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COMMISSION DELEGATED REGULATION (EU) .../...

of **XXX**

**amending Regulation (EU) 2017/2359 as regards the integration of Environmental,
Social and Governance (ESG) considerations and preferences into the investment advice
for insurance-based investment products**

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

This proposal is part of a broader Commission's initiative on sustainable development. It lays the foundation for an EU framework which puts Environmental, Social and Governance (ESG) considerations at the heart of the financial system to support transforming Europe's economy into a greener, more resilient and circular system. ESG factors should be considered in the investment decision making process to make investments more sustainable when taking into account gas emissions, resource depletion, or working conditions. The legislative acts aim at integrating ESG considerations into the investment and advisory process in a consistent manner across sectors. This should ensure that all financial entities that receive a mandate from their clients or beneficiaries to take investment decisions on their behalf would integrate ESG into their internal processes and inform their clients about it. Such requirements would apply for example to asset managers, insurance companies, pension funds, or investment advisors. Furthermore, to help investors compare the carbon footprint of investments, the proposals introduce new categories of low carbon and positive carbon impact benchmarks. These proposals which are mutually reinforcing should facilitate investments in sustainable projects and assets across the EU.

The Commission's package follows global efforts towards a more sustainable economy. 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 path 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**

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

Plan for Europe³, 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.

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 report⁸ 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. It announced that the Commission would amend the delegated acts under Directive 2014/65/EU on markets in financial instruments

³ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank: An Investment Plan for Europe, COM(2014) 0903 final.

⁴ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Closing the loop – An EU action plan for the Circular Economy, COM(2015) 614 final.

⁵ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank: A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy, COM(2015) 80 final.

⁶ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan on Building a Capital Markets Union, COM(2015) 468 final.

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).

⁸ 'Financing a sustainable European economy' Final Report 2018 by the High Level Expert Group on Sustainable Finance, 31.01.2018.

⁹ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan: Financing Sustainable Growth (COM(2018)097 final).

(MiFID II)¹⁰ and Directive (EU) 2016/97 on insurance distribution¹¹ to ensure that sustainability preferences are taken into account in the suitability assessment.

In addition, the Commission invited EIOPA and ESMA to provide final technical advice, including cost-benefit analysis, by 30 April 2019 on the integration of environmental, social and governance considerations and preferences in the investment decision and advisory processes.

Directive (EU) 2016/97 (Insurance Distribution Directive IDD) became applicable on 1 October 2018 and replaced Directive 2002/92/EC on insurance mediation¹². IDD provides for an updated harmonised legal framework governing the requirements applicable to the distribution of insurance-based investment products.

Under the existing IDD framework, insurance intermediaries and insurance undertakings distributing insurance-based investment products are required to obtain the necessary information about the customers' knowledge and experience in the investment field, their financial situation including the ability to bear losses and objectives including the customers risk tolerance to enable the insurance intermediaries and insurance undertakings to recommend the insurance-based investment products that are suitable for the customer (suitability assessment). The information regarding the investment objectives includes information about preferences regarding risk taking, risk profile and the purposes of the investment. However, the information about investment objectives generally relates to financial objectives, while non-financial objectives of the customer such as environmental, social and governance (ESG) preferences are usually not addressed. Existing suitability assessments generally do not include questions on ESG preferences of customers, while the majority of customers would not raise the ESG issue themselves. As a result, insurance intermediaries and insurance undertakings distributing insurance-based investment products consistently do not give appropriate consideration to ESG factors in the selection process.

This Regulation aims at clarifying that ESG considerations and preferences should be taken into account in the advisory process as part of the duties towards customers.

This Regulation is based on the empowerment set out in Article 30(6) of IDD.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

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*

¹⁰ OJ L 173, 12.6.2014, p. 349.

¹¹ OJ L 26, 2.2.2016, p. 19.

¹² OJ L 9, 15.1.2003, p. 3.

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 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.

In addition, the draft Delegated Regulation was published for feedback in line with the Better Regulation guidelines in the period between 24 May and 21 June 2018. The Commission received feedback from 20 interested parties by means of electronic form. Shareholders from different backgrounds (e.g. NGOs, financial industry associations, public bodies) commented on diverse aspects of the proposed Delegated Regulation. While there was generally strong support to enhance the focus on non-financial objectives within the investment process, some stakeholders were reluctant to change their newly implemented processes based on IDD. As described above, the Commission is not only convinced of the urgency of moving ahead with its Sustainable Finance Agenda but is also of the view that the newly introduced reference to the Regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341 (Disclosure Regulation)¹³ and the proposed timeline for the application of this delegated act (12 months after entry into force) provide for sufficient flexibility.

Some stakeholders also commented on the definitions: while some stakeholders were of the view that the definitions suggested within Art. 2 of this delegated act were too vague, others asked for broader definitions. The Commission addressed this issue by referring to the definition provided in the legislative proposal for a Regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341.

As regards some of the objectives within the suitability assessment process, the Commission included some modifications in order to allow for the necessary differentiation between investment objectives on the one hand and ESG preferences on the other hand. This differentiation is important in order to avoid mis-selling, which may happen should an ESG consideration take precedence over a client's personal investment objective. Another recital shall then clarify that the ESG preferences should only be addressed within the suitability process after the identification of the customer's investment objective.

¹³ <https://ec.europa.eu/info/publications/180524-proposal-sustainable-finance.en>.

To enhance legal certainty, the ESG references were specified and the recitals were amended: it was clarified that a new suitability assessment for existing contracts will generally not be necessary.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

In order to take into account environmental, social and governance preferences of customers, when insurance intermediaries and insurance undertakings provide advice on insurance-based investment products, the present Delegated Regulation amends Articles 9 and 14 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.

Article 1 of this Regulation aims at clarifying that insurance intermediaries and insurance undertakings providing advice on insurance-based investment products should carry out a mandatory assessment of ESG preferences of their customers and potential customers in a questionnaire addressed to them. These investment firms should then take these ESG preferences into account in the selection process of the insurance-based investment products that are offered to these customers.

In addition, Article 1 requires insurance intermediaries and insurance undertakings providing advice on insurance-based investment products to explain in the suitability statement provided to the customer that explains how the recommendation takes into account the ESG preferences expressed by the customer.

Art. 2 of this Regulation sets out the date of application of the proposed Regulation, including the transitional period of 12 months.

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(Text with EEA relevance)

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 distribution¹, and in particular Article 30(6) thereof,

Whereas:

- (1) On 8 March 2018, the Commission published its Action Plan 'Financing Sustainable Growth'², setting out an ambitious and comprehensive strategy on sustainable finance. One of the objectives of that Action Plan is to reorient capital flows towards sustainable investments to achieve sustainable and inclusive growth.
- (2) Already Decision No. 1386/2013/EU of the European Parliament and of the Council³ established the 7th Environment Action Programme. In particular, the prior objective to turn the Union into a resource-efficient, green and competitive low-carbon economy called for stimulating consumer demand for environmentally sustainable products and services through policies which promote their availability, affordability, functionality and attractiveness.
- (3) 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, Commission Delegated Regulation (EU) 2017/2359⁴ sets out that the information on investment objectives should include information about the length of time for which a customer or potential customer wishes to hold an investment, his or her preferences regarding risk taking, his or her risk profile and the purposes of the investment.
- (4) Currently, there is a divergence in how insurance intermediaries and insurance undertakings distributing insurance-based investment products integrate Environmental, Social and Governance (ESG) considerations and preferences in their

¹ OJ L 26, 2.2.2016, p. 19.

² COM(2018) 97 final.

³ 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).

⁴ 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).

suitability assessments which leads to uncertainties and confusion for investors. To improve the functioning of the internal market and to stimulate the investors' demand for ESG products, the way those intermediaries and undertakings integrate ESG considerations and preference into the suitability assessment should be harmonised.

- (5) To enable insurance intermediaries and insurance undertakings to recommend suitable products to their customers or potential customers, those operators should introduce in their suitability assessment questions that help identify the customer's individual ESG preferences. In accordance with their obligation to act in the best interests of the customer, recommendations to customers should reflect both the financial objectives and, where relevant, the ESG preferences expressed by the customer.
- (6) In order to avoid cases of mis-selling, insurance intermediaries and insurance undertakings providing advice on insurance-based investment products shall first assess the individual customer's investment objectives, time horizon and individual circumstances, before asking the customer for any potential ESG preferences.
- (7) Insurance intermediaries and insurance undertakings should also explain to the customers how their ESG preferences for each financial instrument are taken into consideration in the selection process to recommend insurance-based investment products.
- (8) For existing customers, for whom a suitability assessment has already been undertaken, insurance intermediaries and insurance undertakings should be able to rely on the existing suitability assessment.
- (9) The provisions in this Regulation are closely linked since they deal with investment advice. To ensure coherence between those provisions, which should enter into force at the same time, and to ensure easy access to them, it is desirable to include those provisions in a single regulation.
- (10) To allow insurance intermediaries and insurance undertakings to adapt to the new requirements contained in this Regulation, its application should be deferred.
- (11) Delegated Regulation (EU) 2017/2359 should therefore be amended accordingly,

HAS ADOPTED THIS REGULATION:

Article 1

Amendments to Delegated Regulation (EU) 2017/2359

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

1. In Article 2, the following points are added:
 - “(4) ‘ESG preferences’ means a customer's or potential customer's choice as to whether and which environmentally sustainable investments, social investments or good governance investments should be integrated into his/her investment strategy;
 - (5) ‘ESG considerations’ means any factor associated with environmentally sustainable investments, social investments or good governance investments, or a combination of those factors;

- (6) ‘environmentally sustainable investment’ means an investment as defined in Article 2 (o) (i) of Regulation XXX of the European Parliament and of the Council⁵;
- (7) ‘social investment’ means an investment as defined in Article 2 (o) (ii) of the Regulation XXX of the European Parliament and of the Council;
- (8) ‘good governance investment’ means an investment as defined in Article 2 (o) (iii) of the Regulation XXX of the European Parliament and of the Council.”
2. Article 9 is amended as follows:
- (a) in paragraph 2, point (a) is replaced by the following:
- “(a) it meets the investment objectives of the customer or potential customer in question, that person’s risk tolerance and any preferences, including ESG preferences, where relevant;”;
- (b) paragraph 4 is replaced by the following:
- “4. The information regarding the investment objectives of the customer or potential customer 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 preference regarding risk taking, the risk profile, the purpose of the investment and his or her ESG preferences, if any. 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 whether the customer’s investment objectives are achieved by taking into account the ESG preferences expressed by the customer;”.

Article 2

1. This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.
2. This Regulation shall apply from [12 months after the date of entry into force].
3. 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

⁵ See the Proposal for a regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341, https://ec.europa.eu/info/publications/180524-proposal-sustainable-finance_en.