KEYNOTE SPEECH

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Future of the insurance supervision and challenges for Ireland

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

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Ladies and Gentlemen,

I would like to congratulate the Central Bank of Ireland in the person of its Deputy Governor Cyril Roux for the organization of this event and thank the Insurance Director Sylvia Cronin for inviting me to speak to such a distinguished audience.

Three years ago being here in Dublin, I said that the thoughts about the future of financial regulation associate to me with one of my favourite songs by U2 "I Still Haven't Found What I'm Looking For". At that time we faced a high degree of uncertainty about the future of Solvency II.

Now, when less than 9 months remain before the entry of the new framework into force, I am thinking about another U2 song – "Elevation", and also reflecting that like in Bono's lyrics and The Edge guitar solo, Solvency II sometimes also developed in "Mysterious ways".

2015 will be a challenging year for the EU insurance industry as we move to the full implementation of Solvency II from 1 January 2016. EIOPA has been working hard, together with the National Supervisory Authorities in all member states, to ensure a successful transition to the new regulatory regime.

In my intervention today I would like to share with you some thoughts about a number of fundamental elements that we need to get right in order to reap the proper benefits from Solvency II implementation and explain how I see the role of EIOPA in the move from regulation to supervision. Thereafter, I will make reference to some aspects that I find particularly relevant for the Irish market and will end with some challenges going forward.

As the time is coming for the full implementation of Solvency II it is appropriate to look back and reflect on what we have achieved.

The EU was faced with an outdated and fragmented regulatory and supervisory regime in insurance. Solvency I is not risk sensitive, contains very few qualitative requirements regarding risk management and governance and does not provide supervisors with adequate information on the undertakings' risks: consequently, national authorities have been introducing different add-ons in their regimes in order to cope with market developments.

Solvency II was built with the objective to increase policy holder protection, using the latest international developments in risk-based supervision, actuarial science and risk management.

Coming back to the basics, it is fair to say that Solvency II is based on fundamentally sound principles:

- A total balance sheet approach and an economic market consistent valuation of assets and liabilities in order to have a realistic basis for assessing risks;

While the main principles were preserved along the way, it is fair to say that the valuation of long-term liabilities in the life business proved to be a real challenge.

The long-term guarantee package is a political compromise. And, as all political compromises, it strikes a balance between different interests. The adjustments included in the regime like the matching adjustment, the volatility adjustment, the ultimate forward rate in the calculation of the relevant risk free rate, - they all pretend to deal with the inherent volatility of market consistent valuation and mitigate part of it considering the underlying economic rationale of the business.

These are complex adjustments, but they are transparent and we will see their effect through the disclosure requirements.

- Two capital requirements, MCR and SCR, assuring a risk based calculation but also a more robust and simpler floor designed for ultimate supervisory action.

This is a very important feature of the new system. We ended up perhaps with a too complex SCR formulation, but risk sensitivity is definitely achieved.

We have an overall level of prudence in the calculation of capital requirements and the regime provides an explicit recognition of risk diversification.

We have the possibility to use internal models after a process of validation by supervisors that is focused not only on the quality of risk modelling but also on the actual use of the model in the day-to-day business decisions;

- We have an updated group supervision approach with the definition of a group solvency requirement and clear powers assigned to the group supervisor;

- A robust system of governance, including the definition of a number of key functions.
- An own risk and solvency assessment (ORSA) that is now considered as the best practice at an international level.
- EU harmonised templates for supervisory reporting and enhanced public disclosure.

Does this make Solvency II "the perfect regulatory regime"? No, for the simple reason that there is no perfect regulatory regime as such.

Solvency II is a pretty good starting point for risk-based regulation in the EU. We will start with the implementation in 2016, we will take our lessons and the regime will evolve like all things in life do.

The implementation of Solvency II will be a test for undertakings and supervisors in the EU.

Let me touch upon a couple of challenges:

The ORSA and risk culture

The ORSA needs to be a truly game changer, helping to promote a strong risk culture in insurance undertakings. We need to see insurers relying 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 ORSA is not an instantaneous move. It takes time, commitment, effort and especially a clear tone 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 implementation of the ORSA should be 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. We need to see in all insurance companies that risk considerations and their capital consequences are explicitly taken into account in their strategic decisions.

The validation and approval of internal models

Solvency II is one of the first insurance regulatory regimes in the world to allow for the use of internal models to calculate the undertaking's Capital Requirements. Conceptually, internal models will be more risk-sensitive, will better capture individual risk profiles and will provide a better alignment between the truly underlying economic risks and the capital requirements placed on insurance companies by Solvency II.

However, internal models are subject to validation and approval by supervisory authorities. Insurance companies and groups need to demonstrate that their internal model meets a number of requirements: the use test, statistical quality standards, calibration standards, validation standards and documentation standards.

The development of an internal model is a burdensome task, both from the technical and the management perspectives. It requires huge effort and investment and the capacity to ensure that changes in the underlying economic risk reality are adequately captured on an-going basis. Furthermore, we all know that models will always be an imperfect approximation of reality and so model risk needs to be captured.

As insurance supervisors we observe that the use of internal models in the banking side has been subject to increased scrutiny and scepticism. Lessons need to be learned.

Going forward, it is the responsibility of the Boards of insurance companies to make sure that internal models will continue to adhere to the highest possible technical standards and that the corresponding capital will continue to fulfil the prudential requirements set out in the Solvency II regime.

A tone from the top is also needed here, to ensure that as time goes by internal models will not be transformed in a capital optimization tool. A race to the bottom will kill the underlying idea of an internal model.

Solvency II harmonized reporting requirements

Another major step of Solvency II is the harmonization of reporting requirements. This will allow huge economies of scale for the industry, especially for cross-border groups, and will create a basis for consistent risk-based supervisory analysis within the EU.

Bearing in mind the challenges of implementing a new reporting system, EIOPA has dedicated since a long time special attention to this work stream, extensively engaging with industry and other stakeholders through various consultations. The comments and suggestions received helped us to shape a more efficient and proportionate reporting package.

Let me also highlight that EIOPA worked very closely with the European Central Bank (ECB) to align the new ECB statistical reporting requirements with the Solvency II reporting requirements. The result is that a large part of the ECB requirements will be met by the Solvency II data and the additional reporting in the form of ECB add-ons will be provided within the same reporting framework. This avoids, to the maximum extent possible, any unnecessary burden on the industry.

Recognizing the need of early engagement and preparation, EIOPA included the provision of information to supervisors in the Solvency II Preparatory Guidelines.

Lastly, in the first quarter of 2015, EIOPA has publicly consulted on the final reporting package. We totally understand that finalizing a reporting package so late in the process of implementing Solvency II is not the optimal solution. However, the reality is that only after the publication of the Delegated Acts on Solvency II EIOPA could finalize the templates and consult on them. Facing the changes coming from the Long Term Guarantees Package, we have done our best to limit the modifications in the final templates compared to the preparatory phase ones. We will continue to engage with the industry and other stakeholders to fine tune the final templates and reporting deadlines.

As part of this process EIOPA will maintain a workshop with stakeholders on the 24 April to better understand key stakeholders' comments and discuss possible solutions to overcome the main difficulties. The time has come to make a final push in preparing for the actual submission of information. Both the industry and supervisors will benefit from this last effort.

The new reporting requirements will increase the quality of the data available in the companies, which is a fundamental element to upgrade risk management.

At the same time, supervisors throughout the EU will have access to better and more granular data on assets and liabilities of insurers, allowing for a quantum leap in terms of risk-based supervision.

From regulation to supervision – The strategy of EIOPA

Solvency II is a huge step forward for policyholder protection and the implementation of a true single market in the EU. But good risk-based regulation remains just a first step. You can only say something is a success after it has been tried out or used, or as the proverb says, "The proof of the pudding is in the eating". It is now up to the insurance industry, National Supervisory Authorities, EIOPA and the insurance professions to bring Solvency II to life on 1 January 2016.

Going forward, EIOPA's main responsibility is to develop a European supervisory culture that can ensure that Solvency II is implemented in a consistent way throughout the EU. Knowing the current different supervisory cultures in the member states you would agree with me that this is a huge task.

EIOPA is instrumental in delivering the desired outcomes and since 2013 we started to refocus our strategic approach in the insurance area from regulation to supervision.

First of all, let me mention our work on Technical Standards and Guidelines. In the Technical Standards we define forms, templates and procedures for specific areas under Solvency II, while by our Guidelines we ensure common, uniform and consistent application of the regime and establish consistent, efficient and effective supervisory practices.

In October 2013, EIOPA issued the Guidelines for the preparation of Solvency II, paving the way for a consistent preparation of the new regime by insurers and supervisors during 2014 and 2015.

In October 2014, EIOPA delivered to the European Commission 6 Technical Standards on the supervisory approval processes for Solvency II that have been recently published in the Official Journal. We are now finalizing the review, after a public consultation, of another 10 Standards, including the crucial harmonization of regular reporting requirements by insurance undertakings in the EU.

At the same time EIOPA developed Guidelines in a number of areas, 19 were published in February 2015 and 8 are under review after consultation. Some of these Guidelines concern the basic alignment of supervisory processes while others provide clarity to firms on what are supervisors' expectations and limit the risk of divergent interpretations by national supervisors.

I understand the concerns from some parts of the industry in relation to the sheer volume of regulation and will be extremely attentive to limit further regulatory texts in the coming months to the indispensable ones. But I remain convinced that overall the benefits in terms of supervisors alignment, level playing field and better policyholder protection will outweigh the costs.

But EIOPA's role goes well beyond issuing standards and guidelines. Our vision is to build EIOPA as a credible supervisory authority within the European System of Financial Supervision. We are focused on adding value to the overall supervisory process in the EU, using our unique position to upgrade the quality and consistency of national supervision and strengthen the oversight of cross-border groups.

Our oversight activities are structured in 3 main areas: the participation in Colleges of Supervisors, the Centre of Expertise in internal models and the Supervisory Oversight team.

Colleges of supervisors

We intend to strongly use and continue reinforcing EIOPA's participation in the colleges of supervisors. In the EU, in most of the Member States, colleges have made good progress in the last years and have been fundamental to increase the exchange of information between supervisors worldwide, moving towards a more common analysis and measurement of risks.

The implementation of Solvency II represents a big change for colleges. EIOPA has prioritised the consistent and coherent functioning of colleges and we will closely follow the implementation of the new risk-based requirements, starting with the discussions around internal model approval.

EIOPA staff will keep on working closely, in both informal and formal way, with group supervisors and individual supervisory authorities to improve the status and quality of the Colleges work.

EIOPA's Centre of Expertise in Internal Models

EIOPA's Centre of Expertise in Internal Models was created two years ago with the objective to contribute to the enhancement of convergence and consistency through the development of new tools and practices in the area of internal models.

The Centre proved to be very instrumental. Last year it helped to develop the Common Application Package aiming to promote consistent supervisory practices for the application processes related to internal models. The package supported insurers in understanding the granularity of documentation and evidence that is required for the formal application process.

Recently EIOPA issued the Opinion on Internal Models covering some key areas where we found inconsistencies in approaches. In the Opinion we provided our position that for example risks related to Sovereign Exposures should be appropriately taken into account in internal models. We provided guidance to NSAs on how to assess applications prepared in the absence of some related formal decisions, including decisions on granting equivalence to the third countries; and finally on the need to use comparative studies on internal models at the national and EU levels.

Currently the Centre focuses on the development and testing of sound on-going appropriateness indicators and benchmarking.

Later on, we will engage with the NCAs in a follow-up exercise to our Opinion. Our goal will be to understand what actions have been taken in light of this Opinion and afterwards to consider the further measures required.

Supervisory Oversight Team

In order to build trustful relations with the NSAs, which would allow EIOPA to provide independent and challenging feedback on supervisory practices, we created a Supervisory Oversight Team.

Last year, this team already conducted 10 bilateral visits to the national supervisory authorities. As part of its oversight role and in close cooperation with the national supervisory authority, EIOPA is overseeing the balance sheet review of the Romanian insurance sector.

At the same time I would like to underline: EIOPA does not replace national supervisory authorities. The responsibility of the day-to-day supervision of individual undertakings and groups rests with the NSAs.

In 2015, EIOPA adopted a multi-annual Oversight Strategy with the following goals:

- To achieve a convergent approach to supervision across the EU in order to bring a level playing field, and remove scope for supervisory arbitrage.
- To ensure a consistent implementation of European regulatory and supervisory frameworks.
- To increase the quality of supervision in the EU, including contributing to an appropriate supervision of undertakings within the EU, and finally
- To increase the overall efficiency of the supervisory system by promoting effective exchange of information and developing high quality supervisory tools.

Our strategic oversight approach is to gain experience, gather information and build trust and credibility. We want to improve quality, efficiency and consistency of the supervision of insurance firms.

EIOPA's feedback to NSAs can be about different issues: for example about the way they interpret and implement EU regulations; their information exchange with other authorities; risk and financial stability analysis; actions or non-actions to particular events.

EIOPA's feedback will be insightful, because it comes from experienced staff and is based on their observations and data about individual NSAs in the context of a view across multiple NSAs. At the same time our feedback can sometimes be challenging. Convergence often implies change and movement from the status quo.

As part of our oversight work we also perform "Peer Reviews". Their purpose is to compare and assess the practices of supervisors and contribute to the creation of convergent supervisory standards.

EIOPA has developed methods allowing for the objective assessment and comparison between the authorities reviewed. On the basis of the Peer reviews, EIOPA identifies the outcomes achieved; best practices and makes concrete recommendations for improvement.

Underpinning all the supervisory convergence agenda, EIOPA is also developing a Supervisory Handbook. The objective is to build an array of good supervisory practices on the different areas of Solvency II.

We have already covered areas like risk assessment; how to supervise board responsibility within the Solvency II governance system; business model analysis; supervision of non-life technical provisions; proportionality in the key functions of the system of governance; as well as prudent person principle in investment policy.

EIOPA encourages NSA's to adequately implement these good practices in their supervisory processes.

In my view, this programme fully reflects on the purpose for which EIOPA was created: to promote supervisory convergence; to contribute to upgrading of the quality and consistency of national supervision and to strengthen oversight of cross-border groups. Strong and credible supervision is needed across the EU. It is essential to avoid market fragmentation and deliver a truly level playing field in the internal market, for the ultimate benefit of EU undertakings and consumers.

Let me now touch on particular aspects relevant for the Irish market.

Proportionality approach in Solvency II

The Solvency II framework was designed not only for big insurance groups but also for small and medium sized undertakings (SMEs). While developing our preparatory Guidelines we already took a close look at the proportionality issue. And today I would like to reassure the Irish SMEs that for the next years EIOPA will continue to focus on the proper application of the proportionality principles in the insurance regulation and supervision.

Therefore, I welcome the Irish PRISM risk-rating system, which differentiates different impacts of undertakings and sets up for example different reporting deadlines and easier conditions for the ORSA. This approach is fully in line with Solvency II principles. The implementation of the new regime should not be disproportionately burdensome for SMEs. And EIOPA’s goal in this regard is to make sure that Solvency II is implemented in a manner which would be proportionate to the nature, scale and complexity of the companies’ risk profiles.

In order to support the SMEs, in the 3rd quarter of 2015, EIOPA is going to publish the Tool for Undertakings (T4U) related to XBRL reporting under Solvency II. With this tool we aim to assist SMEs in creating, editing and validating XBRL documents. The T4U will help firms without knowledge and resources to implement Solvency II harmonized quantitative reporting in XBRL. We provide the tool free of charge and intend to decommission it after undertakings conduct the first Solvency II reporting in the second half of 2016. By then we expect that more advanced market solutions will already be available.

The Solvency II Directive, Delegated Acts, Standards and Guidelines provide a good basis for the convergence of supervisory practices in the EU. But there are still certain aspects of supervision of the insurance industry that are not harmonized by the Solvency II framework. In this context, I fully support the decision from the CBI to retain a number of elements of the existing Irish regime, in particular regarding the governance framework supporting reserving requirements. Elements like peer reviews by actuaries, establishment of reserving committees and of a reserving policy are key tools to support the management, oversight and supervision of insurance undertakings. I believe that this good practice should be followed by other countries.

Let me also use this opportunity to congratulate the CBI for the excellent and structured approach to Solvency II implementation and for the full implementation of EIOPA's guidelines.

Furthermore, I want to highlight the high quality of the structured communication with the industry. Top of the class.

Lastly, a word on the excellent contribution that Irish colleagues have made to EIOPA - both at senior level in the Board of Supervisors, and at expert level in the different EIOPA's structures. High level quality of intervention and a much appreciated constructive spirit and European vision. Thank you.

Challenges going forward - Conduct Risk regulation and supervision

The crisis alerted all of us to the effects and impacts of conduct of business failures on customers of financial institutions. Furthermore it is also evident that those failures can pose a threat to the stability of the financial sector.

In particular, the miss-selling of financial products can pose high detriment to individual consumers and creates lack of trust in the sector.

The usual factors that drive miss-selling such as information asymmetries, misaligned incentives of sales or poor product oversight, require action by board of companies and a specific supervisory approach.

In the specific case of the Irish insurance market, special attention needs to be devoted to the fulfilment of the general good provisions of host countries by the companies selling cross-border. Any failures in this area can have huge reputational consequences.

Overall there are 4 lines of action that are paramount:

Strengthening corporate governance

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.

But it is not only about designing and putting in practice appropriate governance structures and controls. It is now time to ensure that they are effective and that they 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.

Reinforcing the regulation of product oversight and governance and sales incentives

To address miss-selling practices, changes are required in the companies processes related to the manufacturing and distribution of products.

From the inception of the process of bringing a new product to the market, new rules are needed to reduce the risk of miss-selling: when designing products, manufacturers have to identify the target market of the product, analyse its characteristics and ensure that the product meets the identified objectives and interests of that target market.

The distribution channels selected also have to be appropriate for the target market and clear, accurate and up-to-date information has to be disclosed to distributors.

In effect, companies need to establish processes so that they and their senior management and boards can take more responsibility for ensuring their products are only sold to those they are designed for.

These and other principles are part of a common position published by the Joint Committee of the three European Supervisory Authorities and are further developed in a guideline on „ Product oversight and governance‟ recently put out of public consultation by EIOPA.

Furthermore, another element that has long been considered a major driver of miss-selling is the use of inappropriate arrangements over sales incentives, both in direct and intermediate sales.

New rules and principles coming from IMD2 (or IDD) should be implemented in an effective way to mitigate possible conflicts of interest.

Enhancing conduct of risk supervision

Conduct supervision on a risk-based and systematic basis should continue to be strengthened.

This entails putting in place systematic monitoring to identify conduct risks as these develop, and processes for assessing those situations in which additional supervisory measures should be considered, including the use of thematic reviews, for instance to „deep-dive‟ into specific market segments.

Monitoring should be developed on the basis of appropriate risk-based indicators.

Furthermore, supervisors should perform off-site analysis as well as on-site and „mystery shopping" activities. These supervisory practices, as well as the monitoring of complaints and other conduct risk indicators, could be particularly effective in reaction to the miss-selling of products or other detrimental practices towards clients.

EIOPA will take this work as a priority for the coming years in the field of Consumer Protection. Also in this area supervisory practices in the EU need to be more consistent.

Credible and dissuasive enforcement

Supervision should always be flanked by enforcement. Without credible and dissuasive enforcement, conduct risks can become a „cost of doing business‟.

However, evidence shows that the sanctions applied vary between countries. It is also worth noting that individual sanctions have been rarely applied. This is an area where further harmonisation would be needed at an EU level.

Conclusion

Let me conclude.

In the insurance sector the following years will be fundamentally impacted by the implementation of Solvency II. This represents an enormous opportunity to improve risk management, embed a risk culture in the organisations and develop sustainable business models putting customers at the centre of the undertaking's strategy. It also creates an opportunity to improve the functioning of the internal market, in particular by ensuring a high, effective and consistent level of supervision, preventing supervisory arbitrage, guaranteeing a level playing field and ensuring a similar level of protection to all policyholders.

I am confident that if both insurers and supervisors remain faithful to the sound, basic principles of the Solvency II framework, the results for enhanced consumer protection and financial stability will be very positive.

Like Bono's song back in 2000 it's going to be a "Beautiful Day".

I count on the Irish market to adopt and live up to the Solvency II principles and deliver sound and sustainable business practices and strategies for the benefit of European citizens and companies.

Thank you.