.BVI

Frankfurt,
13 May 2022

BVI[1]'s reply to the Consultation Paper on EIOPA Draft Guidelines on the integration of the customer's sustainability preferences in the suitability assessment under the Insurance Distribution Directive (2016/97)

Q1. Do you have any general comments regarding EIOPA proposed approach?

Please provide a detailed answer. (5000 characters)

We would like to provide input to the EIOPA's consultation from the perspective of fund and asset managers that provide investment options offered as part of insurance-based multi-option products. Our members also manage a large share of cover pool assets held by insurance undertakings. Solutions offered by the fund industry are thus essential for the insurance sector's ability to respond to sustainability preferences of customers.

The market for sustainable products under SFDR is evolving to incorporate the relevant product features specified under MiFID and IDD. As it stands there are hardly any products classified under Article 8 SFDR in the market that already meet one or more criteria for sustainability preferences under MiFID and IDD as binding elements of their investment strategy. Products according to Article 9 SFDR provide per se for a high proportion of sustainable investments and consideration of principal adverse impacts that such "Article 9" funds generally have a targeted focus on sustainable sectors or projects (e.g., renewable energies), they are in most cases not sufficiently risk-diversified in order to be suitable as stand-alone investments for average retail customers.

Investment strategies of "Article 8" funds are progressively being adapted by the providers, but these adaptations face **several challenges in legal and factual terms**:

- So far, there is **effectively no possibility to commit to a meaningful proportion of Taxonomy-aligned investments in broadly diversified funds** due to (1) the **early stage of development** of the EU Taxonomy that pertains only to a few sectors, in particular energy and transport, (2) the **lack of reported or otherwise reliable data** for assessing investments against the Taxonomy and (3) the **limitations under the draft SFDR RTS for referring to other than data of equivalent quality** as proxies for Taxonomy-alignment. Moreover, it is important to understand that Taxonomy-alignment in case of equity investments pertains not to the company as a whole, but only to that **relevant fraction of turnover** (or alternatively Capex/Opex) by a company that is directly related to economic activities fulfilling the technical criteria under the EU Taxonomy (e.g., in case of car manufacturers, to the proportion of turnover from production of electric vehicles). **High proportions of Taxonomy-aligned investments in diversified equity funds will therefore remain unrealistic in the coming years**, even in case the data availability will improve.

- **Similar problems arise in relation to commitments for sustainable investments** under Art. 2 No. 17 SFDR. Sustainable investments also need to be assessed based on the economic activities of an issuer which means that generally only a **fraction of the entire investment will be**

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset Managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 116 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 28%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

classified as sustainable. The concept of sustainable investments is defined only in loose terms which creates **legal uncertainty for product manufacturers**. In addition, there is also a **significant data problem** since in principle, sustainable investments involve screening of the mandatory indicators for principal adverse impacts under SFDR RTS. As to date, however, there are still major data gaps that inhibit full coverage of the legally prescribed indicators e.g., on biodiversity, hazardous waste or gender pay gap.

- In view of these problems, **many fund managers focus on the concept of considering principal adverse impacts (PAIs)** in their implementation projects. Consideration of PAIs as sustainability features is in general best aligned with the ESG investment approaches most common in Article 8 products such as exclusion-based strategies, best-in-class selection or dedicated ESG engagement. The data gaps with regard to the coverage of PAI indicators are, of course, also problematic for this option, but can be overcome by focusing on certain PAI themes, e.g., GHG emissions or adherence to international social and governance standards where data availability is already broadly satisfactory.

In view of this evolving market situation, it is clear that **by August 2022 the ability of insurance intermediaries to cater for all potential sustainability preferences of customers will be quite limited**. At least in the initial phase of implementation, certain product features (e.g., Taxonomy-aligned products or products with a high share of sustainable investments) will be very scarce. It is **crucial to keep this market reality in mind when making specifications for suitability assessment**. Firms should be able to **inform customers about the respective availability of products addressing sustainability preferences** in order to counteract unrealistic expectations. It is important to communicate openly with customers and provide them with a clear picture of the real possibilities.

Our subsequent remarks focus on the elements of the draft guidelines which we deem problematic in the current stage of the transformation process.

Q2. Guideline 1 – Do you agree that insurance undertakings and insurance intermediaries should explain the purpose of the sustainability part of the suitability assessment and its scope as proposed by EIOPA or do you believe that the information requirement should be expanded further, and if yes, how?

Please provide a detailed answer. (5000 characters)

Q3. Guideline 2 – Do you consider that insurance undertakings and insurance intermediaries should collect information on sustainability preferences as the last element within the collection of information on investment objectives?

Please provide a detailed answer. (5000 characters)

Q4. Guideline 2 – Consistently with the text of article 2(4) of Commission Delegated Regulation 2017/2359, as amended by Commission Delegated Regulation (EU) 2021/1257, EIOPA proposes to collect the information on the minimum proportion for aspects defined in points a) and b) of Article 2(4) of Commission Delegated Regulation 2017/2359 from the customer in terms of percentages or shares. Do you agree with this approach?

Please provide a detailed answer. (5000 characters)

The proposed requirement for insurance distributors to **ask customers about their preferences in terms of specific percentages or shares is not appropriate in the current market environment**. It is important to understand that on the product side, commitment for a minimum proportion of Taxonomy-aligned or sustainable investments faces **several challenges in legal and factual terms**:

- So far, there is **effectively no possibility to commit to a meaningful proportion of Taxonomy-aligned investments in broadly diversified funds** due to (1) the **early stage of development** of the EU Taxonomy that pertains only to a few sectors, in particular energy and transport, (2) the **lack of reported or otherwise reliable data** for assessing investments against the Taxonomy and (3) the **limitations under the draft SFDR RTS for referring to other than data of equivalent quality** as proxies for Taxonomy-alignment. Moreover, it is important to understand that Taxonomy-alignment in case of equity investments pertains not to the company as a whole, but only to that **relevant fraction of turnover** (or alternatively Capex/Opex) by a company that is directly related to economic activities fulfilling the technical criteria under the EU Taxonomy (e.g., in case of car manufacturers, to the proportion of turnover from production of electric vehicles). **High proportions of Taxonomy-aligned investments in diversified equity funds will therefore remain unrealistic in the coming years**, even in case the data availability will improve.

- **Similar problems arise in relation to commitments for sustainable investments**. We understand that sustainable investments need also to be assessed based on the economic activities of an issuer which means that generally only a **fraction of the entire investment will be classified as sustainable**. In addition, there are major challenges as regards the legal concept of sustainable investments which is only loosely defined thus creating **legal uncertainty for product manufacturers**. There is **no common understanding as to what level of ambition needs to be applied** to determine a positive contribution to a sustainable investment objective or the "do not significant harm" assessment. In addition, there is also a **significant data problem** in terms of the prescribed screening of the mandatory indicators for principal adverse impacts. There are still major data gaps that inhibit full coverage of the legally prescribed indicators, e.g., on biodiversity, hazardous waste or gender pay gap.

In view of this challenges, it should be clear that **information on share of Taxonomy-aligned or sustainable investments will likely not be comparable across products** at least in the initial phase of implementation. In both cases, different data sources and different calculation methodologies (especially turnover or CapEx based) can be applied which will significantly impact the calculation outcomes. In the case of sustainable investments, the underlying problems are even deeper and relate to the very concept of sustainable investments, alongside the data and methodology challenge. It is thus quite likely that a product with a quantitatively lower minimum commitment to sustainable investments might in fact ensure a higher degree of sustainability than another product with a quantitatively higher minimum commitment due to a more ambitious approach being applied.

Against this background, **there is no point in asking customers for specific minimum percentages if product commitments cannot be adequately compared or assessed** by distributors. Distributors should rather be able to collect information on customers' preferences with regard to minimum proportions by reference to **preferred ranges or sizes, also in qualitative terms**. For instance, insurance undertakings and intermediaries could assign the available products to qualitative categories "low", "medium" and "high" based on the proportion of Taxonomy-aligned or sustainable investments not in absolute terms, but relative to the market evolvement. Such dynamic "best in market" approach would allow distributors to keep their internal selection process up to date and to take into account progress in the offerings of sustainable products on a continuous basis.

We assume that the proportion of Taxonomy-aligned investments in investment funds pursuing sustainable investment strategies will increase over time due to a variety of factors, i.e., further development of technical criteria for Taxonomy-aligned economic activities, enhanced reporting by companies and increasing progress in transition. Funds that hold for instance 10 percent of Taxonomy-aligned assets might be ranked "high" compared to their peers today but will be likely classified as "medium" in a few years' time. The internal arrangements for assessing sustainability factors of products should be able to keep up with the market evolvement by relying on qualitative ranking features rather than hard quotas that will continuously change.

Q5. Guideline 2 – EIOPA proposes that insurance undertakings and insurance intermediaries should collect information on whether the customer choses the Taxonomy alignment based on all investment of the insurance-based investment product or only based on those assets that are not government bonds, due to the existing limitations to screen taxonomy-alignment of government bonds. Do you agree with this approach?

Please provide a detailed answer. (5000 characters)

We **disagree with the EIOPA's proposal** to ask customers about their preferences for different Taxonomy KPIs as part of the standard procedure for the following reasons:

- A requirement to ask customers about their preferences for two different Taxonomy KPIs cannot be derived from the texts of the delegated Regulations to MiFID and IDD. On the contrary, the **legal texts provide for exploration of sustainability preferences in relation to the financial instrument or insurance-based investment product as such**.
- Also from the investor protection perspective, it should be much **more relevant for the customer to stipulate what minimum proportion of his or her overall investment is Taxonomy-aligned**. Given that the ratio of Taxonomy-aligned assets will tend to be much higher when excluding sovereign investments, but requires double ratio calculations for a proper understanding, there is the risk that an **average customer will not be able to comprehend the relevance of this KPI**.
- Most actively managed funds do not have pre-determined quota for investments in government bonds, but leave flexibility for portfolio managers to increase or decrease sovereign investments according to their evaluation of market opportunities. Without such fixed rates, however, it is **impossible to commit** to a minimum share of Taxonomy-aligned investments when excluding sovereign bonds. Therefore, we expect anyway that **most funds will provide only for one KPI on Taxonomy-aligned investments based on the entire portfolio** in their pre-contractual disclosures.
- Explaining the two different approaches to calculating Taxonomy-alignment foreseen for pre-contractual disclosures under SFDR will likely **overstrain both, advisors and customers** and might lead to overall frustrations and a high breaking-off rate.

Q6. Guideline 2 – When the customer does not determine a specific "minimum proportion" for aspects a) and b), EIOPA proposes that insurance undertakings and insurance intermediaries could guide the customer by providing standardised minimum proportions to help the customer

in determining a minimum proportion. Do you believe that the guidelines should specify how granular should be such standardised minimum proportions?

Please provide a detailed answer. (5000 characters)

We would like to refer EIOPA to our reply to Q4 where we already explained our reservations against asking customers for very precise preferences in terms of percentages or shares. Indeed, there is **no point in asking customers for specific minimum percentages if the product commitments cannot be adequately compared or assessed** by distributors. Distributors should rather be able to approach the customer's preferences with regard to a minimum proportion of sustainable investments by **collecting information on preferred ranges or sizes, also in qualitative terms**. For instance, insurance undertakings and intermediaries could assign the available products to qualitative categories "low", "medium" and "high" based on the proportion of Taxonomy-aligned or sustainable investments not in absolute terms, but relative to the market evolvement. Such dynamic "best in market" approach would allow distributors to keep their internal selection process up to date and to take into account progress in the offerings of sustainable products on a continuous basis.

This more flexible approach would likely avoid situations where customers feel unable to express any kind of specific preferences for Taxonomy-aligned or other sustainable investments. At the same time, a customer's preference for a certain range or size should always be understood as **specification of a minimum proportion** in line with MiFID and IDD requirements. This means that **advisors should still be able to recommend products with a higher minimum commitment** for Taxonomy-aligned or sustainable investments if such products meet the financial criteria of suitability.

Q7. Guideline 2 – Do you agree with the suggested approach where customers answer that they do have sustainability preferences, but do not state a preference with regard to any of the specific aspects mentioned under a) to c) or with regard to a minimum proportion with regard to points a) and b) of Article 2(4) of Commission Delegated Regulation 2017/2359, as amended? If yes, do you believe that the supporting guideline should be more prescriptive with regard to the procedures insurance undertakings and insurance intermediaries should adopt in the case where a customer does not determine specific sustainability preferences?

Please provide a detailed answer. (5000 characters)

Q8. Guideline 2 – Do you consider that further guidance is needed to clarify how insurance undertakings and insurance intermediaries should collect information on the customer's sustainability preferences?

Please provide a detailed answer. (5000 characters)

Q9. Guideline 3 – Do you agree with the approach with regard to the periodic assessment?

Please provide a detailed answer. (5000 characters)

Q10. Guideline 4 – EIOPA provides guidance on how to use the SFDR disclosures under Solvency II Directive to assess whether an insurance-based investment product matches the sustainability preferences of the customer in order to make a personal recommendation. Do you agree with the approach?

Please provide a detailed answer. (5000 characters)

We agree.

Q11. Guideline 4 – For multi-option products, EIOPA provides guidance on how to assess whether an insurance-based investment product matches the sustainability preferences of the customer in order to make a personal recommendation. Do you agree with the approach?

Please provide a detailed answer. (5000 characters)

Q12. Guideline 5 – Do you agree with the approach outlined with regard to the situation where the customer makes use of the possibility to adapt the sustainability preferences?

Please provide a detailed answer. (5000 characters)

The practicability of integration of sustainability preferences into the advice process must be significantly improved in order to actually support, not inhibit, reorientation of capital flows towards investments in sustainable activities and projects as foreseen by the 2018 EU Action Plan.
The approach proposed in the draft EIOPA Guidelines is **overly complex** and will likely **overstrain advisors and customers likewise.**

In the initial phase of implementation, there will be certainly no sufficient products to match all sustainability preferences of customers, including possible combinations. As explained above, most funds that currently classify for Article 8 under SFDR and are sufficiently risk-diversified to pass the suitability test for average customers do not yet provide for the product features relevant in terms of sustainability preferences. Investment strategies of these products are currently being adapted by the providers, but these adaptations face several challenges in legal and factual terms. It is hence quite likely that **by August 2022, there will be no risk-diversified investment funds with any relevant proportion of Taxonomy-aligned investments or with high share of sustainable investments**.

This means that in the initial phase of implementation, insurance intermediaries will **need to manage the gap between potentially very demanding expectations of customers, e.g., in terms of high proportions of Taxonomy-aligned or other sustainable investments, and the range of products available in the market**. In order to make this part of suitability testing feasible and to avoid situations where distributors will be in the end prevented from recommending products to customers because they have been asked about their sustainability preferences in theoretical terms, we see the need for the following adaptations of the draft guidelines, also in line with our suggestions made above:

- Insurance undertakings and intermediaries should be able to **focus in the "know your customer" testing on product features that are available in the market and that form part of their current product range** in order to avoid exploration of customer preferences being detached from the market reality. This more focused approach would significantly reduce the need for subsequent adaptations of individual sustainability preferences and prevent potential frustrations on the part of customers.

- Assessment of sustainability preferences should be **embedded in the overall evaluation of the customer profile** and in particular, should be conducted with due regard to his or her financial needs.

- Insurance undertakings and intermediaries should be **allowed to rank or group products according to a "best in market" relative approach and present the options to customers in a qualitative manner** (e.g., by differentiating between products with high, medium and low proportion of Taxonomy-aligned or sustainable investments).

- In case there are no products that would exactly match sustainability preferences of a customer, it should **still be possible for distributors to recommend products that provide for at least one relevant product feature** (e.g. to recommend products with a certain share of sustainable investments to customers interested in sustainable and Taxonomy-aligned investments) and pass other criteria of the suitability test. **Alternatively, adaptations of sustainability preferences should be admitted on a much broader scale based on the range of products available in the market** at least in the first years of application.

Q13. Guideline 6 – Do you agree with the guidance regarding to the arrangements necessary to ensure compliance with the record-keeping requirements or do you believe that further guidance on this aspect should be needed?

Please provide a detailed answer. (5000 characters)

Q14. Guideline 7 – Do you agree with the guidance regarding to the qualification of employees of an insurance undertaking or insurance intermediary employees or do you believe that further guidance on this aspect should be needed?

Please provide a detailed answer. (5000 characters)

Q15. What level of resources would be required to implement and comply with the guidelines (organisational, IT costs, training costs, employee costs, etc., differentiated between one off and ongoing costs)? When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.

Please provide a detailed answer. (5000 characters)