PUBLIC
CONSULTATION

CONSULTATION PAPER

on EIOPA's advice regarding Article 8 of the Taxonomy Regulation

EIOPA-BoS-20/731
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European Insurance and
Occupational Pensions Authority

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Responding to this paper

EIOPA welcomes comments on the Consultation Paper on EIOPA's advice regarding Article 8 of the Taxonomy Regulation[1].

Comments are most helpful if they:

- respond to the question stated, where applicable;
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA in the EUSurvey, following this link: EUSurvey - Survey (europa.eu), by 12 January 2021.

Contributions not provided in the EU Survey format or after the deadline will not be processed.

Publication of responses

Contributions received will be published on EIOPA's public website unless you request otherwise in the respective field in the survey for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents and EIOPA's rules on public access to documents[2].

Contributions will be made available at the end of the public consultation period.

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[1] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, OJ L 198, 22.06.2020, p. 13.

[2] Public Access to Documents

1. Introduction

1.1. The objective of the Taxonomy Regulation

The main objective of the Taxonomy Regulation[3] is to set out relevant criteria for determining whether an economic activity qualifies as environmentally sustainable in order to address market failures to identify such economic activities and ultimately remove barriers to the functioning of the internal market. Further clarity and transparency can help raising funds for sustainability projects and may prevent the future emergence of barriers to such projects. With a clear definition of such economic activities, entities shall find it easier to raise funding across borders for their environmentally sustainable activities, as their economic activities could be compared against uniform criteria in order to be selected as underlying assets for environmentally sustainable investments. The harmonisation of relevant criteria are expected to facilitate cross-border sustainable investment in the Union.

With the definition of what an environmentally sustainable economic activity is, financial market participants can provide a reasonably founded explanation to investors about how the activities in which they invest contribute to environmental objectives. Equally, investors will find it easier to check and compare different financial products, which may encourage investors to invest in environmentally sustainable financial products. Furthermore, a lack of investor confidence has a major detrimental impact on the market for sustainable investment. Concluding, if financial market participants use common criteria for disclosures about their taxonomy-aligned economic activities across the Union that would help investors compare investment opportunities across borders and would incentivise investee companies to make their business models more environmentally sustainable. Additionally, investors would invest in environmentally sustainable financial products across the Union with higher confidence, thereby improving the functioning of the internal market.

The Taxonomy Regulation empowers the European Commission to develop delegated acts to supplement the disclosure requirements, as established by the NFRD (Non-Financial Reporting Directive[4]), which amended the Accounting Directive[5] to require a non-financial statement, which should contain information relating to at least environmental matters, social and employee-related matters, respect for human rights, anticorruption and bribery matters. Such statement should include a description of the policies, outcomes and risks related to those matters and should be included in the management report (or in a dedicated, separate report) of the undertaking concerned. The NFRD sets out the requirement to include key performance indicators ‘relevant to the particular business’ in the non-financial statement - without specifying the reference points of those performance indicators.

The European Commission’s Guidelines on non-financial reporting: Supplement on reporting climate-related information[6] of June 2019 establish the recommendation that

[3] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, OJ L 198, 22.6.2020, p. 13–43.

[4] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ L 330, 15.11.2014, p. 1–9.

[5] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, OJ L 182, 29.6.2013, p. 19.

[6] Communication from the Commission — Guidelines on non-financial reporting: Supplement on reporting climate-related information, 20.6.2019, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52019XC0620(01).

certain large companies, including insurance undertakings, report on certain climate-related key performance indicators (KPIs). Building on that recommendation, the Taxonomy Regulation requires for non-financial undertakings the annual disclosure of information on the proportion of the turnover, capital expenditure (CapEx) or operating expenditure (OpEx) that is associated with environmentally sustainable economic activities.

1.2. The mandate of the European Commission's Call for Advice (CfA)

The CfA addressed to the European Supervisory Authorities asks to provide input to develop future delegated acts in relation to Art. 8 of the Taxonomy Regulation, which amends the mandatory disclosures following the NFRD in the management report on non-financial report of large public interest entities, including insurance undertakings.

Art. 8 of the Taxonomy Regulation specifies which ratios have to be depicted by <u>non-financial</u> undertakings:

- the proportion of their <u>turnover</u> derived from products or services associated with economic activities that qualify as environmentally sustainable; and
- the proportion of their <u>capital expenditure</u> and the proportion of their <u>operating expenditure</u> related to assets or processes associated with economic activities that qualify as environmentally sustainable

The CfA asks EIOPA to develop the relevant ratio(s) to be mandatorily disclosed by the insurance undertakings falling within the scope of the NFRD. Thereby, EIOPA shall consider whether the mandatory ratios of non-financial undertakings, as set out by Art. 8 of the Taxonomy Regulation, are relevant and appropriate to depict insurance and reinsurance activities or whether they need to be 'translated' to the most appropriate and comparable key performance indicators for insurance and reinsurance businesses. For that, the CfA further specifies three insurance-specific ratios as a possible starting point:

- Proportion of total assets invested in taxonomy-compliant economic activities.
- Proportion of total non-life insurance underwriting exposure associated with taxonomy activities.
- Proportion of total reinsurance underwriting exposure associated with taxonomy activities.

2. Identifying the relevant ratios for insurance and reinsurance undertakings

2.1. Non-financial undertakings' <u>capital expenditure and operating expenditure</u> related to assets and processes in taxonomy-compliant activities

The measures of capital expenditure or operating expenditure of non-financial undertakings provide flow information about the building up and amortisation/depreciation of tangible and intangible assets as well as expenses related to the operational transactions and services carried out in the reporting period.

Capital expenditure, as such, is not defined in the Accounting Directive, but may be described as the change in the amount of fixed tangible and intangible capital that occurred during the reporting year, including any depreciation or amortisation charges for the year, as accounted for under the applicable GAAP in these undertakings' financial statements.

Neither defined in the Accounting Directive is 'operational expenditure'. The expression indicates that the expenditure is related to the main business activity of the non-financial undertaking. Therefore, it could be described positively as all items of expense that arise from the undertaking's main business activities, which are generally identified as the principal revenue-producing activities of the entity and negatively as expenses that do not relate either to the investment or financing categories.

Comparisson of the two measures of 'capital and operational expenditure' with the suggested proportion of insurance undertakings' 'total assets' shows that:

- both types of measures refer to (tangible and intangible) assets,
- stemming from capital investments and non-extraordinary transactions or business activities;
- one type of measure refers to flow information, whilst the second one refers to stock information.

Apart from the question whether the appropriate ratio for insurance and reinsurance undertakings should be limited to the change from the opening to the closing balance of a reporting period and so to reach a better match to the flow information, there are further considerations necessary as to which 'assets' should be considered.

Insurance undertakings hold most assets as investments to cover the financial obligations towards policyholders, whereas assets held for own use (for example office buildings) or intangible assets are relatively less significant. Further, investments for unit-linked or index-linked liabilities are significant in life insurers' balance sheet, but such investments are distinguished from insurance undertaking's (general account) investments, as the investment risks are borne by the policyholder.

Considering the objective to understand to what extent the insurer's activities are directed at funding economic activities identified as environmentally sustainable in the EU taxonomy, the distinction between investments held in the insurer's general account or in a unit-linked investment portfolio is less important. Further, considering that insurers may carry out financial and commercial activities beyond insurance underwriting that are directed at funding economic activities identified as environmentally sustainable in the EU taxonomy, intangible assets and assets held for own use, such as office buildings[7], are important inputs to the ratio.

Questions to stakeholders:

Q1: Do you agree that the extent to which insurance or reinsurance undertakings' 'assets' – in relation to 'total assets' - are directed at funding, or are associated with, economic activities that qualify as environmentally sustainable is an appropriate ratio?

Q2: If not, would you agree to use the insurance or reinsurance undertaking's 'investments' that are directed at funding economic activities that qualify as environmentally sustainable? Would you differentiate investments held for unit-linked or index-linked contracts?

[7] Art. 6 of Directive 91/674/EEC allows for land and building held for own use to be accounted for as 'investments' of the insurance or reinsurance undertaking.

Q3: Would you propose any additional key performance indicators for insurance and reinsurance undertakings to measure the extent to which the undertaking makes an effort in engaging more in environmentally sustainable activities?

2.2. Non-financial undertakings' turnover derived from products or services associated with economic activities that qualify as environmentally sustainable

'Turnover' of non-financial undertakings is indirectly defined by the Accounting Directive as *net* turnover in Article 2(5):

"'net turnover' means the amounts derived from the sale of products and the provision of services after deducting sales rebates and value added tax and other taxes directly linked to turnover"

Following from that, 'turnover' should be understood as the amounts derived from the sale of products and the provision of services, which would most closely be captured by 'gross premiums written' following Article 34(1) of the Insurance Accounting Directive[8]. IFRS 4 *Insurance Contracts*, in IG 24, would define this as 'revenue from insurance contracts issued' and IFRS 17 *Insurance Contracts*, in B120, as 'total insurance revenue'.

Whilst there are slight differences between the definitions of gross written premium, IFRS 4's and IFRS 17's concepts, the results would be comparable when focussing on non-life premiums. In life premiums, gross written premium would most often include a deposit or savings element relating to the savings component in life insurance products and are expected to be re-paid to the policyholder at the end of the contract. This deposit or savings element cannot be regarded as 'revenue'. Therefore, as suggested by the CfA, it seems most appropriate to relate the 'turnover' ratio to non-life insurance and reinsurance underwriting and to exclude life insurance written premiums.

Alternatively, measuring the insurer's or reinsurer's underwriting exposure associated with taxonomy activities, could be depicted by the extent to which the technical provisions, i.e. the insurance liabilities, or the claims incurred – net of reinsurance - are associated with taxonomy activities. Again, life insurance technical provisions would include the obligations towards policyholders in relation to the savings element. It could be further explored to use the technical provisions as the reference point, however, as technical provisions are 'stock' information from the balance sheet, the current activities of underwriting in relation to taxonomy activities per reporting year could not be presented.

Questions to stakeholders:

Q4: Do you agree to measure the insurers' and reinsurers' insurance activities corresponding to those identified as environmentally sustainable in the EU taxonomy by the proportion of the non-life 'gross premiums written' or - depending on the accounting framework - non-life 'revenue from insurance contracts issued' or 'total insurance revenue'?

[8] Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings, OJ L 374, 31.12.1991, p. 7.

Q5: Do you see merits in further exploring an alternative ratio that depicts the extent to which non-life insurance or reinsurance liabilities are associated with taxonomy activities?

3. Identifying the economic activities and providing accompanying information

Art. 3 of the Taxonomy Regulation defines an economic activity as environmentally sustainable where that economic activity:

(a) contributes substantially to one or more of the environmental objectives set out in Article 9 in accordance with Articles 10 to 16 of the Taxonomy Regulation;

(b) does not significantly harm any of the environmental objectives set out in Article 9 in accordance with Article 17 of the Taxonomy Regulation;

(c) is carried out in compliance with the minimum safeguards laid down in Article 18 of the taxonomy Regulation; and

(d) complies with technical screening criteria that have to be established by the Commission in accordance with Article 10 (3), 11(3), 12(2), 13(2), 14(2) or 15(2) of the Taxonomy Regulation.

Some risk coverages clearly link to taxonomy-relevant activities, for example insuring against the losses stemming from natural catastrophes, which may mitigate the effects of climate change and support the adaptation to climate change. Here, one can distinguish between the impact of the climate related risks on the policyholder and the impact of the policyholder's activities on the environment. Regarding the former, the insurer can reduce the losses stemming from climate change related natural catastrophes otherwise borne by the policyholders. Regarding the latter, the insurer could actively mitigate the effects of climate change and support the adaptation to climate change through the pricing[9].

Other insurance activities may only partly address taxonomy-relevant objectives, so that insurance undertakings will have to apply an appropriate split of the premiums that can be allocated to taxonomy-relevant activities and such that are not. Such a split is potentially more complex in reinsurance contracts where the underlying contracts may not be known – at sufficient granularity – to the reinsurance undertaking. It is suggested that insurance and reinsurance undertakings provide a narrative basis for the allocation of their insurance activities identified as environmentally sustainable and to provide an appropriate proxy in case the underlying portfolio of insurance contracts is too complex to decipher.

To understand the approaches applied, the mandatory ratios should be accompanied by relevant disclosure about the accounting policies applied, in particular on the level of granularity when assessing individual contracts and the extent to which enabling services have been provided.

Further, some insurers may offer services that are not directly insurance activities, yet may enable taxonomy-relevant activities. Such services, for example consultancy services, may be separately charged and not be counted in the gross premiums written. Depending on the significance of such services, and where they are not accounted for

[9] For example where insurers would offer premium discounts for homeowners who take steps to protect their houses from wildfires or install natural flood barriers if the building is close to a river, see Technical Expert Group (TEG) on Sustainable Finance: Technical annex to the TEG final report on the EU taxonomy; p. 574 to 576.

in the non-life insurance underwriting results, they may be added as revenue from ancillary or enabling services.

Questions to stakeholders:

Q6: Do you agree that when assessing the insurance activities that correspond to environmentally sustainable economic activities insurers and reinsurers may have to apply judgement to determine a reasonable split?

Q7: Do you agree that when applying judgement, insurers and reinsurers shall provide a narrative on the split, together with information on the accounting policies used?

Q8: Can you provide insights into the prevalence of ancillary services to insurance activities, such as consultancy services, that enable taxonomy-relevant activities and how they are accounted for (e.g. as part of insurance or other revenue)?

4. Further questions raised in the CfA

The CfA requires EIOPA to consider whether:

- there should be a difference between the disclosures of insurers and reinsurers and between insurance and reinsurance activities;
- all existing activities should be covered retroactively or only those relevant to the time period as of the when the disclosure rules start to apply[10]; and
- the recommendations can be justified based on their potential impact regarding the need for information which is disclosed to be accurate, useful, usable, and cost-efficient.

Need for specifying disclosures of insurers versus reinsurers and their corresponding activities

Generally, the main business activities of insurers and reinsurers are the same, as both provide cover against risks and maintain investments to fund claims. Considering the objective to identify the levels of funding provided to environmentally sustainable economic activities, there is no obvious distinction between insurance and reinsurance undertakings that would require different key performance indicators. Further, insurance and reinsurance activities that qualify as environmentally sustainable do not require a distinction by the type of the insurance undertakings, rather by type of risk exposure (non-life versus life).

Questions to stakeholders:

Q9: Do you agree that it is not necessary to distinguish different types of key performance indicators of insurance and reinsurance undertakings or by insurance or reinsurance activities?

[10] The disclosures under Article 8 apply as of 1 January 2022 for the environmental objectives of climate change mitigation and adaptation, and as of 1 January 2023 for the other four. The obligations relate to the previous financial year respectively (the disclosure obligation for 1 January 2022 covers the financial year 2021, the disclosure obligation for 1 January 2023 covers the financial year 2022).

Q10: Do you agree that a distinction between non-life and life exposures is necessary?

Need for retroactive application of the disclosure requirements

Retroactive application of disclosure and accounting requirements is usually burdensome, requiring reconciliation to previously accounted figures, and is prone to hindsight where the current knowledge may skew the assessment that would have been made at the historical point in time. However, it provides for the opportunity to more accurately depict the current situation.

As the mandatory disclosure of the key performance indicators, as discussed in this Consultation Paper, are close, yet probably not identical, to the current disclosures in the insurance and reinsurance undertaking's non-financial reports and management reports, a mandatory retroactive application seems disproportionate. Instead, a voluntary retrospective application should not be prevented, where possible, which links to the availability of the screening criteria for the different environmental objectives.

The consideration to apply the disclosure requirements retroactively on a voluntary basis is particularly important considering the staggered approach of the Taxonomy Regulation where the disclosure requirements apply to climate change mitigation and adaptation first before they are extended to cover the other four environmental objectives, as set out in Art. 9 of the Taxonomy Regulation.

Question to stakeholders:

Q11: Do you agree that the retrospective application of the disclosure requirements should be possible, but not required?

Considerations on the potential impact of the recommendation

EIOPA believes that the suggested key performance indicators are relevant to depict the degree to which insurance and reinsurance undertakings carry out - or fund - environmentally sustainable economic activities. Based on the available data today and in the future, insurance and reinsurance undertakings are expected to disclose sufficiently accurate, consistent and comparable information in a cost-efficient manner.

Questions to stakeholders:

Q12: Can you share your insights into the relevance and usability of the recommended key performance indicators? Which key performance indicators are you currently disclosing or are you using for internal performance monitoring?

Q13: Do you have any feedback on the costs of implementing the recommended key performance indicators? To which extent will you be able to use existing processes and data sources?

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