AIBA Conference

Sustainability and insurance

Speech by IVASS Board Member
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I thank AIBA and in particular its President Flavio Sestilli and its Secretary General Pietro Negri for the kind invitation.

This year's conference is dedicated to the theme of Sustainability, which is perhaps the broadest, cross-sectoral and pervasive topic of our times, together with that of digital and technological evolution.

Sustainable finance, which started to be a hot topic in the United States in the mid-1970s in relation to corporate social responsibility, in the wake of the observations already made on the subject of ethical finance, saw, towards the end of the 1990s, the definition of the acronym 'ESG' (Environment, Social and Governance), which is now widespread and aimed at identifying the three factors which encapsulate the concept of sustainable actions and investments[1].

The inspiration and aspiration toward an ethical finance, which pays attention to the impact on future generations, which supports and stimulates a fairer and more inclusive society, which reduces the carbon footprint and the impact on the environment, was first solidified in a process of self-regulation, undertaken by various companies, that have implemented policies which are sensitive not just to financial performance but also to the environmental impact. This also with a view to boosting the value of their reputation and strengthening the bond of trust with customers. In a second phase, virtuous practices fostered the emergence of projects and the adoption of soft rules at international level (I am thinking, for example, of the UN *Principle of Sustainable Finance and the Principle of Sustainable Insurance; Sustainable Development Goals* of 2015, etc.) and then, in a third phase, the abundant European legislation that now embraces and covers the sector and which cascades down to national legislation.

[1] Environmental ('E') factors regard the need to favour less energy-intensive production processes with lower impact on the environment; social sustainability ('S') factors refer to labour relations, inclusion, community welfare and respect for human rights; finally, corporate governance ('G') factors concern the respect for diversity policies in the composition of the companies' boards of directors, the presence of independent directors or the methods for remunerating executives, elements that play a central role in ensuring that social and environmental aspects are taken into account in the decisions of companies and organisations. In the past, the acronym SRI was often used to mean Socially Responsible Investments.

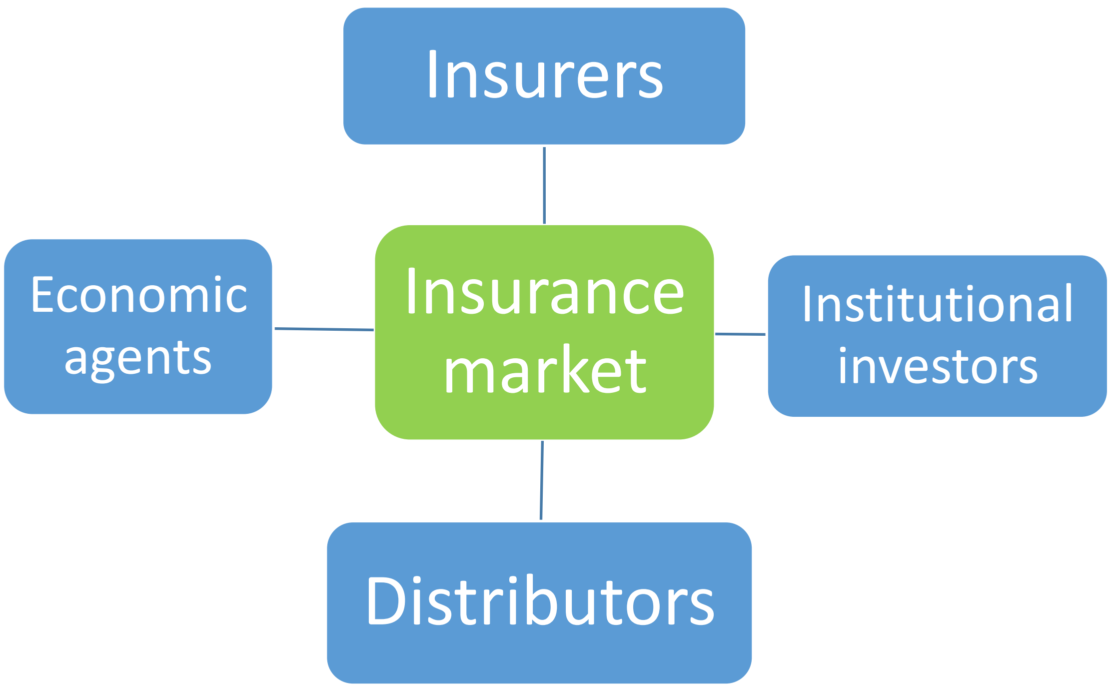
It is a gradual and constant journey that laboriously puts lofty, intangible and abstract concepts into practice, introducing them into the materiality of risks, disclosure, product design and their actual value to the customer, customer service and advice in the insurance product proposal phase.

We are all fully aware that ESG investments can influence positive changes in society, even in the current extremely complex scenario, characterised by a year-long conflict in the heart of Europe, resulting in an energy crisis, growth in inflation and rising interest rates. The entire insurance market is called upon to contribute to this change driven by extensive and increasingly complex legislation for the sector, which is sometimes not easy to implement.

Regulatory developments and institutional action

The profusion of supranational legislation on the subject of financial and insurance sustainability is justified by an awareness of the crucial role of insurance companies in achieving the ecological transition and fostering models of environmental, governance and social sustainability both as institutional investors and as distributors of investment and protection products (Fig. 1)

FIG. 1 The fourfold role of the insurance market



The adoption of European legislation on sustainable finance[2] has meant amending and aligning, among others, European insurance industry regulations under the Solvency II and IDD framework[3]. This has made it appropriate to undertake an initial alignment of IVASS' regulatory provisions directly affected by the new rules, in order to foster consistency in implementation between the existing national regulations and the new European rules and facilitate their application by market operators.

I am referring to the proposed amendments to Regulation 24/2016 on investments and assets covering technical provisions (amendments aimed to integrate sustainability risks into investment and risk management activities); to Regulation 38/2018, concerning the corporate governance system (amendments aimed at integrating sustainability risks into the risk management system and remuneration policies); to Regulation No. 40/2018, concerning insurance distribution (amendments aimed at integrating sustainability preferences in the rules of conduct relating to investment advice for the placement of IBIPs products) and amendments to Regulation No. 45/2020 concerning product oversight and governance requirements (aimed at integrating customer sustainability objectives in the identification of the target market, including the negative target market, as well as in product testing, monitoring and review and information flows between manufacturer and distributor) (see Fig. 2)

[2] In particular, the adoption of Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019, in effect since 10 March 2021, on sustainability- related disclosures in the financial services sector (SFDR - **Sustainable Finance Disclosure Regulation**) supplemented by the Delegated Regulation adopted by the European Commission on 6 April 2022, in force since 1 January 2023, specifying the details of the content and presentation of the disclosure requirements, envisaged by the SFDR for financial market participants and financial advisers, thus consolidating the thirteen regulatory technical standards (RTS) developed in 2021 by the three European supervisory authorities of the financial sector (EBA, ESMA, EIOPA) into a single Regulation. This is also the legal framework of Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 (Taxonomy Regulation), which establishes the criteria for determining whether an economic activity qualifies as environmentally sustainable for the purposes of establishing the degree to which an investment is environmentally sustainable, and which was followed by Delegated Regulations (EU) 2021/2139 ("Climate Delegated Act"), 2021/2178 ("Disclosure Delegated Act") and, more recently, Regulation 2022/1214 ("Complementary Climate Delegated Act").

[3] On 2 August 2021 in particular, the following were published: Delegated Regulation (EU) 2021/1256 - amending Delegated Regulation (EU) 2015/35 (Solvency II Delegated Acts) as regards the integration of sustainability risks in the governance and investments of insurance and reinsurance undertakings - and Delegated Regulation (EU) 2021/1257 - amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 (IDD Delegated Acts) as regards the integration of sustainability factors, risks and preferences into the product oversight and governance requirements and into the rules on conduct of business for the distributors of insurance-based investment products, with special regard to the suitability assessment.

Fig. 2 Sustainability and regulatory changes

IVASS Regulation No. 40/2018
on insurance distribution
to integrate policyholders' sustainability preferences (conflicts of interest, advice, sale of IBIPs and suitability assessment)

IVASS Regulation No. 24/2016
investments and representative assets
to integrate sustainability risks in investment and risk management

IVASS Regulation No. 38/2018
on the corporate governance system
to integrate sustainability risks in the risk management system and remuneration policies

IVASS Regulation No. 45/2020
POG
to integrate customers' sustainability objectives regarding the identification of the reference market, product testing, monitoring and review and information flows between manufacturer and distributor

On the other hand, the decision was taken to subordinate the full adjustment of the IVASS regulatory provisions most directly affected by the SFDR and the Taxonomy Regulation to the unitary intervention to simplify the pre-contractual disclosure envisaged by IVASS Regulations No. 40/2018 and No. 41/2018, on which the Institute is also working as a result of the cycle of meetings with trade associations held in the second half of last year 2021.

On the supervisory front, the monitoring activities already started since 2016 (as part of the semi-annual monitoring of vulnerabilities in the insurance sector) led last year to a new, more structured and comprehensive survey model that will enable the Institute to have detailed and up-to-date information on both the state of integration of ESG factors into insurers' corporate governance and risk management processes, and on the exposure to (physical and transition) climate change-related risks in underwriting, investment and insurance product design[4].

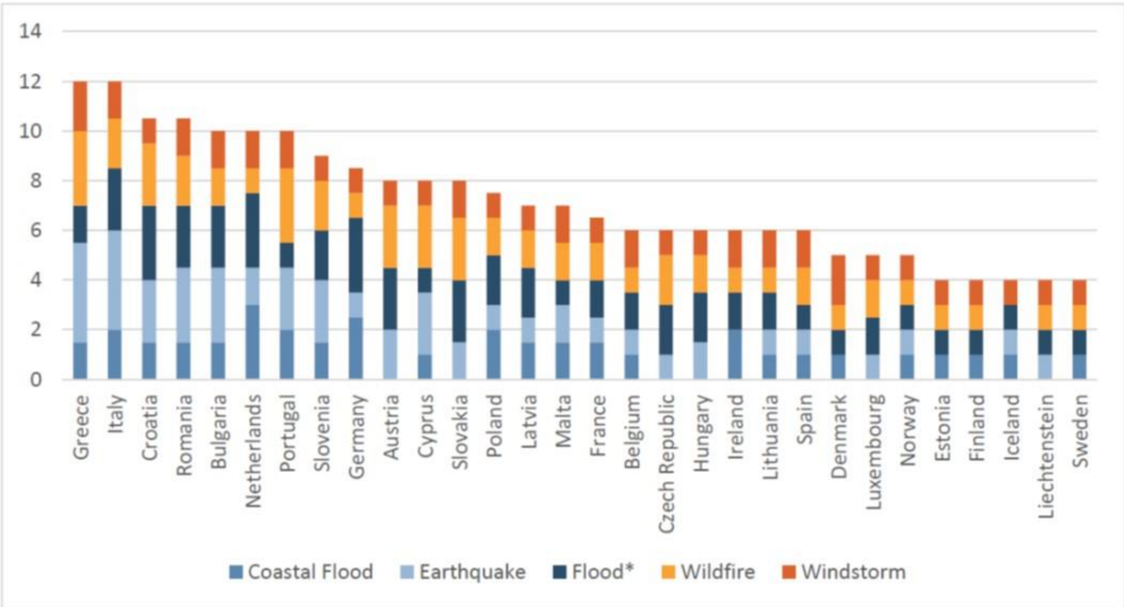
The aim of the survey (the results of which are currently being examined by IVASS) is to better monitor key financial stability profiles at national level related to increasing

[4] Letter to the market dated 27 July 2022: Monitoring of risks from natural catastrophes and sustainability

environmental risks; to draw on up-to-date information on the progress made by Italian companies in adapting to the new European provisions on sustainable finance and to contribute more effectively to steering work on sustainable finance at international level in the various forums in which the Institute is a member or is involved.

Perhaps it is worth pointing out once again the wide protection gap for natural catastrophe risk in our country in both absolute and relative terms when compared with the international situation (Fig. 3).

Fig. 3 Protection gap with respect to 5 natural hazards as at December 2022



Source: EIOPA Dashboard on insurance protection gap

The Sustainable Finance Coordination Table was recently set up at the Ministry of Economy and Finance to, among other things, facilitate discussion between institutions, stimulate the formulation of proposals and shared policies in the field of sustainable finance aimed at promoting environmental issues, as well as reducing and managing environmental, social and governance risks and mobilising financial resources towards sustainable investments.

The EIOPA Guidance

A survey conducted by the Sustainable Finance Forum in cooperation with BVA Doxa on Italian savers and energy transition shows that in 2022 the share of Italian savers who consider the role of ESG issues in their investment choices to be very or fairly relevant has reached 87% and is growing. Subscribers of Sustainable and Responsible Investments (SRI) increased from 18% to 22% also due to the more proactive approach of financial operators[5].

This growth is facilitated by the legislation, which encapsulates customers' investment preferences in suitability questionnaires.

The suitability assessment is one of the most important requirements for consumer protection under the IDD. It ensures that insurance companies and intermediaries providing advice make personalised recommendations to their customers by indicating which products would best meet their personal needs. The main objective of including sustainability factors in the advisory process is to ensure that it does not lead to misselling practices or the misrepresentation of IBIPs as meeting sustainability preferences where this is not true.

How to help customers better understand the concept of 'sustainability preferences' and their investment choices? How to collect information on sustainability preferences from customers? How to match customer preferences to products? What provisions are necessary to ensure the suitability of an insurance-based investment product?

These are not easy tasks, EIOPA is well aware of this, and with its Guidance on the Integration of Customers' Sustainability Preferences in the Suitability Assessment under the Insurance Distribution Directive (EU) 2016/97 has provided guidance to facilitate the implementation of Delegated Regulation (EU) 2021/1257 by competent national authorities, insurance undertakings and insurance intermediaries providing advice on insurance-based investment products (IBIPs).

[5] See Risparmiatori-italiani-e-transizione-energetica-WEB.pdf (finanzasostenibile.it)

The objective of the Guidance is to promote better understanding of the new rules and facilitate a correct implementation by presenting the new requirements in a more user-friendly language and presentation[6].

Greenwashing

A 'splash of green' can mislead consumers and make them buy products that are not in line with their preferences; it can divert them to less sustainable or unsustainable factors, thus hindering the transition; can hamper stakeholders' ability to assess the actual social and environmental impact of companies, generating false expectations and unfair reputational benefits, and it ultimately risks undermining confidence in financial markets.

Action to combat this phenomenon involves the entire supervisory community (EIOPA and national authorities). Work on greenwashing risks and supervision of sustainable finance policies was initiated by EIOPA in July 2022.

The starting point of the work, which focused on both policy and supervisory aspects, was the sharing of an operational definition of greenwashing by the three ESAs. The need arose to arrive at an unambiguous statement that would allow a correct assessment of the phenomenon, its characteristics and implications:

"*a practice whereby sustainability-related statements, declarations or communications regarding an entity, a financial product may be misleading to consumers and investors as it does not reflect the underlying sustainability features or characteristics".*

Two additional aspects useful for analysing the phenomenon were also highlighted: the contexts in which greenwashing can occur (entity level, product level and financial service level) and whether the phenomenon is intentional or unintentional (i.e. resulting from incomplete knowledge of ESG issues as a reference context, the relevant products and their correct classification)[7].

[6] EIOPA has indicated that it may revisit work on a more effective convergence instrument after insurers and insurance intermediaries and national authorities have gained some experience with the application of the new legislative framework.

[7] Two surveys are currently in progress, one addressed to stakeholders and one to the competent national authorities, with a deadline for responses in early 2023. At the same time, dialogue will be initiated with the companies that have joined the UN Net Zero Insurance Alliance project in order to gain more insight into the policies implemented.

For IVASS, one of the main focus points to counter greenwashing is the analysis of the value that the insurance product has for the policyholder (so-called value for money). Attention is therefore on the companies' POG processes, which lead to the design and manufacturing of insurance products for market placement, with a focus on the levels of costs incurred and guarantees offered.

IVASS has started initial analyses of IBIPs presented to customers as 'sustainable', to verify that they really are. We approach these audits in the knowledge that the picture is not clear-cut, that data are scarce and that at present their quality is not high.

Climate change adaptations in underwriting and pricing practices: the EIOPA survey

Over the course of 2022, EIOPA conducted a survey and analysis project "Pilot exercise on impact underwriting"[8], with the support of a number of European supervisors (including IVASS), on insurance products sold on the European market that:

- ✓ offer cover for climate-related risks due to temperature, wind, water and solid masses;
- ✓ integrate climate change-related adaptation measures that reduce policyholders' exposure to physical climate risk;
- ✓ provide incentives (e.g. through reduced premiums or deductibles) for policyholders to take preventive adaptation measures when climate risks occur.

The focus covered four main areas: (i) influence and materiality factors of climate change on companies' exposures to physical risk and on non-life insurance lines of business; (ii) level of integration of climate adaptation measures into non-life insurance products; (iii) effects of these underwriting policies in terms of risk management; (iv) information needed for a possible prudential treatment of climate-related adaptation measures.

The exercise revealed a high degree of non-homogeneity in the climate adaptation measures taken by European non-life insurers and the relative levels of integration into their

[8] The pilot exercise involved 31 insurance companies on a voluntary basis from 14 countries and three responses received from insurance-related associations were also included in the analysis to obtain a more complete picture. The sample includes small and medium-sized companies with typically regional underwriting activities, but also large insurers with global business activities.

policies, and a broad consensus that such measures are an effective means of maintaining the availability and affordability of coverage in the future.

Preventive actions taken by policyholders are not always considered by companies as suitable to change product pricing mainly due to the difficulties in assessing the exact risk reduction (contracts are usually annual, too short a time to take into account the impacts of ongoing climate risks); the most sensitive business was property and, to a lesser extent, motor, marine, aviation and transport insurance[9].

The role of non-life insurance in climate adaptation is definitely crucial for the entire European economic system; as is well known, it is particularly so for Italy, historically among the countries most exposed to the risk of natural disasters and at the same time among those for which the degree of protection of businesses and households against the materialisation of such risks is lowest.

Perhaps this is the aspect - among many - that still needs to be brought into closer focus. I am convinced that today's work will contribute to this.

Thank you for your attention.

[9] The next steps announced will concern: 1) bridging the protection gap; 2) identifying possible tools to improve awareness of climate-related risks and understanding of relevant prevention measures among industry and the market; 3) promoting the use of open source models and data and improving data collection (e.g. on insured claims); 4) promoting the standardisation of adaptation measures in insurance contracts; 5) assessing the potential for dedicated prudential treatment of climate-related adaptation measures in non-life insurance; 6) starting to re-evaluate the capital requirements of the standard formula for natural disaster risk.