

[12] EIOPA, 2022c includes the following actions:

– Assess the prudential treatment under Solvency II of assets and activities associated substantially with environmental and social objectives or which are associated substantially with harm to such objectives (subject to the deadline in the final version of SII);

– Initiate reassessment of the natural catastrophe risk standard formula capital charges (Q4 2024).

[13] Motivated by the proposed mandate in article 304a of the Solvency II Directive, pursuant to the Commission Proposal of September 22, 2021, referred to in footnote 63.

[14] EIOPA invited stakeholders to provide feedback on the discussion paper until March 5, 2023.

[15] EIOPA acknowledges that, while the prudential analysis should be risk-based and policy implications evidence-based, ESG data-gaps are a constraining factor for the scope of the prudential analysis, chapter 1, paragraph 6 of the discussion paper.

insurance business, familiar with the assessment over longer periods of time and with the management of uncertainty. However, sustainability risk may materialize over different time periods than insurance undertakings take into account in their assessments of risks. There appears to be a broad consensus that capital requirements should remain based on an economic and risk-based assessment of risk. The integration of sustainability considerations in the Solvency II framework has so far been focused primarily on the risk management and the system of governance. In addition, changes have been made to the prudent person principle, which means to the regulation of assets, which has both quantitative (pillar 1) and qualitative elements (pillar 2). This seems a logical approach, that reflects the nature of sustainability risks and sustainability considerations at this stage. In its application, the prudent person principle leaves room to take into account other objectives than the 'traditional' focus on policyholder protection, without leaving sight of this primary objective of Solvency II. More fundamental changes in Solvency II, such as dedicated capital treatment for 'green' or 'brown' assets and activities, integration of transition planning as well as stewardship considerations might be valuable, but will require further analysis and debate, as this might mean in some cases a partial departure from the original objectives of the Solvency II framework.

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