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Keynote Address

Opportunities, challenges and regulatory developments

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Ladies and Gentlemen,

Thank you very much for inviting me to speak again at this year's - which I understand is the Twenty-First - Annual European Financials Conference. Since last year a lot has happened and the challenges for the global financial system have not diminished.

Today I will share with you my thoughts about the evolving landscape of regulation and supervision in the area of insurance and focus my intervention on the following three topics:

- *First*, EIOPA's approach **towards consistent supervisory practices and common European supervisory culture** to ensure a level playing field
- *Second*, the development of a **successful industry in a challenging environment**
- *Third*, **the international capital standards**

To my first topic: **Towards consistent supervisory practices and a common European supervisory culture**

Here let me start by referring to the implementation of Solvency II, the key milestone towards smart regulation and a level playing field.

Within a very difficult macroeconomic scenario with historically low interest rates, the application of a more demanding risk-based solvency regime - Solvency II - was carried out smoothly as a result of timely preparation and appropriate transitional periods. In an industry with **€ 11 trillion of assets under management** and € 8.7 trillion in technical provisions, this success is remarkable and has contributed significantly to the stability of the European financial sector.

Overall the European insurance sector is adequately capitalized with an **average solvency ratio of 230%**. Specific transition periods are used mostly by life insurance companies with long-term guarantees business. The use of transitional measures is transparent and insurance companies published their solvency ratios with and without the application of these measures. Transitional measures form an integral part of Solvency II and are intended to limit the procyclicality and to facilitate the entry into the new regime by giving companies the time needed to adapt to the new solvency requirements.

In the past six years, EIOPA has been delivering high quality regulation, technical advice and analysis at the European Union level, reinforcing consumer protection and strengthening the European supervisory position. While these high-level strategic goals stay a driving force of our organisation we intensively shift our focus from regulation to supervision.

Why? To move towards a common European supervisory culture with consistent supervisory practices across the European Union.

A culture, which will ensure a level playing field, prevent supervisory arbitrage, safeguard financial stability, enhance consumer protection for all policyholders in the European Union and foster innovation.

To ensure sound and effective supervision of the insurance sector EIOPA strongly believes in a **holistic and integrated approach towards European prudential and conduct of business supervision**.

In the insurance business model, long-term promises and variable allocations of risks between insurers and policyholders strongly link the profitability and solvency of the company and the fair treatment of its customers. Recent history has shown how conduct failings can lead not only to consumer detriment but also solvency issues and contagion risks, while the pursuit of solvency can in a crisis put policyholder interests at risk. These interlinkages are reinforced by emerging changes in business models and the trend towards digitalisation.

EIOPA has developed in the recent years a number of supervisory convergence tools like the handbook of supervisory practices, the platforms on cross-border business, the EU-wide thematic reviews, and EIOPA's staff assessment of national supervisory practices. Furthermore, EIOPA is implementing its strategy on preventive risk-based conduct supervision to prioritise actions in areas of possible emerging consumer detriment.

Further progress on supervisory convergence has been given fresh urgency by the implementation of Solvency II and the increasing number of cross-border cases and failures, which amplify risks to consumers and the stability of the financial system. The ability to passport services should imply at the same time a sound supervision of such activities throughout the European Union. Only strong European responses are able to counter these negative developments, and provide the consumer with additional safeguards. Therefore, **EIOPA's regulation should be strengthened**

with a mandate to act more intrusively when it detects signals of risks of cross-border failures.

Going forward, **regulatory certainty** is an important value that we all need to preserve. The review of Solvency II will follow the structured process envisaged in the legislative texts: By 2018, the review of the Solvency Capital Requirement (SCR) and by 2021, the overall review of the regime, including the treatment of long-term guarantees.

Last December EIOPA issued a discussion paper on the review of the Solvency Capital Requirement (SCR) marking the first phase of the Solvency II review process. In this context during this year through a series of roundtables we will engage with all relevant stakeholders.

EIOPA is committed to an evidence-based policymaking. Changes must be carefully justified and clearly necessary. We are particularly interested in concrete proposals to achieve the objective of more simplicity and proportionality whilst reflecting risk-sensitivity of the system and avoiding pro-cyclicality. **Overall, we are not expecting major changes in the capital needs of Solvency II**.

Let me now go into more details with regard to EIOPA's work linked with investments and Solvency II.

The implementation of a risk-based capital regime comes with profound changes in the way investments are treated from a regulatory perspective.

On one hand, the prudent person principle eliminates regulatory restrictions and limits on investments by giving undertakings much more freedom in their investment choices and portfolio construction. On the other hand, it creates the responsibility for insurance undertakings to establish their own limits and investments restrictions. This requires close monitoring, especially in a period of low interest rates. Granular capital requirements for individual investments should reflect the underlying risks and be calibrated to the overall confidence level established in the Solvency II Directive.

In general, the investment portfolio of European insurers is dominated by **bonds, which is around 55% of total investments by insurers last year**. Almost half of these are government bonds and half corporate. Investments in equities (including participations), be it direct or through investment funds, represent 21% of the overall portfolio, while real estate and mortgages account each for only 2% of the total investment.

A lot has been done to fine tune the regulatory treatment of specific investments in Solvency II. EIOPA developed a pioneer approach with the **creation of a separate asset class under Solvency II standard formula for investments in infrastructure projects** allowing a specific treatment, and lower risk calibration, for qualifying infrastructure project debt and equity.

The qualifying infrastructure investments need to satisfy conditions relating to the predictability of the cash flows, the robustness of the contractual framework, and their ability to withstand relevant stress scenarios. In a next step EIOPA recommended to extend the new asset class to certain **infrastructure corporates** provided that there is an equivalent level of risk and to create a separate differentiated treatment for equity investments in high-quality infrastructure corporates.

This year, EIOPA started working on another Advice to the European Commission on investments with a particular focus on the treatment of **unrated debt and unlisted equities**. In June a workshop will be organised.

Finally, EIOPA worked on the development of a **Pan European Personal Pension product, the PEPP**, which should have a long-term perspective in its investment policy to better reflect the long-term nature of retirement savings. This is particularly welcomed from a macro-perspective because long-term investors are needed to provide stable funding to the European Union economy.

In all this work we followed an important principle: **Asset risk calibration in Solvency II should not be used to privilege or incentive any specific asset class**. If the regime creates incentives that are not properly aligned with risks we will see the emergence of price distortions and vulnerabilities that ultimately will create financial stability risks.

Moving to my second topic: A successful industry in a challenging environment

A successful industry is key in achieving strategic objectives, namely preserving financial stability and enhancing consumer protection. Even though the current environment continues to pose challenges for insurance companies, it is important to act now. EIOPA expects that insurance companies confront the reality by:

- Promoting a strong risk culture
- Using the Solvency II public disclosure as an opportunity
- Developing a consumer-centric culture and embracing the digital era

Promoting a strong risk culture

A crucial element in Solvency II is the risk management requirements. They have the potential to be truly a game changer, helping to promote a strong risk culture in insurance companies. Insurers need to rely on strong risk management capabilities to deal with the challenges posed by the low interest rate environment, the financial markets volatility, the slow economic growth, the digital era.

To implement an effective risk management system is not an instantaneous move. It takes time, commitment, effort and especially a clear signal from the top. Boards of insurance companies have a fundamental role to play. They need to set, communicate and enforce a risk culture that consistently influences, directs and aligns with the strategy and objectives of the business and thereby supports the embedding of its risk management framework and processes. The time for "box ticking" is over.

Using the Solvency II public disclosure as an opportunity

Last month the essential information on the solvency and financial condition of companies was made **publicly available for the first time**. For most parts of the European insurance and reinsurance market this was a novelty and a paradigm shift in terms of communication with the outside world, customers, stakeholders, observers and the public at large. In this sense it is also a great opportunity for the sector to become more transparent.

EIOPA is analysing to what extent the information disclosed fulfils the objectives of market discipline and market confidence by improving transparency on the solvency and financial position of insurers and allowing comparison across different undertakings. Your views are welcomed.

Developing a consumer-centric culture and embracing the digital era

The **governance requirements of Solvency II** are a **paradigm shift towards a more consumer-centric culture**. There is a need to better integrate conduct of business concerns in the institutional governance arrangements in order to ensure that companies reliably place the interest of their customers at the heart of their business.

We expect that insurers ensure that governance structures and controls are effective and deliver the desired outcomes. We do not want a move to a culture of formal compliance; rather we all need to promote a culture based on strong ethical values.

These ethical values need also to be present in the way insurers deal with big data and digitalisation. Technological innovations have the potential to produce better outcomes for customers, through the development of more personalized services and products, helping consumers and society to reduce their risks. They also trigger questions on privacy, fairness, and exclusion that need to be properly dealt with.

***I will now conclude with my last topic*, the international capital standards.**

The creation of a global, consistent international capital standard is needed to address the lack of comparability among existing group capital frameworks applied by internationally active insurance groups. In order to foster effective supervision and promote a level playing field it is fundamental to arrive at a situation where a group capital framework delivers substantially the same outcomes across all jurisdictions.

Ongoing work, like the field tests, is intended to lead to improved convergence over time on key elements like valuation, capital resources and capital requirements, including the use of internal models. However, an international standard should be of high quality and not a lowest common denominator between the current regional regimes. EIOPA supports the development of a robust version of an international capital standard by the end of 2019. This version should then be reported privately by groups to their supervisor and used during a period of 2 or 3 years by international colleges of supervisors to ensure that all supervisors are comfortable with it. A final and fine-tuned standard should then emerge from this practical experience.

Regarding systemic risk, the challenge for the coming years is to develop the "third generation of systemic risk policy in the insurance sector". Building on the progress already achieved, work is being done on an activities-based assessment to complement the entity approach and deal with horizontal activities and business models that may become systemically relevant in adverse market conditions. Furthermore, the assessment of the transmission channels should be consistent with the risk-based measures developed for the international capital standard. The design of the policy measures should consider the mitigation factors and capital requirements eventually included in the micro-prudential regime in order to avoid loopholes or duplications.

Ladies and Gentlemen,

Insurance and reinsurance undertakings across the European Union are now subject to a harmonised, sound, robust and proportionate prudential supervisory regime, for which they have been preparing during the last years. Under the new regime EIOPA has an important role in order to monitor and ensure the consistent and convergent application of Solvency II. I believe that Solvency II not only brings numerous benefits for consumers and industry but it is also the right approach to investment by insurers.

Search for yield is part of the normal economic function but it becomes a topic requiring supervisory attention when it involves risk taking beyond the risk bearing capacity of an institution. In this context, exploring new types of investments although welcomed from an economic growth perspective needs to be pursued with the proper expertise, knowledge and resources in order to protect policyholders and avoid risks for financial stability.

On the day of the general election in the United Kingdom I should also shortly address EIOPA's actions as regards "Brexit". At this point in time, our priority is focused on the supervisory approach towards the insurers based in the United Kingdom seeking relocation of subsidiaries in the 27 European Union Member States. In order to collect evidence, EIOPA's oversight team is visiting national supervisory authorities engaged in discussions with companies in the United Kingdom. Empty shells or letter boxes are not acceptable. Sound supervision demands appropriate location of management and key functions including sound outsourcing and reinsurance policies. EIOPA intends to publish in due course guidance for national supervisory authorities on sound principles for authorization and supervision and will subsequently closely monitor their implementation. EIOPA is also closely monitoring any possible effects on financial stability and consumers.

Thank you for your attention.