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COMMISSION DELEGATED REGULATION (EU) …/...

of 21.4.2021

amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as regards the integration of sustainability factors, risks and preferences into the product oversight and governance requirements for insurance undertakings and insurance distributors and into the rules on conduct of business and investment advice for insurance-based investment products

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

This Regulation is part of a broader Commission's initiative on sustainable development. It lays the foundation for an EU framework which puts sustainability considerations at the heart of the financial system to support transforming Europe's economy into a greener, more resilient and circular system in line with the **European Green Deal**[1] objectives.

Following the adoption of **2016 Paris agreement on climate change** and **the United Nations 2030 Agenda for Sustainable Development Goals (SDGs)**, the Commission announced in the **Action Plan: Financing Sustainable Growth**[2] the intention to incorporate sustainability when providing financial advice and to clarify the integration of sustainability in so-called fiduciary duties in sectoral legislation. The **European Green Deal** Communication confirms the need for long-term signals to direct financial and capital flows to green investment and to avoid stranded assets. This Delegated Regulation will contribute to this specific objective.

Commission Delegated Regulation (EU) 2017/2358[3] supplements Directive (EU) 2016/97 of the European Parliament and of the Council[4] (IDD) by further specifying product oversight and governance requirements for insurance undertakings and insurance distributors, while Commission Delegated Regulation (EU) 2017/2359[5] supplements Directive (EU) 2016/97 by specifying information requirements and conduct of business rules applicable to the distribution of insurance-based investment products. This Regulation modifies Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 in two ways.

First, it integrates customers' preferences in terms of sustainability as a top up to the suitability assessment. Under the existing IDD framework, insurance intermediaries and insurance undertakings distributing insurance-based investment products are required to obtain the necessary information about the customers' knowledge and experience in the investment field, their financial situation including the ability to bear losses and objectives including the customers' risk tolerance to enable the insurance intermediaries and insurance undertakings to recommend the insurance-based investment products that are suitable for the customer (suitability assessment). The information regarding the investment objectives includes information about preferences regarding risk taking, risk profile and the purposes of the investment. However, the information about investment objectives generally relates to

[1] Communication from the Commission to the European Parliament, to the European Council, the Council, the European Economic and Social Committee, and the Committee of the Regions: the European Green Deal (COM(2019)640 final)

[2] Communication from the Commission to the European Parliament, to the European Council, the Council, The European Central Bank, the European Economic and Social Committee, and the Committee of the Regions Action Plan: Financing Sustainable Growth (COM(2018)097 final).

[3] Commission Delegated Regulation (EU) 2017/2358 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to product oversight and governance requirements for insurance undertakings and insurance distributors (OJ L 341, 20.12.2017, p. 1).

[4] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (OJ L 26, 2.2.2016, p. 19).

[5] Commission Delegated Regulation (EU) 2017/2359 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to information requirements and conduct of business rules applicable to the distribution of insurance-based investment products (OJ L 341, 20.12.2017, p. 8).

financial objectives, while other, non-financial objectives of the customer such as sustainability preferences are usually not addressed. Existing suitability assessments generally do not include questions on sustainability preferences of customers, while the majority of customers would not raise the sustainability issue themselves. As a result, insurance intermediaries and insurance undertakings distributing insurance-based investment products consistently could give more appropriate consideration to sustainability factors in the selection process.

Regulation (EU) 2019/2088 of the European Parliament and of the Council (SFDR)[6] requires a financial product's documentation to describe how its stated levels of sustainability or sustainability ambitions are to be achieved or are achieved. As it is not a labelling regime, different sustainability-related ambitions might be described. Whilst financial products referred to in Article 9 of the SFDR must pursue the objective of sustainable investments, with no significant harm, as defined in Article 2, point (17), of the SFDR, financial products that fall under Article 8 of the SFDR might integrate different strategies, even including those that, despite claiming environmental, social and governance (ESG), socially responsible investing (SRI) or sustainability orientation, might lack sustainability-related materiality. Given this and given different product scopes of the IDD, the SFDR and Regulation (EU) 2020/852 of the European Parliament and of the Council[7] (Taxonomy Regulation), this draft Regulation ensures that financial instruments that have some level of sustainability-related materiality are eligible for recommendation to the customers or potential customers who express clear sustainability preferences. Sustainability preferences therefore comprise financial instruments that are either invested, at least to some extent, in taxonomy-compliant activities under the Taxonomy Regulation, or in sustainable investments, as defined in Article 2, point (17), of the SFDR, that also encompass taxonomy-compliant activities, or that consider negative externalities of investments on the environment or society in terms of principal adverse impacts on sustainability. The rules on sustainability preferences support and strengthen the policy objective of reducing the occurrence of greenwashing and mis-selling and encourage the financial system's transition, so that it genuinely supports businesses on their transition path towards sustainability, as well as continuing to support businesses that are already sustainable.

The rules on sustainability preferences ensure consistency with the SFDR and the Taxonomy Regulation and considerably strengthen the effectiveness of sustainability-related disclosures under those Regulations. The Taxonomy Regulation requires disclosure of the degree to which investments are aligned with the EU Taxonomy.

In operational terms, to facilitate internal processes and in particular the development of recommendations to customers or potential customers, based on a preceding analysis of financial instruments, insurance intermediaries and insurance undertakings distributing insurance-based investment products could, for instance, rank in advance and group such

[6] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability- related disclosures in the financial services sector (OJ L 317, 9.12.2019, p. 1).

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

products in terms of the proportion invested in economic activities that qualify as environmentally sustainable, the proportion of sustainable investments, or the consideration of principal adverse impacts, such as categories of principal adverse impacts, types of commitments and qualitative or quantitative indicators. Since investments pursued by insurance-based investment products might cause different principal adverse impacts on sustainability factors, insurance intermediaries and insurance undertakings should explain to the customers or potential customers that the elements demonstrating the consideration of principal adverse impacts on sustainability factors might be relevant for various environmental, social, employee or governance matters, should allow for demonstrating that consideration and for showing the respective commitment to address principal adverse impacts over time, and might be represented by qualitative or quantitative indicators, including but not limited to those in accordance with the SFDR.

Second, this Regulation integrates sustainability risks into the product oversight and governance requirements and into the rules on conflicts of interest. Under the existing IDD framework, insurance undertakings and insurance intermediaries which manufacture any insurance product for sale to customers shall maintain, operate and review a process for the approval of each insurance product and significant adaptations of an existing insurance product before it is marketed or distributed to customers. The product approval process shall specify an identified target market for each insurance product and shall ensure that all relevant risks to such identified target market are assessed and that the intended distribution strategy is consistent with the identified target market. Delegated Regulation (EU) 2017/2358 lays down further details on the product oversight and governance process.

The conditions to identify a target market in Delegated Regulation 2017/2358 adopted under Article 25(2) of IDD did not yet explicitly establish the details of the integration of sustainability factors and sustainability-related objectives by insurance undertakings and insurance intermediaries manufacturing insurance products and insurance distributors. This Regulation clarifies that sustainability factors and sustainability-related objectives should be taken into account in the product oversight and governance process for insurance products.

The part on the sustainability risk is based on technical advice on the integration of sustainability risks and factors in the delegated acts under Solvency II and IDD delivered by the European Insurance and Occupational Pensions Authority (EIOPA)[8]. The technical advice concludes that further clarifications are needed in respect of the integration of sustainability risks and sustainability factors in Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 and identifies specific provisions in this respect.

This Regulation and other sectoral delegated acts that adapt rules on fiduciary duties and that were adopted alongside also reinforce the **SFDR, Regulation (EU) 2019/2089 of the European Parliament and of the Council[9] and the Taxonomy Regulation**. These rules integrate sustainability considerations into the investment, advisory and disclosure processes

8 EIOPA-BoS-19/172, 30 April 2019.

9 Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks (OJ L 317, 9.12.2019, p. 17).

in a consistent manner across sectors. They anchor environmental, social and governance (sustainability) considerations at the heart of the financial system to help transform Europe's economy into a greener, low-carbon, more resilient, resource-efficient and circular system.

This Regulation is based on the empowerments set out in Articles 25(2), 28(4) and 30(6) of IDD.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In December 2016, the Commission set up a High-Level Expert Group on Sustainable Finance (HLEG) to help develop an EU strategy on Sustainable Finance through recommendations. The HLEG published an interim report on "Financing a Sustainable European Economy" in mid-July 2017 and presented its final report at a stakeholder event on 18 July 2017, followed by a consultation questionnaire.

A feedback statement was published along with the HLEG final report on Financing a Sustainable European Economy on 31 January 2018. The feedback statement summarises the respondents' answers. In its final report, the HLEG recommends to "*require investment advisers to ask about, and then respond to, retail investors' preferences about the sustainable impact of their investments, as a routine component of financial advice*". It also recommended to "*discuss the governance of addressing long-term and sustainability risks*".

In March 2018, the Commission sent a targeted questionnaire on the integration of environmental, social and governance considerations in the suitability assessment. The consultation showed that only a minority of the customers proactively raise sustainability issues during the advisory process. Some of the reasons for this are: i) the available information on sustainability-related financial products is not transparent; ii) the risk of 'greenwashing' in existing documentation is high; and iii) there is a lack of education on its impact on risk and performance. Only in rare cases, customers seem to systematically raise interest in sustainability factors during the advisory process.

In addition, a draft Delegated Regulation integrating sustainability aspects into the investment advice for insurance-based investment products was published for feedback in line with the Better Regulation guidelines in the period between 24 May and 21 June 2018. The Commission received 20 answers referring to this Delegated Regulation amending Regulation (EU) 2017/2359. Stakeholders from different backgrounds (e.g. NGOs, financial industry associations, public bodies) commented on diverse aspects of this Delegated Regulation. While there was generally strong support to enhance the focus on non-financial objectives within the investment process, some stakeholders were reluctant to change their newly implemented processes based on the IDD. As described above, the Commission is not only convinced of the urgency of moving ahead with its Sustainable Finance Agenda but is also of the view that the newly introduced reference to the SFDR and the proposed timeline for the application of this delegated act (12 months after entry into force) provide for sufficient flexibility.

As regards some of the objectives within the suitability assessment process, the Commission included some modifications in order to allow for the necessary differentiation between investment objectives on the one hand and sustainability preferences on the other hand. This differentiation is important in order to avoid mis-selling. Sustainability factors should not take precedence over a customer's personal investment objective. Therefore, the sustainability preferences should only be addressed within the suitability process once he customer's investment objective has been clearly identified. The aim of the rules on sustainability preferences is to enhance potential customers' or customers' awareness of the availability of insurance-based investment products with sustainability ambition. Given the rules on sustainability preferences, insurance-based investment products with different levels of sustainability-related ambition will not need to be adapted. Those insurance-based investment products will either benefit from the regime of sustainability preferences or will continue to be recommendable, but not as insurance-based investment products meeting the sustainability preferences of the customer or potential customer, as defined in this Regulation. In operational terms, the sustainability features of insurance-based investment products should be presented in a transparent way that allows insurance intermediaries and insurance undertakings distributing insurance-based investment products to engage in dialogue with customers or potential customers in order to have sufficiently granular understanding of the customers' individual sustainability preferences. To avoid churning, for existing customers, for whom a suitability assessment has already been undertaken, insurance intermediaries and insurance undertakings distributing insurance-based investment products should have the possibility to identify the customer's individual sustainability preferences at the next regular update of the existing suitability assessment.

The rules on sustainability preferences strengthen the use of the EU taxonomy for sustainable activities, i.e. economic activities that qualify as environmentally sustainable under Article 3 of the Taxonomy Regulation, and the pursuance of sustainable investments, as defined in Article 2(17) of the SFDR and also include investments in the aforementioned economic activities that qualify as environmentally sustainable. The rules also incentivise the recommendation of financial instruments that consider and reduce material negative externalities caused by those investments, i.e. principal adverse impacts.

The Commission requested EIOPA to issue technical advice on potential amendments to delegated acts to be adopted under the IDD with regard to the integration of sustainability risks and sustainability factors in the area of organisational requirements and product governance and oversight systems.

On 30 April 2019, EIOPA issued its Technical Advice on the integration of sustainability risks and factors in the Delegated Acts under Solvency II and IDD. The advice took into account the views expressed by stakeholders during the public consultation between 28 November 2018 and 28 February 2019. It includes a cost-benefit analysis. The advice addresses the inclusion of sustainability risks and factors in the product oversight and governance requirements and in the rules on conflicts of interest. The recommendations prepared and publicly consulted by EIOPA were integrated into this Delegated Regulation.

In line with Better Regulation Principles, this draft proposal was published for a second consultation from 8 June 2020 to 6 July 2020. After due consideration of the feedback received further modifications were introduced into the text.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

The legal basis for this Regulation is set out in Article 25(2), Article 28(4) and Article 30(6) of Directive (EU) 2016/97.

This Regulation covers the following amendments to Regulation (EU) 2017/2358 and Regulation (EU) 2017/2359:

Article 1 aims at clarifying that insurance undertakings and insurance intermediaries which manufacture insurance products for sale to customers should duly consider sustainability-related objectives when identifying groups of customers for whose needs, characteristics and objectives the insurance product is compatible. The target market assessment in consideration of the respective product's risk/reward profile and product features should also cover the product’s objective of sustainable investments or environmental or social characteristics. In the context of this review, insurance undertakings and insurance intermediaries manufacturing insurance products should also explicitly take into account the sustainability-related objectives of the customers belonging to the target market.

Further, insurance undertakings and insurance intermediaries manufacturing insurance products should disclose sustainability factors of their products in a transparent way that allows insurance distributors to engage in dialogues with customers or potential customers in order to have sufficiently granular understanding of the customers’ individual sustainability preferences, pursuant to Commission Delegated Regulation (EU) 2017/2358. For sustainable investments, the identification of a negative target market will not be required.

Article 2 aims at clarifying that insurance intermediaries and insurance undertakings distributing insurance-based investment products have to take into account possible conflicts of interest that may arise in relation to sustainability factors. Furthermore, when providing advice on insurance-based investment products, insurance intermediaries and insurance undertakings should carry out a mandatory assessment of sustainability preferences of their customers or potential customers. They should take these sustainability preferences into account in the selection process of the insurance-based investment products that are recommended to those customers. Three categories of insurance-based investment products should be integral to sustainability preferences, namely products that pursue a minimum proportion of sustainable investments in economic activities that qualify as environmentally sustainable under Article 3 of the Taxonomy Regulation or products that pursue a minimum proportion of sustainable investments, as defined in Article 2, point (17), of the SFDR, where the minimum proportion is determined by the customer or potential customer. The third category of insurance-based investment products eligible for individual sustainability preferences are products that consider principal adverse impacts on sustainability factors, where elements demonstrating that consideration are determined by the customer or potential customer.

By way of example, "insurance-based investment products that pursue a minimum proportion of sustainable investments” will always include financial products referred to in Article 9 of the SFDR and financial products referred to in Article 8 of the SFDR, provided such financial products pursue, at least to some extent, sustainable investments. That minimum extent is determined by customers or potential customers, thus the rules on sustainability preference take into full account their sustainability-related ambitions. Other examples include insurance-based investment products with environmental or social characteristics that are, among others, based on an exclusion strategy and that might fall under sustainability preferences provided they, at least to some extent, pursue sustainable investments or they prove the principal adverse impacts are considered and addressed or mitigated, in line with minimum investment proportions or elements demonstrating consideration of principal adverse impacts on sustainability factors respectively, as determined by the customer or potential customer. This also means that insurance-based investment products that promote environmental or social characteristics without a proportion of sustainable investments or without a proportion of investments in taxonomy-compliant activities or where they do not consider principal adverse impacts will not be eligible for recommendation to the customers or potential customers based on their individual sustainability preferences. However, such insurance-based investment products can still be recommended within the suitability test, but not as products meeting individual sustainability preferences.

Article 3 of this Regulation sets out the date of application of the proposed Regulation, including the transitional period of 12 months.

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amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as regards the integration of sustainability factors, risks and preferences into the product oversight and governance requirements for insurance undertakings and insurance distributors and into the rules on conduct of business and investment advice for insurance-based investment products

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution[1], and in particular Article 25(2), Article 28(4) and Article 30(6) thereof,

Whereas:

(1) The transition to a low-carbon, more sustainable, resource-efficient and circular economy in line with the Sustainable Development Goals is key to ensuring the long-term competitiveness of the economy of the Union. In 2016, the Union concluded the Paris Agreement[2]. Article 2(1), point (c), of the Paris Agreement sets out the objective of strengthening the response to climate change by, among others, making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.

(2) Recognising that challenge, the Commission presented the European Green Deal[3] in December 2019. The Green Deal represents a new growth strategy that aims to transform the Union into a fair and prosperous society, with a modern, resource-efficient and competitive economy where there are no net greenhouse gas emissions from 2050 onwards and where economic growth is decoupled from resource use. That objective requires that clear signals are given to investors with regard to their investments to avoid stranded assets and to raise sustainable finance.

(3) In March 2018, the Commission published its Action Plan ‘Financing Sustainable Growth’[4], setting up an ambitious and comprehensive strategy on sustainable finance. One of the objectives set out in the Action Plan is to reorient capital flows towards sustainable investments to achieve sustainable and inclusive growth.

(4) Proper implementation of the Action Plan encourages investors’ demand for sustainable investments. It is therefore necessary to clarify that sustainability factors

1 OJ L 26, 2.2.2016, p. 19.

2 Council Decision (EU) 2016/1841 of 5 October 2016 on the conclusion, on behalf of the European Union, of the Paris Agreement adopted under the United Nations Framework Convention on Climate Change (OJ L 282, 19.10.2016, p. 1).

3 COM(2019) 640 final.

4 COM(2018) 97 final.

and sustainability-related objectives should be considered within the product governance requirements set out in Commission Delegated Regulation (EU) 2017/2358.[5]

(5) Insurance undertakings and insurance intermediaries manufacturing insurance products should consider sustainability factors in the product approval process of each insurance product and in the other product governance and oversight arrangements for each insurance product that is intended to be distributed to customers seeking insurance products with a sustainability-related profile.

(6) Considering that the target market should be set at a sufficient granular level, a general statement that an insurance product has a sustainability-related profile should not be sufficient. It should rather be specified by the insurance undertaking or insurance intermediary manufacturing the insurance product to which group of customers with specific sustainability-related objectives the insurance product is supposed to be distributed.

(7) To ensure that insurance products with sustainability factors remain easily available also for customers that do not have sustainability preferences, insurance undertakings and insurance intermediaries manufacturing insurance products should not be required to identify groups of customers with whose needs, characteristics and objectives an insurance product with sustainability factors is not compatible.

(8) The sustainability factors of an insurance product should be presented in a transparent manner to enable insurance distributors to provide the relevant information to their customers or potential customers.

(9) The impact assessment underpinning subsequent legislative initiatives published in May 2018[6] demonstrated the need to clarify that sustainability factors should be taken into account by insurance intermediaries and insurance undertakings distributing insurance-based investment products as part of their duties toward their customers and potential customers.

(10) To maintain a high standard of investor protection, insurance intermediaries and insurance undertakings distributing insurance-based investment products should, when identifying the types of conflicts of interest the existence of which may damage the interests of a customer or potential customer, include those types of conflicts of interest that stem from the integration of a customer's sustainability preferences. For existing customers, for whom a suitability assessment has already been undertaken, insurance intermediaries and insurance undertakings should have the possibility to identify the customer's individual sustainability preferences at the next regular update of the existing suitability assessment.

(11) Insurance intermediaries and insurance undertakings that provide advice on insurance-based investment products should be able to recommend suitable insurance-based investment products to their customers or potential customers and should therefore be able to ask questions to identify a customer's individual sustainability preferences. In accordance with the obligation to carry out distribution activities in accordance with

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5 Commission Delegated Regulation (EU) 2017/2358 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to product oversight and governance requirements for insurance undertakings and insurance distributors (OJ L 341, 20.12.2017, p. 1).

6 SWD(2018) 264 final.

the best interest of costumers, recommendations to customers or potential customers should reflect both the financial objectives and any sustainability preferences expressed by those customers. It is therefore necessary to clarify that the inclusion of sustainability factors in the advisory process must not lead to mis-selling practices or to the misrepresentation of insurance-based investment products as fulfilling sustainability preferences where they do not. In order to avoid such practices or misrepresentations, insurance intermediaries and insurance undertakings providing advice on insurance-based investment products should first assess a customer's or potential customer's other investment objectives and individual circumstances, before asking for his or her potential sustainability preferences.

(12) Insurance-based investment products with various degrees of sustainability-related ambition have been developed so far. To enable customers or potential customers to understand the different degrees of sustainability and take informed investment decisions in terms of sustainability, insurance intermediaries and insurance undertakings distributing insurance-based investment products should explain the distinction between, on the one hand, insurance-based investment products that pursue, fully or in part, sustainable investments in economic activities that qualify as environmentally sustainable under Regulation (EU) 2020/852 of the European Parliament and of the Council[7], sustainable investments as defined in Article 2, point (17), of Regulation (EU) 2019/2088 of the European Parliament and of the Council[8] and insurance-based investment products that consider principal adverse impacts on sustainability factors that might be eligible for recommendation as meeting individual sustainability preferences of customers, and, on the other hand, other insurance-based investment products without those specific features that should not be eligible for recommendation to customers or potential customers that have individual sustainability preferences.

(13) It is necessary to address concerns about 'greenwashing', that is, in particular, the practice of gaining an unfair competitive advantage by recommending an insurance-based investment product as environmentally friendly or sustainable, when in fact that insurance-based investment product does not meet basic environmental or other sustainability-related standards. In order to prevent mis-selling and greenwashing, insurance intermediaries and insurance undertakings distributing insurance-based investment products should not recommend insurance-based investment products as meeting individual sustainability preferences where those products do not meet those preferences. Insurance intermediaries and insurance undertakings distributing insurance-based investment products should explain to their customers or potential customers the reasons for not doing so and keep records of those reasons.

(14) It is necessary to clarify that insurance-based investment products that are not eligible for individual sustainability preferences can still be recommended by insurance intermediaries and insurance undertakings distributing insurance-based investment products, but not as meeting individual sustainability preferences. In order to allow for further recommendations to customers or potential customers, where insurance-based investment products do not meet a customer's sustainability preferences, the customer

7 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).

8 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (OJ L 317, 9.12.2019, p. 1).

should have the possibility to adapt information on his or her sustainability preferences. In order to prevent mis-selling and greenwashing, insurance intermediaries and insurance undertakings distributing insurance-based investment products should keep records of the customer's decision along with the customer's explanation supporting the adaptation.

(15) The provisions of this Regulation are closely linked with each other and with the provisions of Regulation (EU) 2019/2088 since they establish a comprehensive system of disclosure of sustainability aspects. To allow for a coherent interpretation and application of these provisions and to make sure that market participants and competent authorities as well as investors are provided with a comprehensive understanding and easy access to them, it is desirable to include them in a single legal act.

(16) Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 should therefore be amended accordingly.

(17) Competent authorities, insurance intermediaries and insurance undertakings should be given sufficient time to adapt to the new requirements contained in this Regulation. Its application should therefore be deferred,

HAS ADOPTED THIS REGULATION:

Article 1

Amendments to Delegated Regulation (EU) 2017/2358

Delegated Regulation (EU) 2017/2358 is amended as follows:

(1) in Article 4(3), point (a), point (i) is replaced by the following:

"(i) it takes into account the objectives, interests and characteristics of customers, including any sustainability-related objectives;

(2) Articles 5 and 6 are replaced by the following:

"*Article 5*

Target market

1. The product approval process shall for each insurance product identify the target market and the group of compatible customers. The target market shall be identified at a sufficiently granular level, taking into account the characteristics, risk profile, complexity and nature of the insurance product, as well as its sustainability factors as defined in Article 2, point (24), of Regulation (EU) 2019/2088 of the European Parliament and of the Council*.

2. Manufacturers may, in particular with regard to insurance-based investment products, identify groups of customers for whose needs, characteristics and objectives the insurance product is generally not compatible, except where insurance products consider sustainability factors as referred to in paragraph 1.

3. Manufacturers shall only design and market insurance products that are compatible with the needs, characteristics and objectives, including any sustainability-related objectives, of the customers belonging to the target market. When assessing whether an insurance product is compatible with a target market, manufacturers shall take into account the level of information available to the customers belonging to that target market and their financial literacy.

4. Manufacturers shall ensure that staff involved in designing and manufacturing insurance products has the necessary skills, knowledge and expertise to properly understand the insurance products sold and the interests, objectives, including any sustainability-related objectives, and characteristics of the customers belonging to the target market.

Article 6

Product testing

1. Manufacturers shall test their insurance products appropriately, including scenario analyses where relevant, before bringing that product to the market or significantly adapting it, or in case the target market has significantly changed. That product testing shall assess whether the insurance product over its lifetime meets the identified needs, objectives, including any sustainability-related objectives, and characteristics of the customers belonging to the target market. Manufacturers shall test their insurance products in a qualitative manner and, depending on the type and nature of the insurance product and the related risk of detriment to customers, quantitative manner.

2. Manufacturers shall not bring insurance products to the market if the results of the product testing show that the products do not meet the identified needs, objectives, including any sustainability-related objectives, and characteristics of the target market.

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* Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability- related disclosures in the financial services sector (OJ L 317, 9.12.2019, p. 1).";

(3) in Article 7, paragraph 1 is replaced by the following:

"1. Manufacturers shall continuously monitor and regularly review insurance products they have brought to the market, to identify events that could materially affect the main features, the risk coverage or the guarantees of those products. They shall assess whether the insurance products remain consistent with the needs, characteristics and objectives, including any sustainability-related objectives, of the identified target market and whether those products are distributed to the target market or are reaching customers outside the target market.";

(4) in Article 8, paragraph 3 is replaced by the following:

"3. The information referred to in paragraph 2 shall enable the insurance distributors to:

(a) understand the insurance products;

(b) comprehend the identified target market for the insurance products;

(c) identify any customers for whom the insurance product is not compatible with their needs, characteristics and objectives, including any sustainability-related objectives;

(d) carry out distribution activities for the relevant insurance products in accordance with the best interests of their customers as prescribed in Article 17(1) of Directive (EU) 2016/97.";

(5) in Article 10, paragraph 2 is replaced by the following:

“2. The product distribution arrangements shall:

(a) aim to prevent and mitigate customer detriment;

(b) support a proper management of conflicts of interest;

(c) ensure that the objectives, interests and characteristics of customers, including any sustainability-related objectives, are duly taken into account.”;

(6) Article 11 is replaced by the following:

“*Article 11*

Informing the manufacturer

Insurance distributors becoming aware that an insurance product is not in line with the interests, objectives and characteristics of the customers belonging to its identified target market, including any sustainability-related objectives, or becoming aware of other product-related circumstances that may adversely affect the customer, shall promptly inform the manufacturer and, where appropriate, amend their distribution strategy for that insurance product.”.

Article 2

Amendments to Delegated Regulation (EU) 2017/2359

Delegated Regulation (EU) 2017/2359 is amended as follows:

(1) in Article 2, the following points (4) and (5) are added:

“(4) ‘sustainability preferences’ means a customer’s or potential customer’s choice as to whether and, if so, to what extent, one or more of the following financial products should be integrated into his or her investment:

(a) an insurance-based investment product for which the customer or potential customer determines that a minimum proportion shall be invested in environmentally sustainable investments as defined in Article 2, point (1), of Regulation (EU) 2020/852 of the European Parliament and of the Council**;

(b) an insurance-based investment product for which the customer or potential customer determines that a minimum proportion shall be invested in sustainable investments as defined in Article 2, point (17), of Regulation (EU) 2019/2088 of the European Parliament and of the Council***;

(c) an insurance-based investment product that considers principal adverse impacts on sustainability factors where qualitative or quantitative elements demonstrating that consideration are determined by the customer or potential customer;

(5) ‘sustainability factors’ means sustainability factors as defined in Article 2, point (24), of Regulation (EU) 2019/2088.

** 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).

*** Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability- related disclosures in the financial services sector (OJ L 317, 9.12.2019, p. 1).";

(2) in Article 3, paragraph 1 is replaced by the following:

"1. For the purposes of identifying, in accordance with Article 28 of Directive (EU) 2016/97, the types of conflicts of interest that arise in the course of carrying out any insurance distribution activities related to insurance-based investment products and which entail a risk of damage to the interests of a customer, including his or her sustainability preferences, insurance intermediaries and insurance undertakings shall assess whether they, a relevant person or any person directly or indirectly linked to them by control, have an interest in the outcome of the insurance distribution activities, which meets the following criteria:

(a) it is distinct from the customer's or potential customer's interest in the outcome of the insurance distribution activities;

(b) it has the potential to influence the outcome of the distribution activities to the detriment of the customer.

Insurance intermediaries and insurance undertakings shall proceed in the same way for the purposes of identifying conflicts of interest between one customer and another.";

(3) Article 9 is amended as follows:

(a) in paragraph 2, point (a) is replaced by the following:

"(a) it meets the investment objectives of the customer or potential customer in question, including that person's risk tolerance and any sustainability preferences;";

(b) paragraph 4 is replaced by the following:

"4. The information regarding the investment objectives of the customer or potential customer shall include, where relevant, information on the length of time for which the customer or potential customer wishes to hold the investment, his or her preferences regarding risk taking, the risk profile, the purposes of the investment and, in addition, his or her sustainability preferences. The level of information gathered shall be appropriate to the specific type of product or service being considered.";

(c) paragraph 6 is replaced by the following:

"6. When providing advice on an insurance-based investment product in accordance with Article 30(1) of Directive (EU) 2016/97, an insurance intermediary or insurance undertaking shall not make a recommendation where none of the products are suitable for the customer or potential customer.

An insurance intermediary or insurance undertaking shall not recommend insurance-based investment products as meeting a customer's or potential customer's sustainability preferences where those insurance-based investment products do not meet those preferences. The insurance intermediary or insurance undertaking shall explain to the customers or potential customers the reasons for not doing so and keep records of those reasons.

Where no insurance-based investment product meets the sustainability preferences of the customer or potential customer, and the customer decides to adapt his or her sustainability preferences, the insurance intermediary or insurance undertaking shall keep records of the decision of the customer, including the reasons for that decision";

(4) Article 14 is amended as follows:

(a) in paragraph 1, point (b), point (i) is replaced by the following:

"(i) the customer's investment objectives, including that person's risk tolerance, and whether the customer's investment objectives are achieved by taking into account his or her sustainability preferences;";

(b) in paragraph 4, the following subparagraph is added:

"The requirements to meet the sustainability preferences of customers or potential customers, where relevant, shall not alter the conditions laid down in the first subparagraph.".

Article 3

Entry into force and application

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

It shall apply from [***PO, please insert date - 12 months after publication in the Official Journal of the European Union***].

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 21.4.2021

For the Commission
The President
Ursula VON DER LEYEN