DINNER SPEECH

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Stability and growth – A balancing act

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Ladies and Gentlemen,

I am very pleased to be here with you tonight.

First of all I would like to thank the organizers for their invitation to deliver this short dinner speech. It is my pleasure as Chair of EIOPA, the European Insurance and Occupational Pensions Authority, based in Frankfurt, to welcome you to such an important congress.

The Institutional Money Congress is known as a significant communication platform for institutional investors, providing an ideal forum for professional exchange between internationally renowned asset managers and institutional investors. This year it will also be an opportunity to debate the challenges posed by recent regulatory initiatives, such as Solvency II and Basel III, and discuss their possible effects on the investment policies of financial institutions.

As for challenges I think there is no doubt that the development and implementation of these regimes requires significant effort not only from regulatory and supervisory authorities, but also from the industry. The more these issues are discussed, the easier we will build up a new financial culture based on robust standards of solvency, enhanced risk management and increased consumer protection. And by launching discussions and different workshops on such topics, the Institutional Money Congress creates a basis for this culture. Because only by discussing, by exchanging views we can reach a full understanding of the regimes by all market participants.

Let me start by using this opportunity to make some remarks about the possible consequences of Solvency II on the investment behaviour of insurers and more generally on the financial markets.

It is clear that applying capital charges for investment risk may encourage insurers to shift to less volatile investments, especially when the expected financial returns of risky assets do not off-set the additional capital requirement. However, as insurers are aware of the changing regulation and have been rebalancing their portfolios accordingly, there should not be any significant sudden portfolio reallocations.

Most importantly, a reduction of investment risk could also be achieved by an improvement in asset-liability management, especially on long-term guaranteed products. That is the purpose of the strong focus of Solvency II on enhancing risk management policies and practices. Controlling and ensuring sound and prudent management is far more important than the capital calculations, because management errors by their nature cannot be compensated by capital requirements.

As a consequence of a greater focus on asset-liability management, insurers could be willing to invest more in relatively highly-rated corporate bonds since they offer higher yield and would provide diversification benefits within the fixed income portfolio. Therefore, easier access to financing could be granted to firms with high credit ratings, which will translate into a lower cost of capital and would therefore contribute to higher investment and economic growth.

Overall, regulatory regimes are always a result of a balancing act between different objectives. I am convinced that Solvency II will provide an appropriate basis for increased policyholder protection and will contribute to reinforcing financial stability, while allowing insurance companies to continue to play their role as long-term investors.

In a recent paper one of your distinguished guests, Prof. Thomas Sargent, discussed where to draw the line between stability and efficiency. In my opinion this is a fundamental question for the policy decisions to be taken in the coming years. We need to decide what we want to privilege: security or growth. If we want both, and I believe we should, then we need to be prepared to collectively accept some risks.

One of the major consequences of the financial crisis was the fall of confidence and trust in the financial sector and increase in suspicion on all areas of financial innovation. Unfortunately, the benefits of financial innovation have been overshadowed by the costs of some activities that went really bad.

I believe regulators and the industry need to take a fresh look at this area. Financial innovation tools can be a useful way for investors to protect themselves against unavoidable risks. However, they should be used to facilitate risk transfer and access

to funding within the real economy and not to help institutions to arbitrage regulations and make balance sheets look safer than they are.

In order to increase long term stability and regain consumer confidence in the financial system we need to proceed with the reforms not only by adapting regulation but also by changing behaviour.

We should encourage realistic risk assessment and pricing. Market participants should take concrete steps to promote responsible business conduct. Overall we also need to reinforce preventive risk-based supervision and timely enforcement.

We have all been witnessing during the last years systemic risks caused by excessive leverage combined with risky financial products as well as inadequacies in financial regulation and supervision. Various uncertainties around the global financial system are still at place.

In the modern highly integrated environment financial stability can be already thought of as an international public good. All countries benefit from the stability of the world financial system as a whole. But at the same time all countries experience certain costs when the system is unstable.

So it became clear that without more effective supervision it will not be possible to address further systemic risks in the financial system. This calls for international coordination.

A number of different international bodies such as G20 and the Financial Stability Board are currently working on these issues in their different spheres of influence. EIOPA for example is contributing to the development of a common framework for supervising internationally active insurance groups and developing criteria to identify systemic risk in insurance activities, both conducted under the umbrella of the International Association of Insurance Supervisors (IAIS).

The results of this heavy regulatory agenda will reshape the financial system as we know it and we should be prepared to cope with the challenges ahead.

At EIOPA we are quite aware of the relevance of our mandate and responsibilities. As you may know in January 2012 EIOPA completed the first year in its status as a European institution, one of the three European Supervisory Authorities.

EIOPA's mission is to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the EU citizens and economy.

This mission is pursued by promoting a sound regulatory framework and consistent supervisory practices in order to protect the rights of policyholders, pension scheme members and beneficiaries and contribute to the public confidence in the European Union's insurance and occupational pensions sectors. And I would like to assure you that we are ambitious in fulfilling our obligations towards the EU citizens and businesses.

EIOPA is currently intensively working on the development of technical standards and guidelines that are essential for the implementation of Solvency II. But if I start elaborating further on this, it will not be a dinner speech anymore, but an epic poem. EIOPA is also working intensively on the review of the IORP Directive, advising the EU Commission on the ways to introduce a risk-based framework for the supervision of occupational pension funds.

EIOPA is an institution open to society. We want to listen and debate with the different stakeholders and that is why we value very much the opportunity to exchange views with you during this Congress.

Thank you for your attention and have a good dinner.