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COMMISSION DELEGATED REGULATION (EU) …/...

of XXX

amending Delegated Regulation (EU) 2017/2359 with regard to environmental, social and governance preferences in the distribution of insurance-based investment products

(Text with EEA relevance)

This draft has not been adopted or endorsed by the European Commission. Any views expressed are the preliminary views of the Commission services and may not in any circumstances be regarded as stating an official position of the Commission.

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Governments from around the world chose a more sustainable path for our planet and our economy by adopting the **2015 Paris agreement on climate change** and the **United Nations (UN) 2030 Agenda for Sustainable Development.**

The EU is committed to a development that meets the needs of the present without compromising the ability of future generations to meet their own needs. Sustainability has since long been at the heart of the European project. The EU Treaties give recognition to its social and environmental dimensions, which should be addressed together.

The 2016 Commission's Communication on the next steps for a sustainable European future links the Sustainable Development Goals (SDGs)[1] of the UN 2030 Agenda for Sustainable Development to the European policy framework to ensure that all EU actions and policy initiatives, within the EU and globally, take the SDGs on board at the outset. The EU is also fully committed to reaching the EU 2030 climate and energy targets and to mainstream sustainable development into EU policies, as announced in the 2014 **Political Guidelines for the European Commission**[2] by Jean-Claude Juncker. Therefore, many of the European Commission's policy priorities for 2014-2020 feed into the EU climate objectives and implement the 2030 Agenda for Sustainable Development. These include the **Investment Plan for Europe**[3], the **Circular Economy Package**[4], the **Energy Union package**[5], the **Capital Markets Union**[6] and the **EU budget for 2014-2020**, including the **Cohesion fund** and research projects. In addition, the Commission launched a multi-stakeholder platform to follow-up and exchange best practices on SDGs implementation.

Achieving EU sustainability goals requires important investments. In the climate and energy space alone, it is estimated that an additional annual investment of EUR 180 billion is needed to meet climate and energy targets by 2030.[7] A substantial part of these financial flows will have to come from the private sector. Closing this investment gap means significantly reorienting private capital flows towards more sustainable investments and requires a comprehensive rethinking of the European financial framework.

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1 The 17 SDGs provide qualitative and quantitative objectives for the next 15 years to prepare ourselves for the future and work towards human dignity, stability, a healthy planet, fair and resilient societies and prosperous economies.

2 A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change - Political Guidelines for the next European Commission, Strasbourg, 15 July 2014 available at: https://ec.europa.eu/commission/sites/beta-political/files/juncker-political-guidelines-speech_en.pdf

3 [insert reference]

4 [insert reference]

5 [insert reference]

6 [insert reference]

7 The estimate is a yearly average investment gap for the period 2021 to 2030, based on PRIMES model projections used by the European Commission in the Impact Assessment of the Proposal of the Energy Efficiency Directive (2016), http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1483696687107&uri=CELEX:52016SC0405.

In this context, the Commission established in December 2016 a **High-Level Expert Group (HLEG)** to develop a comprehensive EU strategy on sustainable finance. The HLEG published its final report[8] on 31 January 2018. This report provided a comprehensive vision on sustainable finance for Europe and identified two imperatives for Europe's financial system. The first is to improve the contribution of finance to sustainable and inclusive growth. The second is to strengthen financial stability by incorporating Environmental, Social and Governance (ESG) factors into investment decision-making). The HLEG issued eight key recommendations, which it believes are essential building blocks of a sustainable European financial system. Among these recommendations, the HLEG calls for the establishment of a technically robust classification system at EU level to provide clarity on what is 'green' or 'sustainable' – a so-called sustainability taxonomy.

To follow-up on the work of the HLEG and contribute to broader efforts to connect finance with the needs of the planet and society, the Commission published on 8 March 2018 an **Action Plan on Financing Sustainable Growth**[9]**.**

Under Directive (EU) 2016/97 (Insurance Distribution Directive IDD), insurance intermediaries and insurance undertakings distributing insurance-based investment products have to collect, as part of the assessment of suitability, information about their customers' knowledge and experience of the relevant investment field, their financial situation including the ability to bear losses and their investment objectives including the risk tolerance. But no further clarifications are provided regarding the term 'investment objective' and requirements are not tailored to encompass the customers' ESG preferences.

Investment advice typically consists of two elements: (i) customer profiling to understand a customer's risk preference, investment objectives, financial situation and investment experience; and (ii) product selection in order to assure that the insurance-based investment products recommended to the customer are in line with the customer's profiling. In practice, product selection appears to be primarily driven by a customer's risk profile, but ESG preferences are not systematically assessed.

Overall, a customer might therefore not be able to communicate his/her ESG expectations clearly as they are not integrated in the customer profiling and product selection process. At the same time, investors are not sufficiently aware of ESG risks to allow them to raise their ESG expectations on their own.

Overall, the evidence also points to a regulatory failure in terms of implementation regarding the consideration of ESG preferences/factors in the investment and advisory process.

The main other obstacles to consider ESG factors as part of the duties towards investors and beneficiaries are: (i) possible heterogeneity of beneficiaries' ESG preferences; (ii) lack of reliable and comparable ESG information; (iii) lack of data and tools to analyse ESG risks; and (iv) the impact on costs and risk-adjusted performance.

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The objective of this initiative is therefore to create a mandatory requirement to take into account ESG preferences in the advisory process (both in the customer profiling and product selection).

IDD provides in its chapter on specific conduct of business requirements for the sale of insurance-based investment products an empowerment for the Commission aimed at further specifying how insurance intermediaries and insurance undertakings are to comply with the rules on the assessment of suitability, including with regard to the information to be obtained when assessing the suitability of insurance-based investment products for their customers. On the basis of this empowerment, the Commission adopted on 21 September 2017 the Delegated Regulation (EU) 2017/2359.

This Regulation amends Delegated Regulation (EU) 2017/2359 to include the customer's ESG preferences in the criteria and practical details to be taken into account by insurance intermediaries and insurance undertakings when assessing the suitability of insurance-based investment products for their customers. It aims to complement and reinforce others measures as part of the action plan on sustainable finance such as the implementation of a green EU taxonomy, the creation of an harmonised methodology for low-carbon benchmark and the clarifications of the asset managers and institutional investors' duties towards investors as regards sustainability and the improvement of their disclosure requirements.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

- **Stakeholder consultations**

Targeted questionnaire on the usefulness of suitability tests

The High-Level Expert Group on Sustainable Finance (HLEG) was set up in December 2016 to help develop an EU strategy on Sustainable Finance through recommendations: it published a HLEG interim report on "Financing a Sustainable European Economy" in mid-July 2017 and presented the report at a stakeholder event on 18 July 2017, followed by a consultation questionnaire. A feedback statement was published along with the HLEG final report on Financing a Sustainable European Economy on 31 January 2018. The feedback statement summarises the respondents' answers. In its final report, the HLEG recommends to "*require investment advisers to ask about, and then respond to, retail investors' preferences about the sustainable impact of their investments, as a routine component of financial advice*".

In March 2018, the Commission sent a targeted questionnaire on the integration of environmental, social and governance considerations in the suitability assessment. The consultation showed that only a minority of the clients proactively raise ESG issues during the advisory process. Some of the reasons for this are: i) the available information on ESG products is not transparent; ii) the risk of 'greenwashing' in existing documentation is high; and iii) there is a lack of education on the impact of ESG factors on risk and performance. Only in rare cases, clients seem to systematically raise ESG issues during the advisory process.

The replies to the questionnaire on the suitability test showed that during the process either a general question is asked in relation to ESG preferences in the questionnaire (to collect customers' information) or several specific questions are posed in order to clearly understand customers' preferences as regards sustainable finance. One respondent noted that they present or make available to customers their ESG risk management policies as part of their presentation of a product as these polices can impact the process of investment selections.

The level of interest of customers in considering ESG factors in their investment decision process and choice of asset managers depends on each customer, but overall this interest is growing. This is evident from the increase in the request for information linked to ESG issues.

For most respondents, a minority of customers raise proactively ESG issues during the advisory process. Some of the reasons for this are: i) the information on ESG products is not very transparent; ii) the risk of 'greenwashing' of existing documentation is high; and iii) there is a lack of education on the impact of sustainability factors on risk and performance. In the case of one respondent, a majority of their customers raise these issues during the advisory process.

Respondents had divergent views on the need for providing more information to clients (e.g. in the prospectus, KID PRIIP or on an asset manager's website) on ESG factors and sustainable finance. Some believed that investors have sufficient information to take informed investment decisions. These respondents were concerned that harmonising the type of ESG information in product documentation might bring large discrepancies in understanding the reality of ESG risk management policies.

However, there was also support for the provision of further ESG information as it would be useful for investors, especially individual investors who are by nature mostly long-term driven and therefore have a great need for sustainable finance products. In addition, it was pointed out that the issue is a matter of educating the investment advisors and fund distributors, as well as of making ESG portfolios transparent.

Respondents consider ESG factors in their product selection, but with different periodicity (i.e. always or only when the product is specifically dedicated to ESG strategies).

As for requiring the integration of ESG considerations into the suitability assessment, views were split among the options of not doing it, using non-binding guidance or clearly requiring it in legislation.

The Commission also organised a High-level conference on 'Financing sustainable growth' on 22 March 2018 to keep up the momentum with the One Planet Summit and continue to consolidate the support and commitment from EU leaders and key private players for the changes needed in the financial system to fund the transition towards a low-carbon economy.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

To integrate the customers' ESG preferences into the assessment of suitability, the present Delegated Regulation amends Article 9 of Delegated Regulation (EU) 2017/2359 as regards the details of the elements to be taken into consideration by insurance intermediaries and insurance undertakings when assessing the suitability of insurance-based investment products for their customers.

Under the existing rules, insurance intermediaries and insurance undertakings are required to obtain the necessary information about the customer's knowledge and experience in the investment field, that person's ability to bear losses, and the objectives including the risk tolerance (suitability assessment). Based on this information, insurance intermediaries and insurance undertakings assess which insurance-based investment products are suitable for the customer. The information to be obtained with regard to the investment objectives of the client includes the length of time for which the client wishes to hold the investment, preferences regarding risk taking, risk profile, and the purposes of the investment. However, investment objectives and risks are often associated with financial objectives and insurance intermediaries/insurance undertakings do not always consider non-financial aspects such as environmental, social or ethical impact of the insurance-based investment products. In addition, the ESG awareness among customers, in particular retail investors, is relatively low and, as a consequence, customers do not point to ESG in suitability questionnaires as a factor for a firm to consider.

Article 1 of this Regulation seeks to clarify that insurance intermediaries and insurance undertakings are obliged to conduct, as part of the suitability assessment, an assessment of sustainable preferences of their customers both in the selection process and the questionnaire to collect customers' information. In addition, insurance intermediaries and insurance undertakings have to include information on the ESG preferences in the sustainability statement explaining how the recommendation meets the customer's objectives, risk profile, capacity for loss and ESG preferences (ex-post information).

Art. 2 of this Regulation sets out the date of application of the proposed Regulation, including the transitional period of 18 months.

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution[10], and in particular Article 30(6) thereof,

Whereas:

(1) On 25 September 2015, the UN General Assembly adopted a new global sustainable development framework: the 2030 Agenda for Sustainable Development[11], having at its core the Sustainable Development Goals (SDGs). The Commission's Communication of 2016 on the next steps for a sustainable European future[12] links the SDGs to the Union policy framework to ensure that all Union actions and policy initiatives, within the Union and globally, take the SDGs on board at the outset. The European Council conclusions of 20 June 2017[13] confirmed the commitment of the Union and the Member States to the implementation of the 2030 Agenda in a full, coherent, comprehensive, integrated and effective manner and in close cooperation with partners and other stakeholders.

(2) The Union concluded the Paris Climate Agreement in 2016. Article 2(c) of the Paris Climate Agreement sets the objective to strengthen the response to climate change, among other means by making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.

(3) Sustainability and the transition to a low-carbon and climate resilient, more resource-efficient and circular economy are key in ensuring long-term competitiveness of the Union economy. Sustainability has long been at the heart of the European Union project and the Union Treaties give recognition to its social and environmental dimensions.

(4) On 8 March 2018, the Commission published its Action Plan 'Financing Sustainable Growth'[14], setting up an ambitious and comprehensive strategy on sustainable finance. One of the objectives of that Action Plan is to reorient capital flows towards sustainable investment to achieve sustainable and inclusive growth.

[10] OJ L 26, 2.2.2016, p. 19.
[11] *Transforming our World: The 2030 Agenda for Sustainable Development (*UN 2015).
[12] COM(2016) 739 final.
[13] CO EUR 17, CONCL. 5
[14] COM(2018) 97 final.

(5) Decision No. 1386/2013/EU of the European Parliament and of the Council[15] called for an increase in private sector funding for environmental and climate-related expenditure, notably through putting in place incentives and methodologies that stimulate companies to measure the environmental costs of their business and profits derived from using environmental service.

(6) Directive (EU) 2016/97 establishes an obligation for insurance intermediaries and insurance undertakings distributing insurance-based investment products to act in accordance with the best interests of the customer. As part of that obligation, insurance intermediaries and insurance undertakings providing advice are required to obtain the necessary information regarding the potential customer's knowledge of, and experience in the investment field and his or her financial situation and investment objectives, including his or her risk tolerance. Delegated Regulation (EU) 2017/2359[16] already sets out that the information on investment objectives should include information on investment objectives, including that potential customer's risk tolerance, information on the length of time for which the customer or potential customer wishes to hold the investment, the customer's or potential customer's preferences regarding risk taking, his or her risk profile and the purposes of the investment. To identify the customer's investment objectives, as part of the insurance intermediaries' and insurance undertakings' duties towards clients, it is necessary to clarify what consideration should be given to environmental, social and governance (ESG) preferences in the investment and advisory process.

(7) There is currently a divergence in how insurance intermediaries and insurance undertakings integrate ESG preferences in suitability assessments. That leads to uncertainties and confusion for investors. To improve the functioning of the internal market, the way those intermediaries and undertakings integrate ESG preferences into the suitability assessment should be harmonised.

(8) To enable insurance intermediaries and insurance undertakings to recommend the most suitable products to their customers or potential customers, those operators should introduce in the suitability assessment questions that help identify the customer's ESG investment objectives. The final recommendations to the customer should reflect both the financial and, where relevant, ESG preferences of that customer. The insurance intermediaries and insurance undertakings should offer those products that correspond to the ESG preferences of the customer, in accordance with their obligation to act in the best interests of the customer.

(9) To allow insurance intermediaries and insurance undertakings to adapt to the new requirements contained in this Regulation so that they can be applied in an efficient and effective manner, this Regulation should apply 18 months after the date of its entry into force.

(10) Delegated Regulation (EU) 2017/2359 should therefore be amended accordingly,

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[15] Decision No. 1386/2013/EU of the European Parliament and of the Council of 20 November 2013 on a General Union Environment Action Programme to 2020 'Living well, within the limits of our planet' (OJ L 354, 28.12.2013, p. 171).

[16] Commission Delegated Regulation (EU) 2017/2359 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to information requirements and conduct of business rules applicable to the distribution of insurance-based investment products (OJ L 341, 20.12.2017, p. 8).

HAS ADOPTED THIS REGULATION:

Article 1

Delegated Regulation (EU) 2017/2359 is amended as follows:

1. in Article 2, the following point (4) is added:

   "(4) 'ESG preferences' means ESG preferences as defined in Article 2(7) of Commission Delegated Regulation (EU) 2017/565*;

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   * Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (OJ L 87, 31.3.2017, p. 1).";

2. Article 9 is amended as follows:

   (a) in paragraph 2, point (a) is replaced by the following:

   "(a) it meets the customer's or potential customer's investment objectives, including that person's risk tolerance and his or her ESG preferences;";

   (b) paragraph 4 is replaced by the following:

   "4. The information regarding the customer's or potential customer's investment objectives, including that person's risk tolerance, shall include, where relevant, information on the length of time for which the customer or potential customer wishes to hold the investment, his or her ESG preferences , his or her preferences regarding risk taking, the risk profile, and the purposes of the investment. The level of information gathered shall be appropriate to the specific type of product or service being considered.";

3. in Article 14(1) (b), point (i) is replaced by the following:

   "(i) the customer's investment objectives, including that person's risk tolerance and ESG preferences ;".

Article 2

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

It shall apply from [*OP: Please insert date 18 months as of the date of entry into force*].

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President
Jean-Claude JUNCKER