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Chairman of EIOPA

Statement

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

Hearing at the Economic and Monetary Affairs (ECON) Committee of the European Parliament
Brussels, 14 September 2015

Mr Chairman,

Honourable members of the Committee on Economic and Monetary Affairs,

Thank you for inviting me to our regular exchange of views which plays a fundamental role in honouring our accountability towards the European Parliament. This hearing provides me with the opportunity to report to you on how we are achieving our objectives and delivering on the tasks assigned to us during the last year and to highlight some of the challenges that we are facing going forward.

Supervisory convergence

I am happy to be here just less than four months before the full implementation of EIOPA's top-priority project - Solvency II, which will start on 1 January 2016. Since the end of 2014, the strategic focus of EIOPA's work on Solvency II has been on **supervisory convergence,** with the aim to ensure the highest consistency possible in the implementation of Solvency II across the EU. This is a project that has delivered state-of-the-art risk-based regulation in Europe, and which is the outcome of joint efforts by the co-legislators, regulators, supervisors and industry and consumer representatives. The European Parliament has played a key role in this process.

As a first step towards ensuring this consistency, in the past 12-month period, EIOPA delivered in total 18 **Implementing Technical Standards (ITS)**, of which six have already been endorsed by the European Commission (EC). We also delivered two sets of **Guidelines** that cover the most relevant areas and elements of the Solvency II framework. Some of these Guidelines concern the basic alignment of supervisory processes, while others provide clarity to firms on supervisors' expectations, while reducing the risk of divergent interpretations by national supervisors.

While regulatory stability is paramount in the run up to the Solvency II implementation date, EIOPA quickly responded to a request to take a more granular look at the treatment of **infrastructure projects**. During the first half of this year EIOPA published a discussion paper; consulted representatives of public authorities, insurance and infrastructure industries, asset managers and academics; and finally launched a public consultation in early July. In the consultation paper we propose new definitions and criteria for identifying qualifying infrastructure debt and equity investments, which may warrant more specific treatment in the standard formula capital calculation. We made some proposals for a better calibration of the treatment for these qualifying infrastructure investments and additional risk management requirements. Currently we are considering the feedback received during the public consultation and our final advice will be submitted to the European Commission by the end of September. One thing is clear to me: calibrations need always to be based on evidence, and we should stand firm against privileging or incentivising specific asset classes. A regime that creates incentives that are not properly aligned with risks will see the emergence of price distortions and vulnerabilities.

Knowing that new legislation is always more burdensome for smaller companies, we have made the **proportionality principle** a cornerstone of our work. 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 companies' risk profiles.

Proportionality is embedded for example in the Solvency II **regulatory templates,** a significant area of potential costs. So, we have ensured that companies with simple business models, few business lines and simple investment strategies will see their reporting requirements significantly diminished. SMEs will see reduced frequency in reporting, with quarterly reporting concerning only some core elements. Furthermore 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.

In order to support SMEs even further, in summer 2015 EIOPA published the Tool for Undertakings (T4U) related to XBRL reporting under Solvency II. With this tool we assist SMEs in creating, editing and validating XBRL reporting documents. The Tool is offered for free and will help firms without knowledge and resources to implement Solvency II harmonized quantitative reporting. Estimations show that approximately 1,200 undertakings will make use of the T4U. The Tool is also widely used for quality assurance purposes both at SME and NCA level.

The availability of relevant Technical Information is also of great importance for the industry and supervisors during the preparations for full implementation of Solvency II. Since February 2015 – well ahead of the actual implementation date - we have therefore been **publishing the relevant risk free interest rate term structures** and related components. This information is a key input for the assessment of the (re)insurance companies' solvency and financial positions. The use of harmonised relevant risk free interest rate term structures will ensure the consistent calculation of technical provisions by (re)insurance companies throughout the European Union.

EIOPA also adds value to Solvency II implementation by strengthening the oversight of cross-border groups, and in general upgrading the quality and consistency of overall supervisory processes in the EU.

Our oversight activities are structured in 3 main areas: Colleges of Supervisors, the Centre of Expertise in Internal Models and Supervisory Oversight.

Colleges of supervisors across the EU have been fundamental in increasing the exchange of information between supervisors, moving towards a more common analysis and measurement of risks. EIOPA's actions ensured consistent processes at college level and are now focused on more substantial aspects of supervision and supervisory decisions, for instance closely following the discussions around internal model approval.

Created two years ago, our **Centre of Expertise in Internal Models** proved to be very instrumental in developing new tools and practices in the area of internal models. In December 2014, we published the Common Application Package, which supported insurers in understanding the granularity of documentation and evidence that is required for the formal internal model application process. In April 2015, EIOPA issued a supervisory **Opinion on Internal Models** covering some key areas where we found inconsistencies in approaches, for example risks related to Sovereign Exposures and the absence of formal decisions on equivalence. We provided relevant guidance to NCAs and plan to engage with them in a follow-up exercise. Currently the Centre focuses on the development and testing of sound on-going appropriateness indicators and benchmarking for internal models.

In 2014, we created a **Supervisory Oversight Team** to continue building our relations with NCAs on a basis of mutual trust, while providing NCAs also with a chance for independent and challenging feedback on supervisory practices. In the period under reference this team already conducted 18 bilateral visits to the national supervisory authorities.

As part of its oversight role, EIOPA has in particular been engaged with the national competent authority **in strengthening supervision in Romania**. EIOPA contributed to a **balance sheet review** and stress test of insurance companies representing more than 80% of the Romanian market. Both exercises were completed in July 2015, and in full transparency a report was published that identified a need for significant adjustments to the balance sheets and corresponding prudential ratios of a number of insurance undertakings, followed by a number of supervisory measures. This was a credible exercise that proved fundamental for enhancing consumer protection and confidence in the Romanian insurance sector.

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

Finally a reference to the important work performed by EIOPA on the development of **international standards** in insurance. EIOPA's presence in the IAIS has been a catalyst for a stronger and more aligned representation of EU supervisors.

Consumer protection

Consumer protection is since day one an integral part of EIOPA's DNA and continues to guide our priorities. EIOPA pursued works simultaneously on different issues that are crucial for consumer protection: **transparency, conflicts of interest and conduct risks.**

Preparing the future implementation of the new Insurance Distribution Directive EIOPA developed work on **product oversight and governance** by insurance undertakings. Insurers need to implement proper processes to deal with product design, development and marketing as well as to identify and manage consumer risks.

Furthermore, EIOPA started to develop a **comprehensive risk-based and preventive framework for conduct of business supervision** on a European level.

Failures in business conduct can pose a serious threat to the stability of the financial sector, while mis-selling on a mass scale can lead to serious detriment to individual consumers. This can result in significant reputational damage for companies and for consumers in a material loss of confidence in the financial market.

To address these concerns, EIOPA is developing a framework **which anticipates emerging consumer detriment, rather than just reacting to problems after they have occurred**. This entails putting in place systematic monitoring to identify conduct risks as these develop, and proportionate 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.

On the **pensions** side EIOPA worked on the response to the Call for Advice from the European Commission on the development of an EU-wide framework for personal pension products. In July 2015, we launched a public consultation where we suggested the creation of a **simple, trustworthy, standardised and fully transparent pan-European personal pension product, the PEPP**. Creating a truly single market for personal pensions in the EU can reduce costs and provide better returns to consumers by increasing economies of scale. It can also help the provision of long-term stable funding to the EU economy and be a catalyst of the Capital Markets Union. Ultimately it can reinforce the trust and confidence of EU citizens in the EU project.

After the public consultation is completed, we intend to submit our final advice to the Commission in the beginning of 2016.

Financial Stability

In line with its mandate, EIOPA continued to initiate and coordinate **EU-wide stress tests** with the purpose to assess the resilience of financial institutions to adverse market developments.

In November 2014, we completed an EU-wide stress test for insurance companies based on the upcoming Solvency II regime. We tested a range of credible adverse market scenarios, developed in conjunction with the ESRB, complemented by a set of independent insurance-specific shocks covering mortality, longevity, insufficient reserves and catastrophe shocks. An additional stress test module addressed the impact of a low yield environment.

The EIOPA insurance stress test has provided EU supervisors with an updated picture of undertakings' preparedness to comply with the upcoming Solvency II capital requirements. By applying a set of rigorous and severe stresses we were able to identify the areas where companies are most vulnerable, in a coordinated and consistent way across the entire EU.

EIOPA's stress test results showed that the insurance sector is vulnerable to a "double hit" scenario that combines a readjustment of risk "premia" with decreases in asset values due to a continued lower risk free rate.

In the current market situation, action is clearly needed from the industry to deal with the vulnerabilities of "in-force" business and to restructure product mixes. Especially within the context of the low interest rate environment, it is important that firms use the time given under Solvency II transitional measures to take the necessary steps to restructure their business models.

As a follow up to the stress test EIOPA issued a set of Recommendations to NCAs. Our recommendations ensured that identified vulnerabilities are addressed by NCAs in a coordinated and consistent way. Supervisors must continue to monitor the situation very closely and challenge the industry on the sustainability of their business models.

In May 2015, EIOPA launched a stress test for occupational pensions. In cooperation with the ESRB, we designed a stress test that considers the key vulnerabilities of pension funds. We highlight as two adverse market scenarios the effects of a prolonged low-interest rate environment together with an independent fall in asset prices. Moreover, we have included a stress scenario analysing further increases in life expectancy.

The objective of the exercise is to test the resilience of Defined Benefit (DB) and hybrid pension schemes to adverse scenarios as well as to identify potential vulnerabilities for Defined Contribution (DC) schemes. The results of the stress test analysis will be disclosed in December 2015.

As part of our work on the **solvency of pension funds**, we are collecting quantitative information on the impact of different supervisory approaches. We aim to finalize our own initiative work in the first quarter of 2016 with an EIOPA Opinion on a possible framework to access the sustainability of pension promises. Both the stress test and quantitative assessment were launched simultaneously and have the same reporting template. This was done on purpose in order to limit the burden on IORPs and supervisors and to avoid the duplication of calculations.

Way Forward

Looking back over the last 12 months, I can proudly state that EIOPA has been instrumental in progressing the EU regulatory agenda in insurance as well as occupational and personal pensions.

We have reinforced our oversight activities for the sake of stronger supervisory convergence. We have taken fundamental steps towards enhancing consumer protection for the future.

Our stress tests serve as a very important supervisory and risk management tool not only for competent authorities but also for the insurance and pensions industry. And finally such work streams as the treatment of infrastructure investments and a pan-European personal pension product contribute to one of the Europe's priority goals – the Capital Markets Union.

Taken together, our work of the last year and the coming period shows our continued commitment to preserve financial stability in the EU and enhance the protection of European consumers.

Looking forward, I would like to focus on two main challenges:

1. The post-evaluation of regulation

EIOPA will be very attentive to any material **loopholes or unintended consequences** of the implementation of Solvency II, especially if they have a negative impact on consumers. Areas like the investment behaviour of insurers and product availability and suitability for consumers will receive special attention. In a period of low interest rates it is of course rational to engage in a "search for yield" but this can create additional risks for insurers, in particular if they invest in unfamiliar asset categories or increase concentrations in certain specific assets. Furthermore, insurers will need to adapt their product design in a sustainable way, pricing correctly the different guarantees and options included in the contracts. In order to be prepared to perform this evaluation EIOPA needs to ensure the collection and processing of relevant data from the supervisory reporting system being developed for Solvency II. Appropriate market evidence will also need to be collected.

2. The convergence of supervisory practices

In spite of the significant progress that we already made in building up a common European supervisory culture, the way towards supervisory convergence remains a tremendous challenge. Convergence is a journey and often implies change and movement for each party from their status quo.

But the benefits of convergence are clear. Our oversight work is starting to prove its vital importance by helping to improve the quality and consistency of supervision in the EU. As we are in an internal market, the quality of national supervision is not only a local issue; it is an EU issue. The EU supervisory system is only as strong as its weakest link. Stronger and more coordinated supervision at the EU level is therefore needed.

Credible and independent supervision is also key for improving the confidence of consumers and investors. It is in all stakeholders' interest that EIOPA has sufficient human and financial resources to ensure that NSA's apply proper and convergent risk-based supervision. EIOPA's drive towards convergence and dialogue amongst NCAs, is essential for avoiding a "mechanistic" and "tick the box" approach to supervision, detrimental both to consumers and the industry. Indeed, the very success of Solvency II depends on a systematic move away from just such mechanistic supervision, and I believe EIOPA has a crucial role in driving forward this change in practice.

Our work on these two challenges will be central, I think, to the coming years. Finally, allow me to use this opportunity to thank the European Parliament for its continuous support to EIOPA. I sincerely hope that we can continue to carry on our efforts in the spirit of fruitful discussions and cooperation.

I look forward to answering your questions.