KEYNOTE SPEECH

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BUILDING A COMMON SUPERVISORY CULTURE

Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

2nd IVASS CONFERENCE

SOLVENCY II AND SMALL AND MEDIUM-SIZED INSURERS

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Good morning Ladies and Gentlemen,

It is always a pleasure to be back in Rome.

First of all, let me thank the Italian Insurance Supervisor, IVASS, and its President, Mr. Salvatore Rossi, for the invitation to speak again at this year's IVASS annual conference. Last year our discussions focused on the implementation and long-awaited start of Solvency II. This year's motto is Solvency II through eyes of small and medium-sized insurers, an important segment of the European insurance landscape and a topic which I very much welcome.

In my intervention today I will cover three main challenges that I believe are important for the European Union insurance market, particularly for small and medium size players, and the European consumers:

- **Proportionality** in Solvency II, both from a regulatory and supervisory perspective;
- **Supervisory convergence** in the EU insurance market;
- The challenges and opportunities of **digitalisation**.

Proportionality in Solvency II

On the regulatory side, the Solvency II framework takes into account in an extensive way the **principle of proportionality**. Requirements should be applied in a way that is proportionate to the nature, scale and complexity of the risks inherent in the business. This principle is defined in the Directive and there are a good number of concrete applications in the different regulatory texts, including EIOPA guidelines:

- The **Implementing Acts** include simplified calculations on the technical provisions and on some modules of the Solvency Capital Requirement (SCR) standard formula.
- The **Guidelines on the Loss Absorbing Capacity** (LAC) foresee a simplified formula for calculating the LAC at group level.

- The **technical standard on reporting** foresees the possibility of the use of exemptions by supervisors allowing for up to 20% of the market to be exempted from the quarterly reporting and the annual asset by asset quantitative reporting.
- The **combination of key functions on the system of governance** is allowed in certain special circumstances.

EIOPA is and will continue to be very attentive to the implementation of the proportionality principle in Solvency II. However, I believe that on the top of that what is already defined in the Solvency II, **supervisors' attitude** towards the practical application of proportionality is key to ensure that we achieve the objectives of Solvency II.

EIOPA is actively working on that and has recently delivered the following:

- We recently issued a **report on the practical use of proportionality** in the reporting requirements.
- We are running a **"Peer Review" on the key functions of the system of governance** with a particular emphasis on proportionality. This "Peer Review" is assessing national practices on how to supervise and decide if the undertaking's setting of key functions fulfils the legal requirements of Solvency II. It also examines the criteria for combining or separating key functions and the supervisory expectations with regards to fitness and propriety of key functions holders.
- In the **development of the Supervisory Handbook** we always include concrete examples of good practices on the proportionate implementation of Solvency II.

But let me be very clear, it is also fundamental to ensure that proportionality is well understood by all stakeholders. Proportionality does not mean not applying the requirements; it means applying them in a manner that is in line with the nature, scale and complexity of the risks inherent in the business.

And, very importantly, by allowing the requirements to be implemented in a proportionate way, supervisors should focus their attention on making sure that we achieve the desired transformation and change from the previous regime. For example, on the Pillar II governance requirements, while accepting different and proportionate implementation of the key functions, it is extremely important to ensure that the cultural change on risk governance is a reality.

We should not forget that bad governance was identified as one of the most relevant causes of solvency problems of insurance companies.

Therefore, the real test should be to assess if in substance and not in form we tackle **a number of important issues**:

- The **4 eyes principle** in the context of dominant CEOs;
- The **level of effective challenge** provided by the Board to the management;
- How in practice the **risk management function** contributes to the definition of product governance and business strategies;
- How **conflicts of interest** are managed by insurers management in financial conglomerates.

And also very important, proportionality works both ways, meaning that high complex and risky business should be subject to higher requirements and enhanced supervisory attention. The clear example for that are companies using internal models.

EIOPA is keen on ensuring a **sound implementation of proportionality in Solvency II**. We are determined to work together with National Competent Authorities to identify good practices in this area and provide guidance on supervisory approaches that privilege substance over form.

This will be fundamental to **ensure a level playing field** throughout the European Union and avoid the emergence of different standards of proportionality. The experience gathered in the first years of implementation will help us all to adjust the regime and make it more proportionate.

The first opportunity is the **review of the SCR standard formula** envisaged to be done in 2018. As you are aware, EIOPA recently launched a discussion paper on the review of the SCR. We very much welcome the engagement of the Italian insurance industry in this consultation.

While we identify a number of concrete technical areas where the review will be focused, it is very important to understand the main objectives that we set up for this review: to reduce complexity, enhance proportionality and keep ensuring a proper risk sensitiveness while mitigating procyclicality.

We welcome **concrete suggestions** on ways to enhance proportionality in Pillar I requirements through the use of simplified methodologies or undertaking specific parameters.

I continue to believe that proportionality in solvency requirements should be achieved by the use of simplified methodologies and that all undertakings should be subject to the same quantitative solvency requirements.

It is not because you are smaller that you should build weaker technical provisions or have less capital to withstand shocks. This would be a bad outcome for consumers but also for those smaller companies that would be seen as second class undertakings.

From a consumer protection perspective, it is **key to ensure that all market players are subject to the same basic solvency requirements**.

Supervisory Convergence

The key challenge for EIOPA in the coming years is to build and implement a **common European supervisory culture**.

To ensure supervisory convergence, the insurance supervisory community needs to have a common interpretation of the laws and regulations, a common understanding of supervisory objectives and a common view on the key characteristics of good and effective supervision.

Only a common supervisory culture will ensure a level playing field, prevent supervisory arbitrage and safeguard a similar level of protection to all policyholders in the European Union.

Let me mention a number of EIOPA initiatives in this area:

- Development of a **Handbook of good supervisory practices in Solvency II**, and a corresponding training programme for National Supervisors.
- Use of the **centralised database of Solvency II data** to develop reliable risk analysis and early warning indicators at individual, group and system-wide level and provide National Competent Authorities with Peer Group comparisons.

- **Bilateral visits** to National Competent Authorities providing independent feedback and challenging supervisory practices.
- Creation of **cooperation platforms between EIOPA and the concerned National Competent Authorities** in situations where cross-border risks following branch or freedom to provide service activities pose important challenges to supervision.
- Supporting improvements in national supervision in exercises such as **Balance Sheet Reviews** as it was the case of Romania and Bulgaria, adding credibility to the market and its supervision.
- Implementation of a **strategy on preventive risk-based conduct supervision**, through the use of Thematic Reviews and Retail risk indicators to prioritise actions in areas of possible emerging consumer detriment.

In order to preserve the internal market and the corresponding freedom, we need to ensure that in all Member States there is high-level quality supervision and that this supervision is done in a consistent way throughout Europe.

We **cannot have situations** where weaker supervisory standards are used to arbitrage the system. The situations where:

- individuals are **considered to not be fit and proper** in one country and are assessed differently in another country;
- companies are **set up in one country but they mostly do business in other countries without a proper assessment of the local risks** and an adequate provisioning of their liabilities;
- due to prioritisation of supervisory resources, **only marginal attention is given to the soundness of business written in other countries**;
- there are **very different supervisory practices on the assessment of the sustainability of certain business models**.

EIOPA has been increasing its work in this area. Recently we approved a new Decision on the exchange of information between National Competent Authorities, increasing the cooperation between home and host authorities before licencing and during ongoing supervision.

Going forward, EIOPA shall have a **clear mandate on ensuring supervisory convergence**, performing independent assessments of supervisory practices and issuing recommendations to National Competent Authorities and a **stronger mandate on coordinating cross-border supervisory issues**.

Furthermore, in order to ensure consistency in the use of internal models, steps should be taken **to centralise the approval and on-going monitoring of internal models.**

Digitalisation

Small and medium size insurers will also be subject to new challenges such as the increased digitalisation and use of new technologies. While this brings risks, it also creates opportunities. I believe that small and medium size insurers have a great opportunity with InsurTech to explore niche and segment markets to develop differentiate and innovative proposals, products and services to customers.

The use of big data and telematics, comparison websites and automated advice tools will impact the way providers interact with consumers. The increasing amount of personal data available and the power of data analytics will inevitably change insurance underwriting models. This has the potential to produce **better outcomes for customers but also brings new risks.**

I strongly believe that regulation should be technological neutral and that we should be attentive to **keep a high level of consumer protection while not hindering innovation.**

EIOPA is keen on involving supervisors, the traditional insurance industry and the new InsurTech in a constructive dialogue to identify the key areas to act and build fair and proportionate solutions.

We will organise InsurTech roundtables, the first of these at the end of April, touching upon issues like:

- The use of **testing approaches (Sandboxes)** from a supervisory perspective;
- The identification of the **biggest opportunities** and **risks** in the insurance value chain from a digitalisation perspective;

- The **ethical standards** followed by companies on the use of personal data;
- How the **underwriting models** are changing due to the personalisation of pricing and how exclusion would be dealt with.

Closely linked to digitalisation is the issue of **cyber risk**. Insurers, including small and medium size players, will be possessing and using bigger and bigger amounts of personal data. The risk of cyber-attacks is increasing and insurers will be key potential targets.

This evolution poses a tremendous challenge from an operational perspective and proper IT security systems need to be implemented and tested.

The use of the cloud and the dependency on external service providers only increases the complexity of managing this operational risk.

On the other side, cyber risk also represents an opportunity for the sector. The development of insurance coverage for this risk is evolving and should be done in a sound basis according to the information available. Nevertheless, particular attention should already be given to the exposure to cyber accumulation risk in the current portfolios.

Ladies and Gentlemen,

Applying requirements in a proportionate way is a balancing act. We should identify concrete elements where burden should be reduced because it is not adding value while making sure that we achieve the desired outcomes with the new risk-based regime.

Policyholder protection and market stability in a single market construction is only achieved if we ensure high quality and consistent supervision throughout the European Union. The system will be as strong as his weakest link.

Digitalisation is here to stay and we better embrace it and use it as an opportunity to provide better services and products to consumers.

We should work together to improve consumer protection and financial stability, being faithful to the European Union motto *"United in diversity".*

Thank you very much for your attention.