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ACP Advice to EIOPA on proportionality areas in AWP 2023

In accordance with Article 1(7) of Regulation (EU) No 1094/2010, EIOPA established, as its integral part, the Advisory Committee on Proportionality (the "ACP"). The ACP shall advise EIOPA as to how, in full compliance with applicable rules, EIOPA's actions and measures should take account of specific differences prevailing in the sector, pertaining to the nature, scale and complexity of risks, to business models and practice as well as to the size of financial institutions and of markets to the extent that such factors are relevant under the rules considered.

The Committee shall assess the proportionality aspects set out in Article 1(7) of Regulation (EU) No 1094/2010 concerning the applicable regulatory framework and shall advise EIOPA in which specific areas proportionality can be improved or prioritised, and give advice on possible elements to be explored by EIOPA.

The Committee may provide ad hoc advice to EIOPA on its own initiative and shall review how EIOPA has taken into account the Committee's advice.

The ACP Advice is a key opportunity to raise awareness on proportionality aspects, both from regulatory perspectives as well as implementation aspects, before policy or supervisory work is initiated by EIOPA. Consideration of proportionality will support the reduction of unnecessary operational complexity and burden in EU law. The ACP has delivered Advices for 2021 and 2022 activities already covering a number of different areas such as Solvency II, Digital Operational Resilience and sustainability aspects. Most of the Advices are still under consideration reflecting the still on-going political discussions on Solvency II Review and the policy development phase for the Digital Operational Resilience Act. The content of the Advice for 2023 activities takes into consideration these on-going activities on proportionality. Also, the ACP has considered to include an Advice on the Recovery and Resolution area but due to the on-going political discussions it decided to delay it, potentially for next year.

The ACP identified the following areas to provide advice. The areas proposed reflect the priorities identified but as well resources availability and the regulatory developments on-going.

1. Diversity and Inclusion in risk management

Generally, diversity refers to the similarities and differences among individuals accounting for all aspects of their personality and individual identity. Diversity may have different definitions and organisations frequently adapt the definition to their specific environment. Some of the most common features are age/generation, disability, ethnicity/national origin, family status, gender identity or expression, physical characteristics, race/color, religion, belief and spirituality, sexual orientation. Correlations between diversity and inclusion and positive outcomes in risk management, good conduct, healthy working cultures and innovation can be observed and the insurance industry is

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already making the path towards this recognition. It is important that both regulation and supervision consider diversity and inclusion moving forward. Diversity and inclusion along all levels of decision-making process mitigates biased decision making and biased outcomes in different processes, be it risk assessment or claims management for example. Diversity and inclusion creates a workplace culture that values difference, fosters inclusion and promotes collaboration and innovation.

Diversity and inclusion should contribute to a strong organisational culture and good governance leading to a more robust risk management framework. EBA and ESMA already addressed this topic under the joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2021/06) as revised with effect from the 31 December 2021 with emphasis on gender diversity and balance.

A number of researches, studies and initiatives in the insurance world emerged in the last years on the same topic highlighting the need for a change.

Considering the above it could be expected that also in Solvency II (and in IORP II) provisions on diversity and inclusion are taken into account. This advice is prepared based on the possibility assumption that the Solvency II Review and the IORP II Review may introduce the issue of diversity similar to the banking regulation. EIOPA proposed to the EU COM in April 2022 (after the BoS support in principle) to pursue a similar approach to gender diversity as laid down in the CRDV Directive in the ongoing/upcoming reviews of Solvency II and IORP II. The call for advice to EIOPA on the review of IORP II includes a request for EIOPA to explore "prudential requirements to include diversity and inclusion issues in relation to management bodies.

Diversity and inclusion is as such not per se a proportionality topic. However the implementation in the risk management framework of diversity and inclusion provisions must keep in mind proportionality aspects, in particular related to the size of the undertakings, i.e. number of employers and/or staff associated to outsourcing.

Example for possible areas for enhancement/review:

- When addressing diversity and inclusion in the context of the composition of the Administrative, Management and Supervisory Body as well as along the decision making process, namely regarding senior managers and key function holders, proportionality should be taken into consideration.

- Proportionality on implementation of such aspects is key in particular for entities with a lower number of staff. Nature and complexity of the risks are not seen as a factor that impacts the implementation of diversity and inclusion. The aim should not be to increase the number of staff to comply with any diversity and inclusion provision but instead to embed the principles into the undertaking culture. While all undertakings should aim for adequate diversity in the composition of their AMSB it could take undertakings with smaller AMSBs longer to achieve their goal. Also, when the number of AMSB members or staff in general is low other measures to ensure diversity and inclusion in the decision making process may be considered.

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- When an undertaking makes use of outsourcing it should ensure that any lack of diversity or inclusion within the service provider do not lead to biased decision making and/or biased outcomes in the processes outsourced.

2. Technical advice on the role of IORPs (Institutions of occupational retirement provision) in the context of COM's Call for technical advice to EIOPA on the review of the IORP II Directive in the assessment of sustainability aspects of the fiduciary duties and stewardship rules of pension funds

The European Commission has sent to EIOPA the Call for technical advice regarding the evaluation and review of the IORP II Directive that includes the assessment of possible options in relation to renewed strategy on sustainable finance:

"Exploring ways to strengthen the sustainability aspects of the fiduciary duties and stewardship rules of pension funds: In line with the Strategy for Financing the Transition to a Sustainable Economy, the Commission invites EIOPA to assess the potential need to broaden the concept of the "long-term best interests of members and beneficiaries" in point (a) of Article 19(1) of the IORP II Directive. In its analysis it should evaluate the possible introduction of the notion of double materiality, considering members' and beneficiaries' sustainability preferences and broader societal and environmental goals. EIOPA should further assess whether the 'prudent person rule' set out in Article 19(1) of the IORP II Directive should be clarified and/or explore possible avenues to require the integration of sustainability impacts in the investment decision".

The integration of double materiality in institutional investors' investment strategy and decisions would imply that the investors should also consider the impact they make on environmental and social issues (inside out), in addition to considering the risk environmental and social issues pose to their balance sheet (outside in). The assessment of the double materiality requires access to relevant data and to have the necessary knowledge and competence to embed the ESG factors in the policies of IORPs or rely on outsourced services. This is potentially difficult and burdensome for smaller IORPs.

Taking into consideration the European Commission's call for advice on the IOPR II Directive, the following areas were identified as relevant to advise EIOPA to consider how the proportionality principle for IOPRs in the sustainable finance could be taken into account.

The IORP II Directive requires IORPs to take into consideration sustainable risks, especially in the system of governance (art. 21), risk management (art. 25) and the own risk assessment (art. 28). However, on investment decisions article 19 of the IORP II Directive sets out that Member States shall allow IORPs to take into account the potential long-term impact of investment decisions on environmental, social, and governance factors. This "shall allow" implies that the consideration of ESG factors remains on a voluntary discretion of the IORP.

Considering the Sustainable Finance Disclosure Regulation (SFDR), the IORP II should reflect the requirement that IORPs offering occupational pensions with sustainability characteristics or objectives should disclose specific information to prospective members in the pre-enrolment phase and should inform periodically the members in the Annual Report. The IORP II Directive only envisages the disclosure for prospective information on whether and how ESG are considered. Hence, it is expected

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that the article 41 of IOPR II Directive on the information to be provided to prospective members on ESG factors is aligned with the requirements defined in the SFDR.

Possible areas for enhancement/review:

- Integrating sustainability considerations in investments can be challenging for IORPs (selection of investments, transition costs…) and have a direct impact on available retirement benefits. The mandatory consideration of the impact of the investment on environmental or social factors could be too burdensome for smaller IORPs. The lack of expertise and knowledge needed to embed ESG factors in all the relevant areas of implementation (governance, transparency, risk-management, investment policy and stewardship) could hinder the sustainable investment decisions. If the concept of double materiality in IORPs investment decisions is considered on a mandatory basis, its introduction should be done in a cost-effective way according to the size (or other proportionality criteria) of the IORP and consider for example the outsourcing of sustainable investment decisions to third parties. It should also consider the need for flexibility on how the IORPs should gauge and articulate the members' and beneficiaries' sustainability preferences in the investment policy, also having regard to the proportionality principle.

- If a review of article 41 of IORP II Directive on the information to be provided to prospective members on ESG factors is to be considered to align with the requirements defined in the SFDR, it should be reflected how IORPs can disclose information on sustainable factors taking into account the proportionality principle. This could be reflected not only in the amount of information provided but also in the forms of disclosure of the information that would be required.

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