# Sustainability in the Insurance Business

## Areas of action for the insurance industry

March 2024
**kpmg.ch**

# Content





# Introduction

While European insurers have been busy implementing binding sustainability requirements for some time now, it is only this year that Swiss insurers are facing a comparable wave of regulation. The requirements pertain to transparency, dealing with climate change and protecting policyholders. The following section outlines specific areas for action and assistance.

# Transparency requirements

## In force

| Legislation | Entry into force | Scope of application | Summary |
|---|---|---|---|
| **FINMA circ. 2016/2 "Disclosure – Insurance Companies"** | For financial years beginning on 01.01.2021 | Insurance companies in supervisory category 2 and insurance groups with insurance companies in supervisory category 2 | Institutions must report on their climate-related financial risks. The regulatory approach is based on the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). |
| **Code of Obligations Transparency on non-financial matters** | 01.01.2022 (first reporting in the 2023 financial year) | Large public interest entities (incl. financial institutions)<br><br>• > 500 FTEs<br>• CHF 20m balance sheet total<br>• CHF 40m turnover | Reporting on strategies, risks and key figures on environmental, social and employee issues, human rights and anti-corruption. |
| **Code of Obligations Due diligence and transparency with respect to minerals and metals sourced from conflict-affected areas and child labor** | 01.01.2022 (first reporting in 2023 financial year) | Medium-sized companies<br><br>• > 250 FTEs<br>• CHF 20m balance sheet total<br>• CHF 40m turnover | For insurance companies, the due diligence obligations in relation to minerals and metals from conflict areas will only be relevant in practice in exceptional cases.<br><br>However, the due diligence obligations relating to child labor concern the upstream supply chain of insurance companies, for which a due diligence assessment must be carried out to determine whether the due diligence obligations (including reporting obligations) are applicable to the insurance company. |
| **Ordinance on reporting on climate-related matters** | 01.01.2023 (first reporting in the 2024 financial year) | Large public interest entities (incl. financial institutions)<br><br>• > 500 FTEs<br>• CHF 20m balance sheet total<br>• CHF 40m turnover | Companies are required to implement the TCFD recommendations on climate risk and opportunity disclosure, including scenario analysis and climate change disclosures. |

## In force

| Legislation | Entry into force | Scope of application | Summary |
|---|---|---|---|
| **EU taxonomy and associated delegated regulations** | 01.01.2022 (first reporting on objectives 1 and 2 according to original del. regulation 01.01.2023, further obligations staggered) | Disclosures at company level:<br>• Large public interest entities (NFRD companies) and future CSRD companies (see CSRD below)<br><br>Reporting at product level:<br>• All financial products classified under the Sustainable Finance Disclosure Regulation (SFDR, see below) | Affected companies must disclose their investments at company level in accordance with the taxonomy for each environmental objective. Insurers must distinguish between investments from life insurance policies and investments from non-life insurance policies.<br><br>For insurance activities, they must also disclose the specific taxonomy KPIs. |
| **Corporate Sustainability (CSRD) and associated European Sustainability Reporting Standards (ESRS)** | 05.01.2023 (first reporting for NFRD companies for 2024 financial year, other companies staggered for financial years 25-28) | Applicability is staggered by company size:<br>• FY 24 - NFRD companies<br>• FY 25 - Other large EU companies<br>• FY 26 - Listed EU companies and certain SMEs<br>• FY 28 - Non-EU companies that meet the EU Turnover Test | Companies must report annually on various Sustainability topics. Transition plans in accordance with the Paris Agreement, dual materiality must be taken into account, internal guidelines on the topic, etc.). In doing so, they must use the ESRS for reporting. |
| **Sustainable Finance Disclosure Regulation (SFRD)** | 10.03.2021 (Revision of certain disclosure requirements currently underway) | Applicability depends on the activity of the insurer:<br>*Financial market participant (FMP)*<br>• Provider of insurance-based investment products (IBIP)<br>• Providers of pension products<br>• Institutions for occupational retirement provision<br>*Financial advisor (FA)*<br>• Insurance intermediaries for IBIP<br>• Insurance companies for IBIP<br>There is an opt-out option for Article 4 for companies with fewer than 500 FTEs | Entities must disclose certain information annually:<br>• Article 3 Dealing with sustainability risks<br>• Article PAI Disclosure<br>• Art. 5 Remuneration policy in conn. with sustainability risks<br><br>In the case of distributed products, the following also applies:<br>• Requirements for pre-contractual disclosures depending on the product category (Articles 6/8/9)<br>• Regular reporting |

## In preparation

| Legislation | Entry into force | Scope of application | Summary |
|---|---|---|---|
| **Revision of the CO with respect to reporting on non-financial matters** | Consultation probably in summer 2024 | Essentially in line with existing requirements in the Code of Obligations | • Alignment of content with CSRD<br>• Mandatory reporting for companies above 250 FTEs instead of 500<br>• Mandatory external audit of reporting on non-financial matters |

Implementation plans must be devised promptly, depending on when the insurance companies are required to prepare a non-financial report for external stakeholders for the first time. One challenge in this context is the ongoing development of transparency standards. Insurers need to start now to plan and implement their transparency obligations in order to be able to react to future developments. This means that Swiss insurers with a presence in Europe in particular will have to apply the European transparency regulations at group level by the 2028 financial year at the latest. The Federal Council also wants to align the Swiss Code of Obligations with European provisions. This will particularly include the introduction of an audit obligation for non-financial reporting (similar to CSRD). These may mean having to adapt the processes and controls in non-financial reporting at short notice in order to ensure that the non-financial key figures are «closed» within 15-20 days.

Internationally active insurers especially need to take into account that they may have to comply with various disclosure standards from different regions (such as the International Sustainability Standards Board, ISSB, and the requirements of the SEC in the USA). It is also important to bear in mind that disclosure at company level is often linked to disclosure at product level and requires close coordination (in addition to CSRD, for example, the Sustainable Finance Disclosure Regulation - SFDR and the EU Taxonomy, which are also relevant for the financial products offered by insurance companies).

When implementing the transparency requirements, the following aspects are key success factors.

- **Coordination and responsibilities:** with the growing number of ESG-related regulations, a suitable governance structure should be established to manage the organization’s reporting and enable comprehensive

governance. As such, it should aim to assign responsibilities in the reporting process and facilitate interaction between different individuals and departments to enable a smooth reporting process. This should be complemented by a robust IT infrastructure as well as ongoing collaboration with internal and external auditors.

- **Data Management:** organizations will need to expand their capabilities to meet transparency requirements, as each metric involves multiple data points that are located in different systems within the organization. Tool-based solutions to support ESG reporting processes should be considered to manage the increasing complexity of data points, especially those that transcend internal organizational boundaries.

- **Objectives:** currently, insurers focus almost exclusively on the climate change component. The impending transparency requirements will raise regulatory expectations for insurers to set targets that go beyond climate-related matters. Among these are biodiversity, pollution and social and governance issues. Intensifying ESG competition will likely result in the formulation of new ESG objectives, which must be strategically and procedurally integrated and coordinated.

- **Portfolio perspective:** as players in sustainable development, the role of insurance companies goes beyond the issue of climate and encompasses the entire risk and investment portfolio of an insurance company. Disclosure requirements also cover activities within the value chain and consequently affect the entire ecosystem of an insurance company and not just its own activities. When it comes to biodiversity, environmental pollution or the circular economy, the data and calculation methods will be at least as complex as for climate issues. This is why insurance companies should start dealing with this early on.

# Dealing with climate change

## In Transition

| Legislation | Entry into force | Applicability | Summary |
|---|---|---|---|
| **Climate and Innovation Act and corresponding Ordinance** | 01.01.2025 Consultation period for Ordinance until 01.05.2024 | All insurance companies | Financial institutions are also subject to the general requirement to reduce Scope 1 and Scope 2 emissions to naet zero by 2050. Financial institutions are also expected to voluntarily participate in climate tests every two years. |

## On the horizon

| Legislation | Entry into force | Applicability | Summary |
|---|---|---|---|
| **FINMA circular on environmental financial risks** | Consultation until 31.03.2024 *Adoption:* Q3/2024 *Entry into force:* 01.01.2025 (with transitional periods) | All insurance companies, except small insurance companies in accordance with Article 1c SO and reinsurers in categories 4 and 5 | The Circular focuses on specific requirements for governance, risk management and scenario analyses with regard to environmental financial risks. |

## In force

| Legislation | Entry into force | Applicability | Summary |
|---|---|---|---|
| **Directive on the taking-up and pursuit of insurance and reinsurance business (Solvency II) incl. the associated Delegated Regulation with sustainability adjustments** | August 2022 | The Directive will be applicable to all companies domiciled in the EU that engage in insurance or reinsurance activities | Inclusion of sustainability risks in the risk management of insurance companies (incl. ORSA climate scenarios). |

## On the horizon

| Legislation | Entry into force | Applicability | Summary |
|---|---|---|---|
| **Corporate Sustainability Due Diligence Directive (CSDDD)** | Draft currently under discussion in the European Parliament.<br><br>*Entry into force:* Not expected before 2025/26 | *Group 1:* Large companies based in the EU<br>• > 500 FTEs<br>• > EUR 150m global turnover<br><br>*Group 2:* Other companies based in the EU that are active in so-called «high impact» sectors<br>• > 250 FTEs<br>• > EU 50m global turnover<br><br>Companies with no registered office in the EU but with substantial turnover generated in the EU (turnover thresholds of groups 1 and 2 applicable) | The current draft initially excludes financial institutions. However, the general requirements for the upstream supply chain also apply to financial institutions (i.e. due diligence with regard to human rights and environmental protection). |

The insurability and pricing of climate-related risks is becoming increasingly important for insurers, and if no mitigating measures are taken, the protection gap is likely to widen.

Projected increases in physical risks and insurance claims arising from climate change will lead to an increase in risk-based premiums over time, which could affect the affordability and availability of insurance products covering climate-related risks in the medium to long term. Also, more frequent and severe natural catastrophes related to climate change may make it more difficult for insurers to accurately predict the likelihood of future losses and appropriately price insurance products.

The insurance industry has a unique role to play in tackling climate change by making society and the economy more climate resilient. For example, insurers could develop innovative insurance products that incentivize the avoidance of climate risks by offering lower premiums to policyholders who take climate-related adaptation measures. Such measures, such as flood doors or early warning systems, can reduce the policyholder's physical risk exposure and insured losses.

Adapting measures can therefore be an important tool for maintaining the future supply of insurance products with cover against climate-related risks and helping to reduce the climate-related insurance protection gap in Europe.

Key success factors for the implementation of climate risk management requirements include:

- **Governance:** Insurance companies are required to define climate risk roles and responsibilities in governance structures across the organization and embed them in directives and policies in line with corporate strategy and risk tolerance. Moreover, the necessary information must be made available to the board of directors and management so they can assess the impact of climate risks and account for them in the business strategy and risk tolerance.

- **Risk management:** With climate risks representing a risk driver, integration into the insurance company's existing risk taxonomy is necessary. In addition, it must be specified in which existing (or new) risk processes climate risks are to be taken into account. For the purposes of risk management, relevant risk metrics must be defined and integrated into the internal information and reporting systems.

- **Scenario analysis:** Insurance companies depend on advanced climate risk models and analyses to assess the potential impact of climate change on insurance portfolios. Integrating climate scenarios allows potential future losses to be quantified and analyzed in more detail. As methodologies continue to evolve and data becomes increasingly available, it is necessary to continuously strive to improve internal procedures

- **Data and technology:** The accuracy and reliability of climate risk models depends on a robust data collection and technology infrastructure. To this end, it is necessary to have a uniform definition of data sources, interpretations or methodologies underlying the models.

# Investor protection

## In force

| Requirement | Dates | Applicability | Summary |
|---|---|---|---|
| **FINMA Supervisory Communication 05/2021 «Preventing and combating greenwashing»** | 01.11.2021 | Fund management companies and their delegated asset managers of sustainability-related funds | Clarifies FINMA's expectations in terms of governance, organization, risk management, the advisory process and disclosure obligations |
| **AMAS self-regulation on transparency and disclosure for collective assets with a sustainability focus** | 01.09.2023 | AMAS member institutions that manage ESG funds | ESG minimum standards for asset managers and creators of collective investment schemes, including definition of ESG approaches, data collection and transparency requirements |
| **SBA guidelines for financial service providers on the inclusion of ESG preferences and ESG risks in investment advice and asset management** | 01.01.2023 | SBA member institutions that offer investment advice and asset management with a sustainability focus. | Suitability assessment and integration of ESG preferences in investment advice and asset management. Consideration of ESG risks and product characteristics. ESG training for advisors. |

## In force

| Requirement | Dates | Applicability | Summary |
|---|---|---|---|
| **Insurance Distribution Directive (IDD) and associated del. Regulation with sustainability adjustments** | 02.08.2022 | The Directive will be applicable to all companies domiciled in the EU that engage in insurance or reinsurance activities.<br><br>There is an exception for insurance brokers in a sideline capacity | Insurers offering IBIPs must inquire about the ESG preferences of their customers and include these in the suitability assessment-<br><br>The corresponding assessment must be disclosed to the customer in the suitability declaration. |

## On the horizon

| Requirement | Dates | Applicability | Summary |
|---|---|---|---|
| **Implementation of the Federal Council's position paper on greenwashing dated December 2022** | Draft by summer 2024 at the latest | Introduction of ESG-related investor protection obligations that are based on existing obligations in the Collective Investment Schemes Ordinance (CISO), the Financial Services Ordinance (FinSO) and the Insurance Supervision Ordinance (ISO). Implementation expected through amendment of the ordinances, self-regulation or a combination of both. | • Framework/definition of sustainable investments and sustainable unit-linked life insurance policies<br>• Requirements for pre-contractual information obligations and periodic transparency obligations<br>• Requirements placed on the organization of companies |

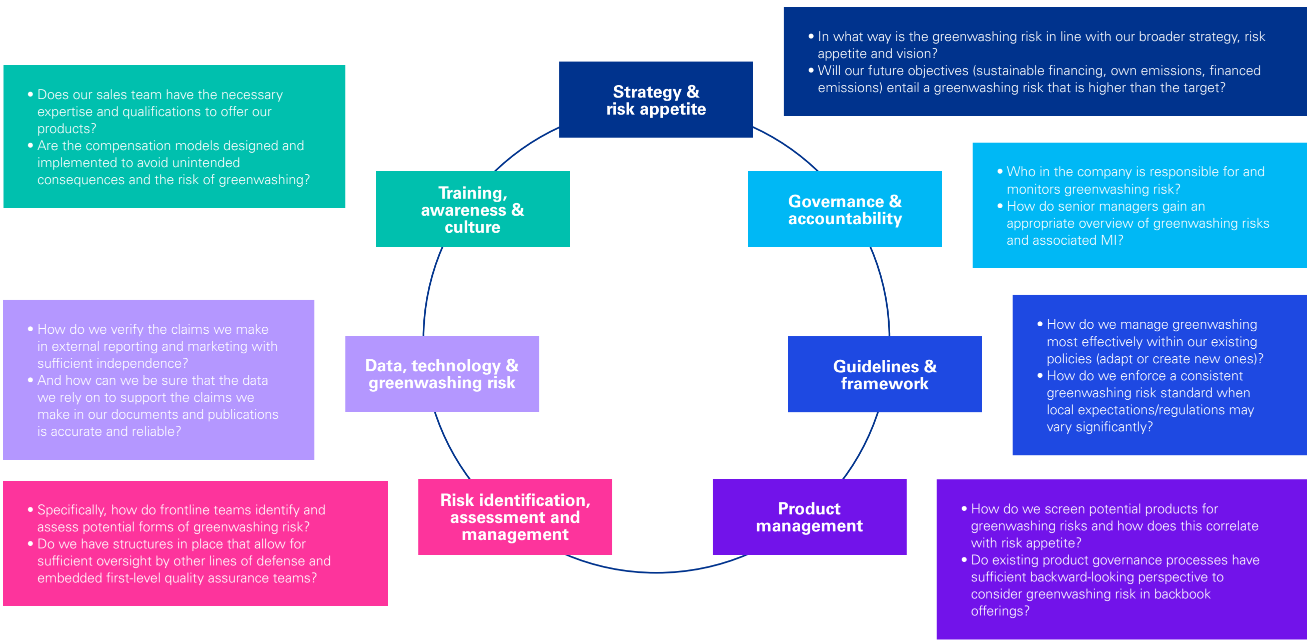
The «greenwashing» problem is currently the most important investor and customer protection issue. While the concept has been around for a long time, it has gained new urgency in recent years as a reputational and legal risk for insurance companies, with reputational damage tending to have a greater impact. The increasing number of legal cases worldwide in connection with greenwashing can be traced back in no small part to climate activists.

One impediment in preventing greenwashing is that there is no clear and uniform definition of what «green» or «sustainable» means. There are different definitions, standards and benchmarks used by regulators for sustainability.

However, there is some international consensus that greenwashing is the **intentional or unintentional misleading** of stakeholders by making **false claims** about the **sustainability of products/services or activities** with regard to ESG issues. Given the unclear definition, it can be complex to identify and assess greenwashing risks in an insurance company and to take countermeasures. In any case, such measures need to be adequate to the nature and extent of the risk.

An effective greenwashing risk management calls for a robust framework to assess the materiality of the risks and to define adequate measures:

## Greenwashing Risk Management Framework



# How KPMG supports the insurance industry

Existing and future regulatory requirements on sustainability require insurance companies to make considerable adjustments. We can advise and support you in implementing these requirements in a trustworthy yet pragmatic manner.

## Our offer

### Transparency

- Carrying out impact assessments and gap analyses for future reporting requirements such as TCFD or CSRD.
- Performing «Double materiality» analyses aimed at providing clarity on the material reporting points for insurers (taking into account regulatory requirements and stakeholder expectations)
- Compiling manuals for non-financial disclosures (documentation of the reporting process, methods and responsibilities)
- Defining non-financial key figures
- Implementing end-to-end solutions for non-financial reporting

### Climate change management

- Performing an ESG risk screening based on industry or geographic exposures to identify climate and other ESG risk drivers and sensitivities
- Developing and implementing governance models, with tolerances and metrics
- Carrying out climate scenario analyses
- Calculating the CO2 footprint and developing corresponding reduction measures (net zero reduction pathway)

### Investor protection

Performing a greenwashing risk analysis in accordance with our “KPMG Greenwashing Risk Framework” to identify and mitigate greenwashing risks

➜ Find out more about regulatory ESG developments

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