The Relevance of Governance in the Insurance Sector Within the Framework of Sustainable Investments

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1 Introduction

The necessary regulation of insurance companies' products following the 2008 crisis has led to regulation at the European level, whose purpose is to offer certain guarantees of investor protection through so-called product governance. The aim, from the moment the product is developed and approved, is that the target market is determined, and its interests and objectives are taken into consideration, guaranteeing a series of product tests that allow more information to be provided on their characteristics, and establishing controls on the distribution of these products. Likewise, the undoubted importance of the insurance sector has led it to become an essential agent for the reorientation of the financial system towards sustainability. For this reason, Regulation 2020/852, known as the European Sustainable Activities Taxonomy Regulation, aims to establish a classification of environmentally sustainable economic activities to facilitate investments in these activities and, in turn, to extend the obligations regarding the disclosure of information on the sustainability of financial products. This had a clear impact on product governance in the insurance sector, modifying the regulations governing product governance requirements and introducing the obligation to consider the investor's sustainability preferences and inform them of the different options for investing in environmentally sustainable activities. This is a matter of recent regulation, but it represents a paradigm shift in

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the insurance sector, and it is already clear that it will be of unquestionable practical relevance in the coming years.

2 Product Governance

2.1 Concept

The growing complexity in the functioning of financial markets has given rise to the need to configure instruments to improve the regulatory framework with the aim of guaranteeing adequate investor protection, reinforcing transparency, and thus offering greater confidence to all those involved in the financial system. The crises experienced in recent years and the situations of abuse by certain market participants have led to the creation of a regulatory framework that allows the gradual adoption of measures to balance these positions to the benefit of investors and to offer greater security in the market.[1] In this context, product governance should be highlighted as an instrument for improving the functioning of the financial system. International regulators have gradually established criteria for the application of a new function of investment institutions that allows for greater control over the process of product design, issuance, marketing, and distribution. The European Securities and Markets Authority (ESMA)[2] issued an opinion on best practices for the implementation of financial product governance obligations[3] to provide the other EU regulators with homogeneous and uniform criteria. This laid the foundations for a system that strengthens the financial system, improves transparency, and protects investors.[4]

Product governance aims to reflect this improvement in the system by offering financial products that have passed certain internal processes within the institution. First, institutions must bear in mind a series of considerations from the initial design of the product.[5] In this respect, the financial needs of the investor will be relevant, and, for this reason, a prior analysis of the potential target market must be carried out. Hence, it will be essential to determine the specific target customer, the knowledge and experience they may have of this type of product, as well as of the financial system in general, the possibility of bearing losses in accordance with their financial situation, risk tolerance, as well as the aims and needs of the investors. Conversely, this analysis is also useful to identify the target audience for whom the product should not be intended, and it is objectively unsuitable. To this end, the specific characteristics of the product, its liquidity, its risk in relation to its profitability and its

[1] Marano (2019), pp. 59–96.

[2] Pursuant to the power provided under Article 29.1.a) of Regulation 1095/2010. On ESMA's technical guides, Palá Laguna (2019), pp. 5–7.

[3] ESMA (2014), p. 332.

[4] Canalejas Merín (2019), p. 3.

[5] Fernández Pérez (2019), p. 258; Moya Ballester (2019), p. 687.

complexity should be considered. Second, the product should be analysed by assessing, if possible, the development of similar products on the market and in any case, by subjecting it to simulations of future scenarios to determine its adaptation to crisis situations and its profitability under different scenarios. This makes it possible to gather information on the specific characteristics of the product and all the relevant information about it, which will be necessary to offer greater guarantees in the market and so that the investor can choose the product with full knowledge of it. If this analysis yields a different result than expected, the target market must be re-evaluated.

Investor information is an essential element of product governance. Therefore, the institution must offer complete and detailed information on the target public, the characteristics of the product, its profitability, its risk, its past performance, if any, the cost of disinvestment, as well as all those issues that are relevant to guarantee adequate investor protection. The aim is to overcome the insurers' exclusive search for greater profits by offering adequate information to the insured, which will be of benefit to them. In this sense, it is convenient to avoid confusing denominations that do not reflect the reality of the product and should be offered following those that adjust to the nature of the product and avoid confusion with it.

Likewise, one of the issues that must be addressed from the beginning is the product's distribution strategy. To this end, it will be advisable to establish the distribution channels through which the product is to be offered and to assess the need to prioritise a channel according to the type of product or the potential customer for whom it is designed.

Appropriate measures should also be taken to ensure constant monitoring of product development by establishing thresholds to which the product must conform, thus making it possible to know whether it is developing as planned and, where appropriate, to take measures to correct any deviation that could have a negative impact on the investor, and the distributors and investors concerned should be informed of the adoption of such measures.

2.2 Regulatory Framework Applicable to the Insurance Sector

The implementation of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (MiFID) initiated the process of establishing a European-wide regulatory framework for protection in the financial system. Subsequently, Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking up and pursuit of the business of Insurance and Reinsurance (Solvency II Directive) contemplated, in relation to corporate governance, a series of duties to promote appropriate risk management by improving internal management and promoting self-monitoring measures for insurance companies.[6] Following this, Directive 2014/65 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (MiFID II Directive) consolidated the regulations on this matter, the impact of which is unquestionable for the insurance sector.[7] A few months later, Regulation 1286/2014 of the European Parliament and of the Council of 26 November 2014, on key information documents relating to PRIIPs and insurance-based investment products was adopted. Directive 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution sets out product governance criteria for insurance distribution, covering product governance requirements in the insurance sector, as well as establishing a legal regime for the insurance intermediary.

This legislation is further developed by delegated Regulations and Directives. Delegated Directive 2017/593 implements MiFID II by setting out product governance obligations for investment firms producing financial instruments and distributors. Similarly, Directive 2016/97 is implemented by Commission Delegated Regulation 2017/2358 of 21 September 2017 as regards control and product governance requirements for insurers and insurance distributors as well as Commission Delegated Regulation 2017/2359 as regards disclosure requirements and conduct of business rules applicable to the distribution of insurance-based investment products. These latter Delegated Regulations, among others, have been subsequently amended to adapt to sustainability factors, risks and preferences and, due to their importance, will be considered in another chapter of this paper.

Finally, it is worth noting the technical guidelines established, inter alia, by the European Securities and Markets Authority (ESMA),[8] the European Banking Authority (EBA)[9] and the European Insurance and Occupational Pensions Authority (EIOPA)[10] on governance and oversight procedures for these products.

All this makes up a regulatory framework that has progressively advanced in strengthening the financial system in general, the investor's protection and, in particular, in improving management by financial institutions and insurance companies.

[6] Paragraph 1.8 of the EIOPA Guidelines (2016). On this, Hernández Barros and Martínez Torre-Enciso (2010), pp. 75–91; Pérez Frutuoso and Gragera Cubero (2018), pp. 219–245.

[7] Peñas Moyano (2020b), p. 883 with quote from Marano (2017), p. 417 expose that the EU is considered to have adopted a process of "mifidisation" in the field of insurance.

[8] ESMA (2014), p. 332.

[9] BDE (2016).

[10] EIOPA (2016).

2.3 *Product Governance in the Insurance Sector*

2.3.1 Entities Obliged and Excluded from the Application of the Regulation

The insurance industry has been forced in recent years to adopt constant changes to adapt to new regulations on insurance products.[11]

Product governance implies an improvement in the governance of insurance companies and thus aims to offer investor protection in various ways. Therefore, these measures should be implemented globally for all insurance and investment products.

First, it should be recalled that insurance producers can be insurance undertakings on the one hand and insurance intermediaries on the other hand. The latter are divided into intermediaries who are insurance preparers or producers and intermediaries who are only insurance distributors. Delegated Regulation 2017/2358 makes a clear distinction in terms of duties between producers, which may be insurance undertakings or producer intermediaries, and distributors, which are non-producer intermediaries.[12]

The obligation to implement product governance measures rests with insurers and insurance intermediaries insofar as they are responsible for the development of products offered for sale to customers.[13] Producers are responsible for the product approval process and the choice of distribution channels. As far as insurance distributors are concerned, they are responsible for obtaining from the producer the necessary information on insurance products in order to offer it to customers in an appropriate manner, and for informing the producer when the product is not in line with the defined target market, its interests or objectives. This is intended to ensure comprehensive investor protection, irrespective of the method of contracting, thus guaranteeing that any party involved in the product design, development and distribution process complies with product governance processes.[14] In those cases where insurance companies or insurance distributors play a key role in the design and development of the product, they will be considered producers.

Therefore, the producer will be considered to be the person in charge of designing the insurance product and responsible for maintaining, managing, and reviewing its

[11] Peñas Moyano (2020a), p. 9, “There is, in principle, no exclusion regarding the application of product governance to any particular type of insurance contract. The regulation is applicable both to newly created insurance products because they have not yet been marketed and to those which have been substantially modified after a period of marketing, as provided for in Art. 1 of the Delegated Regulation. It is also applicable to all types of products, from the simplest to the most complex.”

[12] On insurance distributors, Vercher Moll (2021), pp. 179–195.

[13] Zunzunegui (2021b), p. 90, “we are facing a transition of the sector towards financialisation, which is reflected in the actions of supervisors.”

[14] Peñas Moyano (2020a), p. 6, understands that insurance comparators are included as a distribution activity when they allow the direct or indirect conclusion of an insurance contract at the end of the process.

approval process, and must carry out this task individually and before the marketing or distribution of the product, taking into consideration the nature of the product.[15] Specifically, it is considered that to interpret the relevance of the role of the insurer or distributor, the independent determination of the essential elements of the product, such as the target market, coverage, costs, price, risk, and guarantee rights must be taken into consideration, provided that the insurance company offering the coverage for this product does not modify the above elements in a relevant manner, i.e. that the conditions initially foreseen are maintained.[16]

In the case of producers, an insurer and an insurance intermediary shall agree on a protocol providing for the method of defining the target market for the product and the roles of each in the approval of the product.

In any case, large exposure insurance[17] and all those that are personalised products are excluded from the application of the product governance rules, as it is considered that in this case, it is not necessary to offer such intensive investor protection.

2.3.2 Product Governance Requirements in the Insurance Sector

The need to provide investors in insurance-based products with certain guarantees has led to the imposition of certain obligations on producers.[18]

First, as mentioned above, the target market must be determined. However, in the case of the insurance sector, due to its particularities, the potential clients whose profile fits the product must be determined in detail, taking into consideration the risk, nature, characteristics, and complexity of the insurance product, as well as the financial culture of the selected market and the information available to them.[19] To ensure that the product design complies with these requirements, producers should ensure that the personnel responsible for the design and configuration of the insurance product are properly trained and have the necessary experience and knowledge to be able to understand the insurance products and the potential target market.

Once the target market has been determined, the market behaviour of the target market should be checked beforehand, without prejudice to the subsequent control described below, by testing it in different scenarios.[20] This has two purposes. On the one hand, knowing the product considers the variability of the market and, therefore, being able to offer this information to the investor. On the other hand, if the tests are

[15] Article 3 of Delegated Regulation 2017/2358.

[16] Tapia Hermida (2018), p. 6.

[17] Article 25.4 Directive 2016/97.

[18] De Polis (2020), pp. 4–7.

[19] Hernández Barros (2015), pp. 61–70.

[20] Zunzunegui (2021a), pp. 413–428.

not favourable, to rule out a certain target market and be able to readapt it according to the test result.[21]

In any case, producers should set a specific deadline for reviewing insurance products once they have been introduced on the market. The timeframe will vary depending on the characteristics of the product and the market situation. Such monitoring should ensure that the insurance product continues to meet the objectives envisaged from the outset and that the essential features are maintained after introduction into the financial system, with particular attention to the target market. It will have to be monitored whether it is being distributed to the originally intended market or whether it has been diverted to other unintended markets. If these controls detect any anomaly not foreseen in the product tests indicated, all necessary measures must be taken by the producers to avoid any circumstance detrimental to the investor, and these facts must be brought to the attention of the insurance distributors and the investors who may have been affected. On the contrary, but with the same purpose, if the distributors detect that the insurance product does not in practice meet the objectives of the target market or that any cause that could adversely affect the investor is noticed, they shall inform the producer and where appropriate, cease distribution of the product.[22]

In the distribution of the product, producers must select the distribution channels, which must be adjusted to the needs of the target market according to its own characteristics. Likewise, producers must inform distributors in a complete, clear, and detailed manner about the target market, the characteristics of the product, the risks, the costs, and the proposed distribution strategy to enable them to properly understand the insurance product and to identify customers who might be interested in the product.[23] In this regard, insurance distributors should ensure that they obtain all necessary information from the producer and ensure that they understand the nature and complexity of the product adequately.[24] This is to protect the investor by ensuring that their objectives and interests are considered and to ensure that they have the necessary information to take out the product.

Distributors must update the distribution mechanisms of the product to ensure that, after a certain period on the market, the product continues to be aligned with the objectives of the target market and is being distributed to the target market as indicated by the product.[25] In this respect, the producer must check on a regular basis that the distributor is in line with the distribution strategy and is distributing to the target market.

[21] Canalejas Merín (2019), p. 5.

[22] Almarcha Jaime (2016).

[23] On the information to be provided by insurance intermediaries under Directive 2002/92, Bataller Grau (2007), p. 77.

[24] On this, Armour et al. (2016), p. 57.

[25] Marano (2020), p. 868.

The aim is to ensure that the agents involved in the insurance sector strengthen their governance[26] and offer protection to investors from the very moment the product is designed, taking into account their objectives and interests from the initial stages of product development, which allows the product to be adapted to their needs, thus ensuring that the investor has adequate guarantees to carry out the investment.

3 Sustainable Investments

3.1 Concept

Sustainability is a multi-faceted concept that, in recent years, has become increasingly important in a wide variety of areas. The financial sector has not been oblivious to this reality,[27] and is increasingly involved, either voluntarily or by legal obligation in the implementation of sustainable measures.[28] The Environmental, Social and Governance (ESG) criteria have brought about a gradual but significant change in the financial sector, seeking an orderly transition towards a process of neutral environmental impact and decarbonisation[29] in the financial sector, given the detrimental effects that this can have on the environment.[30]

The European Union is committed to combat climate change and environmental issues on a number of fronts, through different avenues that directly and indirectly affect the financial sector. Support for the Paris Agreement and the UN's 2030 Agenda for Sustainable Development and the development of the European Green Pact, which contains ambitious environmental commitments, demonstrate the EU's interest in tackling climate change.[31] Particularly, the Commission's Communication on the Action Plan: Financing for Sustainable Development 2018 sets out concrete targets that aim, among other things and in different ways, to boost sustainable investment in order to increase financing for sustainable development and thus achieve European and international goals for improving the environment.

[26] On this, Gallego Sánchez (2019), p. 211 and Spainsif (2021), p. 20, "Governance as the backbone of the company is a tool that facilitates the achievement of the environmental and social objectives of the entities and, therefore, of the higher state or European plans."

[27] Sjafjell (2019), pp. 163–165.

[28] Siri and Shanshan (2020), pp. 3–5.

[29] In this regard, the Commission communication "Stepping up Europe's climate ambition for 2030: Investing in a climate-neutral future for the benefit of our people," SWD (2020). In this case, decarbonisation means the process of achieving reductions in greenhouse gas emissions, primarily those in the form of carbon dioxide.

[30] A reference on the impact of the market on the environment is the report by Stern (2007).

[31] Siri and Zhu (2019).

3.2 Measures Taken by the EU

3.2.1 European Taxonomy of Sustainable Activities

One of the main challenges for the EU is to facilitate the raising of capital to support sustainable growth and decarbonisation of the European economy to meet EU and international climate targets. To this end, the European taxonomy of sustainable activities is the basis on which the European Sustainable Finance Standard is being developed. This standard is essential to reduce the fragmentation caused by different classifications in different EU countries and to reduce transaction costs in the markets.

Regulation 2020/852 of the European Parliament and of the Council of 18 June 2020 on establishing a framework to facilitate sustainable investments provides a common classification system for economic activities whose contribution to achieving environmental objectives is relevant[32] according to scientific criteria. This implies that the market has a common definition of sustainability and makes it possible to identify concrete objectives that can be met through economic activity. These environmental objectives are the sustainable use and protection of water and marine resources, the transition to a circular economy, the prevention and control of pollution, and the protection and restoration of biodiversity and ecosystems. This will also combat the so-called "greenwashing," as this common definition, based on scientific criteria, will prevent products from being offered as environmentally friendly if they do not meet the criteria set out in European legislation.[33]

This regulation seeks to establish the requirements that economic activity must meet to be considered sustainable and to be able to provide information on the impact of investments on the environment.[34] It is understood that economic activity is environmentally sustainable when it meets four requirements, namely: the activity makes a substantial contribution to one or more of the six environmental objectives set out in the Regulation, does not cause significant damage to any of these objectives,[35] is carried out in accordance with the procedures of the OECD, the UN and other international conventions, and complies with the technical criteria established by the Commission in implementation of the Regulation.

This ensures that there are standard criteria throughout the EU that allow, without specific technical knowledge, to know and apply the necessary measures to be able to classify products as sustainable.[36] At the same time, it also makes it easier for

[32] As foreseen in the Regulation, the relevance of the contribution is determined by the specific objective pursued.

[33] Murillo García (2020), p. 16.

[34] Recalde Castells (2022), p. 17.

[35] The aim is to prevent an investment that is considered environmentally sustainable from causing more damage than the contribution it makes.

[36] LMA, APLMA (2021).

investors to find out quickly and easily what criteria have been used to qualify the product in this way, offering confidence and security in the market.[37]

Undoubtedly, regulation at the European level makes it possible to homogenise the criteria for classifying activities, given that, if each state were allowed to set its own taxonomy, it would generate a disincentive for investors to carry out cross-border operations by having a regulation with different criteria. This would also mean that actors in the financial sector would be forced to adapt their products according to the interests of each state, and a certain product could be labelled as sustainable in one state and not be so in a neighbouring state due to the different classifications of each of them. This would generate a fragmentation of the market that would be contrary to the purpose of the EU itself.

To clarify the specific aspects of Regulation 2020/852, Delegated Regulation 2021/2139 has been adopted, as amended by Delegated Regulation 2022/1214, which establishes the technical selection criteria for considering that an economic activity makes a substantial contribution to climate change mitigation and does not cause significant harm to environmental objectives. This Delegated Regulation sets out the regulatory technical standards (RTS) that implement Articles 10 and 11 of the Taxonomy Regulation and harmonise the criteria for screening, disclosure, and verification of market activities so that they can be considered environmentally sustainable.

In any case, we are at an early stage in the implementation of the taxonomy of sustainable activities. There are many issues that this taxonomy must overcome to be successful and to fulfil the functions envisaged by the EU. The truth is that for the moment, this regulation is difficult to apply to small and medium-sized enterprises, which make up the majority of the social fabric, as well as to companies from outside the EU due to the high cost of verifying compliance with the requirements. Likewise, it is still necessary to have a greater business culture on the subject, given that the lack of adequate and complete information on the product makes it difficult to qualify it, which can lead to it not being considered sustainable even though it is in fact complying with European regulations. So far only a small percentage of listed companies have sustainable revenues according to the European taxonomy, limiting the possibilities for sustainable investment in the EU.[38]

It is therefore an undoubtedly positive measure, but one that is still in its infancy and will need to be further developed and promoted in the coming years.

3.2.2 Product Information Disclosure Duties

Information on environmental data is essential to establish the sustainability of investments. It is therefore necessary to provide investors with information on sustainability risks, sustainable investment objectives and the environmental

[37] Calvo Vérgez (2021), pp. 119–144.

[38] Romo González (2021), p. 16.

characteristics of a product to be able to make a fully informed, rigorous, and consistent choice from the wide range of products available on the market.[39]

Directive 2013/34 of the European Parliament and of the Council of 26 June 2013 established a number of transparency obligations in the disclosure of non-financial information relating to social, environmental and governance issues. However, this regulation was not as effective as expected because the format and presentation required meant that such information was not usually passed on to the end investor.[40] Regulation 2019/2088 of the European Parliament and of the Council of 27 November 2019 aims to set harmonising rules on transparency in financial markets regarding sustainability risks, adverse impacts at the entity level, remuneration policies, integration of sustainability risks, transparency of environmental characteristics of sustainable investments in pre-contractual information, websites, and periodic reports.

Regulation 2020/852 intensively strengthens the regulation of disclosure obligations in the financial sector. It establishes the obligation to provide certain information on the sustainability of financial products in accordance with the taxonomy established by the regulation itself. Specifically, where a financial product targets sustainable investments, it shall specify which of the objectives set out in the regulation the investment underlying the financial product contributes to, and shall describe how and to what extent the investments are directed towards economic activities that are considered environmentally sustainable, including information on the proportion of enabling and transitional activities and the total percentage of the investments selected for the financial product.[41]

Furthermore, in the case of financial products that aim to promote environmental features, they must additionally disclose in a statement whether or not the investment in question complies with the requirements set out in the Regulation in relation to the concept of "not causing significant harm to the environment," compliance with which is necessary to qualify an economic activity as sustainable. The statement to be included states that "the principle of 'no significant harm' applies only to investments underlying the financial product that meet the EU criteria for environmentally sustainable economic activities." The investments underlying the rest of the financial product do not take into account the EU criteria for environmentally sustainable economic activities.

In terms of pre-contractual information and periodic reports, for those products that are not subject to Article 8 or 9 of Regulation 2019/2088, but are required to comply with non-financial disclosure obligations, they are required to include a statement indicating that "the investments underlying this financial product do not

[39] Mínguez Prieto (2022), pp. 8–15.

[40] As stated in recital 2 of Directive 2014/95 of the European Parliament and of the Council of 22 October 2014.

[41] This is without prejudice to other information to be included, e.g. for products with a carbon emission reduction target, a detailed explanation of how the low carbon emission target is ensured to meet the long-term global warming objectives as foreseen in Article 9(3) of Regulation 2019/2088.

take into account the EU criteria for environmentally sustainable economic activities."

Similarly, on the transparency of companies in non-financial statements, the regulation requires companies to disclose in their non-financial statement or consolidated non-financial statement information on how and to what extent the company's activities are associated with economic activities that are considered sustainable. Particularly, it shall indicate the proportion of its turnover that comes from products or services related to sustainable economic activities, as well as the proportion of its total fixed assets and the proportion of its operating expenses related to assets or processes associated with sustainable economic activities. Compliance with these requirements must be carried out by the competent authorities in each sector in relation to the financial intermediary.

In any case, to harmonise Regulation 2019/2088 and Regulation 2022/852, Article 25 of the latter regulation provides, as a final provision, for Regulation 2019/2088 to be amended to draw up detailed regulatory technical standards on the content and presentation of the information. The result is Commission Delegated Regulation 2022/1288 of 6 April 2022, which supplements Regulation 2019/2088 and lays down regulatory technical standards determining the content and presentation of information on the "no significant harm" principle[42] and establishes and supplements the methods and presentation of information on sustainability indicators and the identification of specific sustainable investment targets in pre-contractual documents. This facilitates the work of stakeholders in the financial sector and supervisors by providing templates that structure the information, the benefit of which will also accrue to the investor as the information can be compared in a more comprehensive and user-friendly way.[43]

This provision is therefore intended to ensure that those involved in the financial sector can be fully, comprehensively, and detailedly informed of all information on financial products and their relationship with environmentally sustainable activities.

4 Product Governance Applied to Sustainable Investments

4.1 Relevance of the Issue to the Insurance Sector

The Commission's 2018 Action Plan: Financing sustainable development indicates that insurance companies are an important source of external financing for the European economy but that they may be affected by risks related to unsustainable economic development.[44] The Commission understands that risks related to climate and other environmental factors may lead to a lack of credibility and effectiveness of

[42] Known as the DNSH (Do No Significant Harm) principle.

[43] On this, Iñiguez Ortega (2022); Palá Laguna (2022); Llopis Blanque (2023).

[44] On this, Internacional Association of Insurance Supervisors, (2018).

the EU prudential framework and its risk-based nature. However, it recognises that insurance distributors can play a key role in reorienting the financial system towards sustainability.[45] The UN through the Environment Programme Finance Initiative and specifically in the Principles for Sustainable Insurance states that sustainable insurance aims to reduce risk, develop innovative solutions, improve business performance, and contribute to environmental, social, and economic sustainability.

The 2021 Social Report on Insurance[46] stresses that the important role of insurance as an institutional investor allows it to act as an instrument for change in the financial system. Thus, three quarters of the sector in Spain consider ESG criteria in the configuration of its investment portfolio. In turn, a quarter of the entities that market savings products have some product that complies with the environmental or social characteristics set out in EU sustainability regulations.

The importance of the insurance sector in promoting a shift in the financial market towards investments in environmentally sustainable activities is therefore undeniable.

4.2 *Impact of Sustainable Investments on the Governance of the Product*

The product governance regulations discussed above are complemented by Delegated Regulation 2021/1257 which amends Delegated Regulations 2017/2358 and 2017/2359 mentioned above to include sustainability factors, risks and preferences in the control and governance requirements for investment products of insurance undertakings and establishes conduct of business and advisory rules for these insurance-based investment products.

Considering the importance of the sector in achieving sustainable economic growth, there is an obligation to take sustainability factors into account in product governance requirements from the time of design and approval for a market that is interested in sustainable insurance products.

During the process of developing and approving the insurance-based investment product, the target market should be defined in sufficient detail, taking into account, in addition to the product features, risk profile, complexity and other product circumstances described earlier in this paper, the sustainability factors. Sustainability factors in this respect are understood to include information on environmental and social issues, employee issues, respect for human rights, and anti-corruption.[47] Therefore, a general classification of the product as sustainable is insufficient, but it should be designed and marketed with the sustainability objectives of the target

[45] Cousy (2009), p. 245, considers that insurance has traditionally been neglected in financial regulation.

[46] UNESPA (2022).

[47] Seventh recital of Directive 2022/2464.

market in mind, always taking into account the level of information of the customers and their financial literacy. Product developers should be qualified to understand the sustainability objectives and characteristics of the target market.[48]

On product testing, sustainability factors should be taken into consideration in terms of how the product will perform in the market during its life cycle and whether it would meet the sustainability objectives and the objectives of the target market throughout its life cycle. Thus, products that after testing are found not to meet the sustainability objectives and the needs of the target market, cannot be placed on the market. In any case, it must be ensured that customers' sustainability concerns are duly taken into account. Therefore, if the insurance distributor detects that a product is not in line with the sustainability interests of the established target market, it should bring this to the attention of the producer to modify the distribution strategy of the product.[49]

Therefore, this regulation establishes that sustainability must be taken into consideration throughout the product development, approval, and distribution process to ensure that environmentally sustainable products reach the target market after having been developed for this purpose, having undergone a detailed and complete analysis of the customer profile and having passed product testing and that there is a control process for compliance with the provisions of the product approval for the protection of the investor.

4.3 Impact of Sustainable Investments on Information Requirements in Product Distribution

Delegated Regulation 2017/2359 on information requirements and conduct of business rules for the distribution of insurance-based investment products is amended by Delegated Regulation 2021/1257 to introduce sustainability preferences.

Investors must be informed of their sustainability preferences, i.e. whether they wish to include a sustainable financial product in their investment to a greater or lesser extent. To this end, in the product selection process and the investor's suitability assessment, investors must be asked whether they have sustainability preferences and, if so, what percentage of their investment they wish to allocate to sustainability. The client should then be offered a threefold possibility to realise these sustainability preferences. First, the investor may choose investments that are considered sustainable under the criteria and requirements of Regulation 2020/852 as set out above. Second, the investor may invest in products that are sustainable under Regulation 2019/2088. Finally, the option should be offered to invest in products that take into consideration the main adverse impacts on sustainability

[48] Zunzunegui (2021a, b).

[49] On the consideration and protection of investors as consumers, Gimeno Beviá (2015), pp. 312–314.

factors, i.e. that manage the negative impacts that the investment may have on climate issues, with the qualitative or quantitative elements being determined by the investor.

The favouring of environmentally sustainable activities is gradual in these options, with the first option being more favourable to sustainable economic activities because of the type of activities invested in under Regulation 2020/852, and the last option being less favourable to sustainable economic activities because it is only investments in products that take into consideration the adverse effects of the activity. Insurance intermediaries should be able to explain the different degrees of sustainability to the investor in such a way that the investor can understand the difference between the different types of sustainability.

In any case, it should be pointed out that, at present, taking into account that this is a relatively recently approved regulation, few investment products comply with the strict requirements of Regulation 2020/852, and the investor has limited choice, with greater variety in the case of the third option, which does not have the same sustainability requirements. In any case, this is a good start for investors to begin to be aware of the different sustainability preferences available, and a greater culture in the financial sector on this type of product is needed to broaden the offer of environmentally sustainable products, which will undoubtedly allow investors to choose the option that best suits their interests.

It should be made clear that the suitability assessment will comprise a series of questions to enable recommendations to be made based on their financial objectives and sustainability preferences. In any case, to avoid any potential for abuse in the distribution of these products, the investment objectives and the specific situation of each investor should be assessed first, followed by questions on their sustainability preferences. In addition, clients who have already completed the suitability assessment prior to this regulatory provision should be able to express their preferences on sustainability factors in the next periodic update of the suitability assessment.

Insurance intermediaries shall not recommend products where there is a conflict of interest and products that do not match the customer's expressed sustainability preferences and shall explain the reasons for this to the customer and keep a record of this. If the customer decides to adapt their sustainability preferences when no product is in line with their preferences, the decision, and the reasons for it must be recorded to avoid mis-selling and greenwashing.

4.4 Integrating Sustainability Risks into Governance

Sustainability has also affected insurers in terms of integrating sustainability risks into the governance of insurers. Commission Delegated Regulation 2021/1256 of 21 April 2021 amends Delegated Regulation 2015/35 and integrates these sustainability risks. The Commission aims to ensure that the governance system of insurance undertakings and the assessment of overall solvency needs reflect sustainability risks. To this end, it defines sustainability risk as any environmental or governance event or condition that, if it were to occur, could have an actual or potential negative effect on the value of the investment or the value of the liability.

It provides for the need to review and adapt risk management policies to integrate sustainability risks in the terms expressed. Likewise, information on how the integration of sustainability risks into the risk management system is taken into consideration should be included in the remuneration policy, given the importance of remuneration policies in ensuring that the risks identified by the risk management system are effectively managed by the insurer's personnel. Similarly, the actuarial function should consider sustainability risks when reviewing the underwriting policy of the insurer.

Finally, the integration of sustainability risks into the principle of prudence is foreseen, whereby sustainability risks should be taken into consideration when determining, managing, and monitoring the risks arising from investments,[50] considering the potential long-term impact of their investment strategy on sustainability factors, and the sustainability preferences of investors should be reflected in these strategies and decisions.

5 Conclusions

The European Union's 2018 Action Plan for Financing Sustainable Development marked a starting point for a significant structural shift in the financial system. To redirect financial investments towards activities that address climate change and achieve environmental objectives, the Regulation on the Taxonomy of Sustainable Activities was approved. The objective of this regulation is to set common criteria for what should be considered environmentally sustainable activities. The EU is aware that the volume of investment to meet environmental objectives requires the financial system to develop instruments of a private nature. This will allow the necessary savings and monetary resources to be channelled to transformative sustainable investments that will help meet the objectives of a circular economy and respond to current environmental needs.

Product governance has become one of the main factors in facilitating this investment by providing security to investors in the product. The aim is to offer financial products that have been previously created by the entity following specific internal processes. The interests and objectives of the potential target market will be taken into consideration from the very beginning of the product's design, and the specific client for whom it is intended will be established. Likewise, the product is subjected to certain tests to obtain complete and detailed information on the charac-

[50] On the incorporation of environmental, social and corporate governance issues into investment analysis processes, Bataller Grau and Córdoba-Mochales (2020), pp. 21–47.

teristics of the product, its response in future scenarios, its adaptation to crisis situations, its possible profitability, etc. All this information will be provided to the investor, who will be able to select the investment product with the best guarantees and with full information on the product, a key element being the information offered to the investor.

The insurance sector has a key role to play in realigning investments towards sustainable activities. Therefore, insurance-based investment products should be designed taking into consideration the governance obligations of the product to ensure the investor. In any case, recent EU legislation sets out a number of obligations on producers and distributors of insurance products to include sustainability factors, risks, and preferences in the governance requirements of investment products. Sustainability factors must be taken into consideration in the governance requirements from the initial design and approval of the product, as well as in its distribution. On product testing in the governance framework, it should be analysed whether the originally envisaged sustainability objectives would be met over the estimated life of the product. In addition, investors should be informed about sustainability preferences and may include a financial product in their investment. Investors should be offered a triple investment choice of sustainable products, which will vary according to their objectives and interests. The investor will be able to select products that meet the sustainability requirements under Regulation 2020/852 (Taxonomy Regulation), products that are considered sustainable under Regulation 2019/2088 (Disclosure Regulation) or products that take into consideration the main issues on sustainability factors. The choice of one option or the other will depend on the interests of the investor, taking into account that the former option offers higher guarantees of sustainability of the products due to the higher requirements to be met, and the latter option offers lower guarantees of sustainability. Distributors of insurance products should provide all the information provided by the producers to the investors on the different products so that they can choose the option they consider most appropriate. However, it cannot be overlooked that at this initial stage of regulation, taking into consideration that the regulations establishing these obligations are recent, the reality is that the options for investors seeking to invest in environmentally sustainable economic activities are still limited. In any case, the paradigm shift is inexorable and still a long way off, so that in the coming years the options for investors will increase, fulfilling the objective of offering a variety of products and extensive information on them.

In conclusion, product governance plays a crucial role in the investment in environmentally sustainable activities within the insurance sector, as it helps overcome the traditional hesitations of investors towards such products. This is achieved through a strict product design, development, and distribution process that takes into account the interests of the target market. Additionally, it provides comprehensive and detailed information about the products, thereby offering security and confidence to the investors.

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