Insurance and Pensions: Securing the Future

Keynote Speech at the 8th EIOPA Annual Conference in Frankfurt

Gabriel Bernardino, Chairman of EIOPA

SPEECH
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Good morning, ladies and gentlemen,

It gives me great pleasure to welcome you all to this year’s annual conference. In particular, it is my pleasure to welcome our distinguished speakers and panellists.

The theme of this year’s conference is ‘Insurance and Pensions: Securing the Future.’ What do we mean by that? Exactly what we say.

Insurance and pensions are sectors where you need to invest short-term, but outcomes are longterm. As consumers, we put money into our pension products to secure our future retirement. We buy insurance policies to protect ourselves against future “rainy” days.

In an age where instant gratification is more the norm, setting aside money for the future takes some trust and commitment.

That is where we come in. Providers need to earn the trust of people to invest in their products or rely on their services. Regulators need to develop a sound and prudent set of rules and principles to be followed. Supervisors need to ensure that those rules are applied and that they deliver appropriate consumer protection and market stability. Providers, regulators and supervisors are crucial for trust. It can take a lifetime to build trust, but it can go in a flash.

This Conference, however, is for the short-term. We are here for a day only, but it is a day that touches on many different aspects of how we are “Securing the Future”:

How we are enabling for good supervision and sustainable finance?

How we are managing new threats and opportunities, so that we can ensure good outcomes for people, for business and for economies?

I am very much looking forward to a day of interesting debate and great interventions from our speakers, panellists, and you, the distinguished audience.

In my intervention, I will touch on three main areas, covering EIOPA’s achievements and priorities over the past and coming year:

Solvency II and its review

Achieving supervisory convergence

Working for consumers

I will finalize by touching on our future, looking ahead to some of the challenges and opportunities that we face.

Solvency II and its review

Coming to my first point, Solvency II and its review

Every year I stand up and talk to you about Solvency II and this year is no exception.

This is because Solvency II has been, without doubt, one of the biggest changes – if not the biggest change – to the European insurance regulatory framework over the past few years. Moreover, it has been a change for good.

In the almost three years since its implementation, the insurance industry has better aligned capital to the risks it runs, uses a risk-based approach to assess and mitigate risks, meaning that it can also better price risk. Insurers have significantly strengthened their governance models and their risk management capacity putting a number of key functions into place and ensuring that boards consider risk and capital factors in their strategic decision-making.

With Solvency II, insurers throughout Europe use harmonised templates for supervisory reporting, instead of a patchwork of national templates, and publicly disclose more relevant information and by that creating the basis for market discipline. This is a big step towards greater transparency.

In short, Solvency II has helped to strengthen the position of insurers across Europe.

But good regulation is only as good as it remains relevant. It must remain fit for purpose if it is to continue to achieve the fundamental objectives of policyholder protection and market stability. The insurance landscape is evolving: business models are evolving to make use of more advanced technology, new risks are emerging, not least in the area of climate change, and the importance of sustainable finance continues to grow.

Therefore, Solvency II must also evolve.

We are now reviewing the Solvency II regime to ensure that it remains effective, in terms of both its principles and its implementation. We are reviewing it so that we can secure its future.

Early this year, we advised the European Commission on possible targeted adjustments to the regime with recommendations to reduce complexity, increase proportionality, remove technical inconsistencies and make corrections where necessary.

We proposed a series of new simplifications and proportionate treatments.

We adjusted the risk calibrations where new evidence emerged.

We proposed a series of common principles for the calculation of the loss absorbency capacity of deferred taxes, an area where we observed material differences in the implementation in different member states.

We proposed the adjustment of the treatment of interest rate risk, because the current method clearly underestimate the risk.

We are happy to see that the European Commission has taken most of our advice into account in their draft Delegated Acts. Nevertheless, I regret the decision to postpone to the 2020 review the review of the treatment of interest rate risk. In that context, I would expect that a similar decision regarding other areas like the treatment of equity risk and the risk margin is taken.

Regarding the 2020 review, EIOPA believes in evolution, not revolution.

Solvency II should adapt to the new market conditions without fundamentally changing the basic principles of the risk-based regime.

At EIOPA, we are already working on a number of areas:

The Long-Term Guarantee measures

The treatment of long-term illiquid insurance liabilities and the assets that back them

The reporting and public disclosure requirements

The supervisory tools and measures needed to reinforce the macro-prudential nature of Solvency II

Sustainability in Solvency II

The way sustainability is considered in Solvency II

On the Long-Term Guarantee measures, we will revisit their design and calibration in light of the experience collected. These measures have an important impact on the financial position of insurers and relevant financial stability implications. I believe that it is possible to fine-tune them to ensure that they continue to work properly under different market conditions.

On illiquid liabilities, we just published a discussion paper. The illiquidity characteristics of liabilities may contribute to the ability of insurers to mitigate short-term volatility by holding assets throughout the duration of the commitments, even in times of market stress. We are particularly interested on how the short and long-term risks of long-term investments relate to the potential illiquid characteristics of insurance liabilities.

EIOPA will further assess whether the risks connected to illiquid liabilities and the assets covering long-term liabilities are adequately reflected in the current regulatory regime. This analysis will include an assessment of any unintended consequences of the current regulatory treatment and how such consequences, if any, could be mitigated.

Proportionality will be a key word in the 2020 evaluation of the reporting and public disclosure requirements in Solvency II.

The embedded proportionality included in the current design of the reporting requirements delivers appropriate relief to European insurers: for example, only 21% of the undertakings report the look-through template for investments in collective investment undertakings and only 26% report the derivatives templates. EIOPA is open to explore other meaningful ways to increase proportionality and reduce burden to firms in line with the nature, scale and complexity of their risks. For example, that could be the concrete case of certain types of captives.

Regarding public disclosure, namely the Solvency and Financial Condition Report (SFCR), streamline and standardize should be the keywords. The SFCR was a paradigm shift in the transparency of the insurance sector. The feedback that we receive from investors, analysts and consumer associations confirms the relevance of this tool for market discipline. It also identifies possibilities to streamline it in some areas, obtain more comprehensive and better structured information on the risk sensitivity to different scenarios or stresses, together with more standardized information on the sources of changes in own funds and the Solvency Capital Requirement.

Following our work on systemic risk and macro-prudential policy in insurance, EIOPA intends to present concrete proposals on how to integrate some additional macro-prudential tools in Solvency II, to enhance the capacity of supervisors to monitor and intervene preventively.

Enhanced reporting and monitoring tools need to be designed to ensure that supervisors early identify potential systemic risks and vulnerabilities that are or could be building up in the system in relation to capital, reserving, liquidity and asset and liability exposures. Furthermore, clear intervention powers should be available to be used in the hopefully rare circumstances where the other measures may not suffice to address the sources of systemic risk, such as limits or restrictions or the imposition of a capital add-on for systemic risk.

These tools and measures should build up, complement and be consistent with the Solvency II framework in order to avoid different incentives for insurers' risk management. Well-tailored, calibrated and proportionate macro-prudential measures should contribute to mitigate systemic risk by ensuring sufficient loss-absorbency capacity and reserving, discouraging excessive levels of direct and indirect concentrations and overall limit pro-cyclicality.

Finally, in the context of the sustainable finance agenda, EIOPA is working on the way Environmental, Social and Governance (ESG) risks and factors should be integrated in the three pillars of Solvency II.

First and foremost, we believe that insurers should include in their risk management system processes to identify, measure, monitor, manage and report, on a continuous basis, the ESG risks. Regarding capital requirements, the debate is only starting, but in my view, any reorientation of capital flows should arise because insurers take a long-term approach, including a view of sustainability over a long-term horizon, and not because of regulatory incentives.

On disclosure, reliable information on insurers' exposure to ESG risks will strengthen the stability of the financial system.

This brings me to my second point,

Achieving supervisory convergence

Last week, the European Court of Auditors published its Special Report on EIOPA's contribution to supervision and stability in the insurance sector. We welcome the publication of the report in particular the recognition of our 'important contribution to a common supervisory culture and financial stability in the insurance sector' and I am honoured that Mr Rimantas Sadzius, Member of the Court has joined us today.

Ensuring high quality and consistent supervision is fundamental to the proper function of the Single Market. And, this is one of the reasons why supervisory convergence is our highest priority. We have been working closely with national supervisors to foster a common European supervisory culture since our inception and we will continue to do so. This is a marathon, not a 100-metre race.

Last year, we outlined the key characteristics of a common European supervisory culture. This year we published our supervisory convergence plan for 2018/2019 in which we identified three main areas of action:

The further development of common supervisory tools and benchmarks

The supervision of cross-border business

And the supervision of emerging risks

As the European Court of Auditors recognised, we have made good use of a wide range of tools to support supervisory convergence, but these require further development. As part of our supervisory convergence plan, we will focus on:

Tools and benchmarks related to the application of proportionality

The supervision of internal models

And very importantly ont the supervisory assessment of conduct risks

Cross-border business is an asset of the single market and it is supposed to deliver benefits for competition and consumers. To achieve this, stronger supervision is required. In this field, our priorities for the coming year are:

The detection of unsustainable cross-border business models

Sufficiency of technical provisions in cross-border business

And fit and proper analysis

We also need to be aware of emerging risks. Securing the future means being able to mitigate both existing and emerging risks. In the immediate term, we are examining:

Supervisory practices related to IT resilience and cyber risks

The use of big data

And, of course, Brexit

In particular, EIOPA has built up and coordinated the so–called cooperation platforms with home and host supervisors to look at concrete cases of companies with cross–border activities and their supervision. To date EIOPA has coordinated 13 platforms involving national supervisors from many different countries. For each platform, EIOPA provided concrete supervisory recommendations to the home supervisor. In some instances, these recommendations were aimed to strongly encourage the home supervisory authority to initiate intrusive interventions towards the firm, such as prohibition of writing new business, in order to limit the risk to prospective policyholders.

The business models of the companies subject to a cooperation platform differ significantly, from motor insurance, French construction business, medical malpractice insurance to complex unit-linked products. In general, the focus of the companies is on growth outside the home market and on long-tail business where the risk will only materialize on the medium to long-term. Usually, there are deficiencies in the data available, insufficiencies in technical provisions and complex

intermediation structures. The impact of failure of such companies can cause significant waves in the host markets and severely disrupt public trust in the functioning of the internal market.

The supervision and enforcement of the new requirements is essential to ensure the desired increase in consumer protection. It is EIOPA's expectation that all the national competent authorities reinforce their market monitoring activities, deepen their knowledge about the products sold in their markets and effectively take supervisory measures to stop eventual bad practices. It is time to take conduct of business supervision seriously.

For EIOPA, both prudential and conduct of business supervision are an integral part of the consumer protection mandate. With the Solvency II implementation, EIOPA and the national competent authorities have put in place a number of activities in order to ensure a high degree of consistency and quality of prudential supervision in the European Union. It is now time to do a similar exercise on conduct of business supervision. There is a long way to go in order to ensure that the consumers in the different Member States benefit from an attentive and effective conduct of business supervision.

For that, we need more and better resources to be focused on conduct of business supervision. And, we also need a cultural change in supervisory authorities to indeed attribute sufficient attention to this area.

Overall, the focus on supervisory convergence activities by EIOPA is also reflected in a growing number of peer reviews, of mediation cases and breaches of Union Law investigations. At the same time, these activities also show limitations of EIOPA's current powers. That's why we have been advocating for concrete amendments to the EIOPA Regulation to build a stronger framework for EIOPA's independent assessment of supervisory practices and preventive tools regarding crossborder business, namely through the right of initiative to set up cooperation platforms.

In this regard, we fully agree with the recommendations of the European Court of Auditors to strengthen our powers through the ongoing review of the three European Supervisory Authorities, known as the ESAs Review, so that we can act more intrusively when and where we detect signs of cross-border failure.

I have talked so far about regulation and supervision. For us, these are day-to-day topics. But these are only tools to achieve our main objective which is consumer protection.

This brings me to my third point:

Working for consumers

For consumers, much of our work is intangible. Companies are supervised, crises are minimised, risks are mitigated and consumers, for the most part, are untouched.

But more and more consumers are seeing the evidence of our work in their daily financial lives especially through the information that they receive from providers.

Under the Insurance Distribution Directive, the IDD, we have seen the introduction of the Insurance Product Information Document, the IPID. This document provides customers with standardised information about non-life insurance products in a short, stand-alone and easy-toread document that allows customers to better compare products and make informed decisions.

The document was developed on the basis of extensive research with consumers of various ages and levels of financial literacy.

The result is a document in which the key features of non-life insurance products are presented in a simple and easy to understand ‘Questions & Answers’ format without technical jargon. The IPID is eye-catching because of its use of colours and icons. The proposed design also takes into account how information will be presented via digital media, for instance by allowing the layout of the information using pop-ups to adjust on the small screen of a mobile device.

In terms of practical experience so far with the IPID at national level, we have received a lot of positive feedback. A number of existing national product information documents were considered as too long with lots of text and confusing text for consumers. What the IPID has brought is more comparable and clearer information for the customer based on its standardised design.

Another example of our work to improve the experience of consumers when engaging with insurers and distributors is the key information document (KID) from the Packaged Retail Investment Products Regulation (PRIIPs), the so called, PRIPP’s KID.

While we believe that the PRIIP's KID is a step forward regarding the standardization of relevant information to consumers of investment products. At the same time, we are also attentive to the concerns raised in its implementation. We recently launched a process to make targeted changes to the KID. We also see benefit in limiting the delay to a wider review of PRIIPs that was due to take place this year. Furthermore, it is critical that the same rules apply across all types of packaged investment products, including Undertakings for Collective Investment in Transferable Securities, the so called, UCITS, to achieve the aim of comparability and avoid consumers receiving different types of information.

On the occupational pensions sector, EIOPA recently published a guidance on the implementation of IORP II in relation to the Pension Benefit Statement, an important pillar in the provision of pension information.

The Pension Benefit Statement's main goal is to provide important information such as the current situation of the pension scheme member regarding the accrual of pension benefits, projecting future retirement benefits, to enable retirement planning and help the member to take informed decisions.

EIOPA identified a number of guiding principles for the design and content of a Pension Benefit Statement. It should be based on a behavioural approach to facilitate a member's decisions about retirement savings. The information should be layered to help the member to find key information at a glance and to navigate easily through the content to find the answers to the questions.

Very importantly, the Pension Benefit Statement should enable the member to understand the impact of costs on pension entitlements and to compare pension scheme cost levels.

EIOPA will continue to promote consistent practices at national level, including the development of examples of standardised designs of the Pension Benefit Statement.

Going forward it is a priority for us to ensure that consumers are not overloaded with information, which they do not understand and do not use. A deep analysis of the current disclosure requirements in place for insurance products in different parts of the European legislation is needed in order to streamline it, eliminate duplications, layer the information and make sure that the result is ready for the digital economy. This should ensure that simpler, more targeted and standardized information is offered to consumers while limiting the burden on the industry.

Now, I won't say that either the IPID or the KID make choosing a financial product as easy as child's play.

I won't say that this girl that you see standing behind me would ever pick up one of these documents and read it with interest.

But I will say that, for her parents, these documents will make their financial lives and their financial choices easier.

Where this girl will benefit – although she probably does not know it yet – is through the PanEuropean Personal Pension Product, the PEPP.

The PEPP has come a long way since our initial proposal. PEPP provides European citizens an entirely new personal pension framework in the form of a safe, portable, long-term retirement savings product.

So imagine the life of this young girl. Here we see her dreaming of her future. Will she learn to fly? Will she be a pilot? Will she be an astronaut? We do not know. But what we do know is that over the course of her lifetime she will probably hold several jobs. She will possibly move cities, possibly countries for her work. She will definitely want a safe and secure source of income when she stops working.

With the PEPP, consumers will have a simple, safe, transparent and cost-effective long-term retirement product to complement national systems, adding a default opportunity to save for future retirement income within a European personal pension framework.

With PEPP, we can have smart portability to adapt to changes in labour markets, so that mobile workers will be able to pay into the same product when moving within the European Union.

With PEPP, we are providing a level playing field for providers, encouraging competition and increasing consumer choice.

However, PEPP will only be successful if it is trusted. As a European supervisory authority, EIOPA can ensure consistent high standards throughout Europe. In this regard, a central authorization hub and a key contact point for accessing information on PEPP are crucial for its success. I am confident that the political trilogue will be successful and an agreement will be found before the end of the current European Parliament mandate.

Coming to my last point, the strategic challenges and opportunities

I will finalize by touching on our future, looking ahead to some of the challenges and opportunities that we all face, which are to me the following:

First: Digitalisation

EIOPA will continue the close dialogue with market participants (incumbents and start-ups), consumer representatives, academia and data protection experts in order to early identify regulatory barriers to innovation and contribute to the necessary societal and regulatory debate about the appropriate ethical standards to be used by insurers when dealing with big data.

Furthermore, priority will be given to the analysis of the fragmentation of the value chain and the corresponding impact on business models. We will need to be attentive to the emergence of business models where the insurance value chain (product design, pricing, client interaction and claims management) is originated and managed by technological platforms and find appropriate answers on how to supervise this “inverted outsourcing” model.

Increasing digitalisation coupled with a growing number of cyber incidents has made cyber risk a major concern for institutions, individuals and financial markets, leading to a growing demand for cyber insurance. To enhance understanding of cyber risk underwriting in the European insurance market, EIOPA undertook a structured dialogue with insurance companies across Europe. The findings, published in the report ‘Understanding Cyber Insurance’, highlight the need for a deeper understanding of cyber risk as a core challenge for the European insurance industry. A questionnaire on cyber risk has been included in the 2018 Insurance Stress Test and the subject will be a growing area of focus for

EIOPA, becoming a cross cutting activity in our 2019 work programme.

Second: Sustainable finance

Sustainability has long been at the heart of the European project. Following the adoption of the 2016 Paris Agreement on Climate Change and the United Nations 2030 Agenda for Sustainable Development, the European Commission has published this year the Action Plan on Financing Sustainable Growth. This step was in my view a truly act of leadership. A vision that should inspire and motivate all of us to contribute to a more sustainable world.

The success of the sustainability agenda will depend to a great extent on the capacity of financial market participants, including insurers and pension funds, to incorporate into today’s risk measurement and decision making processes the expected long-term consequences of climate change, resource depletion, environmental degradation as well as social and governance issues. This will be certainly challenging for all market players, but in particular, for insurers and pension funds, it is essential. They need to consider physical and transition risks because their business models are based in liabilities and corresponding assets with time horizons of several decades.

So, for insurers and pension funds, the inclusion of ESG risks and factors in their risk management systems is not a consequence of a political or regulatory imposition! It is a responsible business practice! That’s why we see more and more insurers and pension funds taking important decisions in their investment and underwriting policies in line with their ESG risk assessment.

Insurers and pension funds, as big institutional investors, should use their stewardship role to engage with companies in which they invest incentivizing them to take concrete steps towards a lower carbon footprint. This will ensure that the necessary transition to a low carbon economy is

done in a gradual and stable way, avoiding financial stability incidents and the emergency of pockets of stranded assets.

Furthermore, insurers should use a similar approach in their underwriting activities, incentivizing risk reduction through adequate risk-based pricing.

The recent report of the Intergovernmental Panel on Climate Change (IPCC) highlights the rapid, far-reaching and unprecedented changes needed to limit global warming to 1.5°C. As rising temperatures accelerate sea level rise and catalyse extreme weather events, communities, businesses, cities and countries are facing new types and higher levels of risk. Insurers and pension funds should act in the best interest of their policyholders, members and beneficiaries and be part of the solution.

Third: Brexit

Based on the data collected through the monitoring of the Brexit contingency planning of insurance undertakings, in particular of the undertakings from the United Kingdom with crossborder business in the remaining European countries, and due to the nature and scale of the business concerned, EIOPA's assessment is that the service continuity issue does not give rise to financial stability risks. At the same time, EIOPA is working with the national competent authorities and addressing the residual risk to ensure that consumers will be protected.

Closing

Ladies and gentlemen, we have come far in the insurance and pensions sectors to secure the future.

At EIOPA we will continue to learn from the past, act in the present in order to secure the future.

I wish us all an exciting and enjoyable day.