SPEECH

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Sound risk management enhances Consumer protection, Stability and Reputation

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

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Ladies and Gentlemen,

It is a huge pleasure to be in here today in the Chief Risk Officer Assembly and be able to provide you with some thoughts on my vision for the insurance industry in 2025. It is risky business to look so far ahead. It makes me feel like Columbus heading west, not completely confident that he would not fall off the earth. But being a European supervisor is also a risky activity, so I embrace the challenge. Of course, as always every risk brings an opportunity, so this forward looking voyage gives me the chance to share with you some thoughts on important challenges for the industry.

I will touch on a number of issues viewed from 2025, all in a positive way:

1. The effects of risk based prudential regulation
2. Enhanced supervision
3. Conduct and consumer risk is seriously taken
4. Shifts in business
5. Macro-economic context
6. International standards

The effects of risk based prudential regulation

By 2025, one of the most relevant and innovative changes introduced by Solvency II, the ORSA, proved to be a truly game changer and definitely helped to promote a strong risk culture in insurance undertakings. Insurers relied more and more on strong risk management capabilities to deal with the different challenged posed by the economic slowdown, the low interest rate environment, the financial market volatility and the stress on sovereign debt.

It wasn't an instantaneous move. It took time, commitment, effort and specially a clear tone from the top. CRO's had a fundamental role in this process.

In 2025 boards 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 implementation of the ORSA was used as an opportunity to further embed the strong risk culture in the day to day operations of the undertakings, providing at the same time for an appropriate balance with the natural sales driven culture. Nowadays, in all insurance companies, risk considerations, and their capital consequences, are explicitly taken into account in the strategic decisions of the company.

This robust framework proved to have good effects on insurers' behaviour. Because you as a CRO ensure that we see sound risk management. That we see a more diversified investment policy and insurers investing only in assets whose risks they can identify, manage and control.

Insurers continue to take on risks (it's their core activity) and they price them in a more appropriate way. Markets don't penalise insurers for the remaining volatility in the prudential requirements, instead they have the transparency of economic balance sheets and risk based regulation.

By 2025 CRO's have an independent position, and use that independency to challenge everyone within the firm. You dare to ask the unwelcome questions, enhancing the right attitude and behaviour. Sometimes you have to be the hornet. No guts, no glory. All for the sake of the undertaking's most precious assets: reputation and stability.

In 2025 CRO's are key elements in a board structure. We don't have any more CRO's reporting to CFO's.

Enhanced supervision

By 2025 insurance supervision is much more consistent in the EU. EIOPA's efforts have paid off. The focus on better supervision initiated some years ago proved to be the right way forward. Not only is supervision now more preventive than reactive, but also more intensive supervision avoided the need for a continuous flood of new regulation.

Supervisors have now access to more qualified and experienced resources. Supervisors are addressing the problems early enough and have strengthened their supervision of conduct of business.

Integrated European supervision is centralised in a green tower in Frankfurt, coordinating a system of national supervisory authorities.

Conduct and consumer risk is taken seriously

In 2025, product governance, product suitability and appropriate selling practices are on the top of the agenda of the boards of insurance companies. Board members want to make sure that product characteristics are suitable to the target market, that distribution channels are appropriate for the market segment, that full transparency on costs is provided to consumers.

The insurance market has learned the lesson from the miss-selling cases occurred in the previous decade and also learned from the huge reputational and financial consequences stemming from the unacceptable misconduct behaviour of some financial institutions.

By 2025 insurers have incorporated in their governance systems adequate strategies and processes to deal with conduct and consumer risk. From product design to claims management, insurers take full consideration of the consumer related issues.

New consumer attitude prompts shifts in business

In 2025 consumers are more demanding; they are more aware of their rights. The 'web generation' demands greater transparency, comparability and flexibility from all service providers. Consumers demand more integrity and they don't trust so easily. The perception of poor quality service is rapidly transmitted and exposed through social media networks.

The most successful financial institutions provide an adequate answer to this change. They develop more simple and understandable products and devote further attention to the fairness of contractual conditions. There is full transparency of the remuneration and companies have a close eye on the charges and commissions applied, ensuring that they are not disproportionate.

This actually had a positive impact on the business. Simpler products have reduced cost structures, provide more competitive pricing and reduced the potential for miss-selling. By improving selling practices and avoiding conflicts of interest insurers serve their customers better and are compensated for it.

In 2025 insurance is one of the economic activities with higher growth potential. In fact, the evolution of society created more and more risks and citizens and businesses are more and more looking to transfer or mitigate them in an efficient way.

Regulation was a catalyst of positive movements. By moving towards a better alignment between risk and capital, promoting good risk management practices and fostering transparency, the insurance prudential regime, which was implemented in the EU back in 2016, created good conditions to develop a sound and sustainable business. The insurance market read the signs of change and acted.

In 2025 we face increased global demand for retirement products. Budget sustainability is inevitable4 reducing the generosity of social security systems, creating higher demand for 2^{nd} and 3^{rd} pillar private savings solutions.

The increase in longevity created a growing awareness that mitigating the risks of longer life expectancy will fall increasingly on households – we will need to save more in order to maintain sustainable levels of living after retirement.

In 2025 we see the emergence of new products combining retirement, healthcare and dependency. Insures are using ‘big data’ through social media to present tailor made solutions to different costumers. Different types of guarantees depending on the life cycle, including periods of capital preservation are popular. Product innovation is more and more critical and new intermediation channels are emerging. Furthermore, new entrants in the business are coming with a more sophisticated technological background much more prone to deal with commoditised products.

In 2025 we have specialized companies managing some back books of guarantees and an increase of innovation in capital solutions through securitization of mortality and longevity risks.

In 2025 the reinsurance industry continues to present robust business models. The influx of alternative capital into the reinsurance market through insurance-linked securities and catastrophe bonds was appropriately managed, without any build-up of risk, amend underwriting and reserving discipline was preserved.

Macro-economic context

By 2025 insurance companies are recognized as knowledgeable actors from a macro-economic perspective. Their increased role in providing retirement savings and the emergence of many public-private partnerships were instrumental in the business growth. This reinforced the investment power of insurers and made them interconnected with the real economy.

By 2025 general banks are fully aware of the relevance of insurance for the economy and consider thoroughly the effects of monetary policy in the insurance markets.

Insurance macro prudential policy has been developed in the last decade. Specialized and appropriate macro prudential tools, designed to take account of the insurance market features, are at the disposal of macro-prudential supervisors.

By 2025 there is no dispute about insurers being or not systemic. Risk based capital requirements have evolved and they capture all the risks including the ones that can lead to systemic events.

Appropriate capital charges are applied but, more importantly, strong risk management policies implemented under the control of CRO's actively mitigate the emergence of such risks.

The sovereign debt crisis is over

The sovereign debt crisis challenged some old maxims that guided the investment strategy of insurers and what was once considered risk free has been reassessed as not being so. The subsequent flight to safety saw a dramatic divergence in spreads on sovereign debt and led to a variety of actions on the part of insurers. Those insurers holding 'safe haven' assets were impacted by the low yield environment, while those holding assets issued by more vulnerable sovereigns found themselves exposed to credit risks. Being ever cautious, however, insurers did not unload their positions in sovereign debt in one go, but rather worked down their positions in a gradual manner. The home country bias in sovereign debt holdings remains, but we have seen some portfolio shifts towards corporate bonds as well as insurers exploring new asset classes. This latter development seems to reflect both a search to enhance yields and a desire for diversification.

This movement was done in a sustainable manner, preserving the good asset-liability management principles. CRO's were instrumental in ensuring that the political incentives towards certain particular investments did not result in risky concentration policies.

The constraints facing the banking sector have provided an environment where insurers were approached to engage in credit provision, in particular to provide funding for infrastructure and SMEs.

By 2025 the investment spectrum of insurance companies is truly diversified. Insurers took advantage of the move towards a more capital market driven system and enlarged their asset category holdings.

We don't see the concentration in sovereigns and financial sector (especially banks) that we have observed in the past. Bail-in systems implemented in the banking sector contributed to this.

International standards

By 2025 a global capital standard is also available for the insurance sector. International active groups are slowly becoming subject to a level playing field from the solvency perspective.

As usual the EU was in the front row of the implementation. The Solvency II (adapted) regime is widely seen as a practical implementation of the international capital standards.

In the banking sector, Basel 5 is underway. It seems that the old leverage ratio will become more risk based because it seemed to give the wrong incentives to banks.

Basel 5 is finally dealing with the difficult issue of the interest rate risk in long-term guarantees provided by banks. It seems plausible that a Solvency II type of approach will be applied.

Concluding

You may think: is this is a vision or a wish list? It doesn't matter! The important thing is to set goals for the future and establish strategies to get there. In the way there will be lot of challenges and dangers. Different risks and obstacles will arise. There is a lot to do, but a lot has already also been done.

It takes a lot of courage to think and act independently and long-term. That’s my role and it’s your role. It’s not an easy one. When you despair, once in a while, remember Columbus. He looked for India and never got there. But he discovered a whole New World, full of promises.

Thank you for your attention.