

2020 Review of Solvency II: Opportunities and challenges

Keynote speech by Gabriel Bernardino at the conference '2020 Solvency II Review: Challenges and opportunities'

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SPEECH

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Executive Vice-President Dombrovskis

Ladies and Gentlemen

Introduction

It gives me great pleasure to join you today for today's discussions on the 2020 review of Solvency II and it is an honour to open the proceedings.

I would like to thank the Commission for organising this event on the opportunities and challenges of this review.

The implementation of Solvency II has been a step change in how insurers approach their relationship to risk. Since its implementation 4 years ago the insurance industry has better aligned capital to risk, uses a risk-based approach to assess and mitigate risks, which means that it can better price them. Insurers have also significantly strengthened their governance models and their risk management capacity.

These are all positive outcomes that are both good for insurers and for consumers. After all it is consumers that the regime is designed to protect.

This review is a fundamental step in enabling us to continue to protect policyholders and in maintaining the credibility of the regime.

This review is an opportunity to:

Ensure that the regime continues to be fit for purpose by being capable to

reflect the evolution of the market conditions.

To fine tune the regime to ensure that it is more proportionate to the scale and complexity of risks insured by different types of insurers and creates better conditions for insurers to develop new sound business models.

To complete the EU regulatory toolbox by introducing a macro prudential dimension and a minimum harmonisation regarding recovery and resolution and insurance guarantee schemes.

Let me touch on these three areas:

Reflecting the evolution of market conditions

Solvency II was designed in very different market conditions. The on-going ultra-low/ negative interest rate environment has a substantial impact on the business model of insurers, especially on the life insurance side.

So the current approach to interest rate risk in the Solvency II standard formula clearly underestimates the real interest risk rate in a low/negative yield environment.

This is something we have to fix urgently, and EIOPA will come with concrete proposals to do so in a sound technical way. And conscious of the impact of this adjustment, we will also propose a step-by-step approach to build the needed resilience.

The evolution of market conditions also requires an adjustment in the extrapolation of interest rates. The current approach does not reflect the market consistent nature of Solvency II and is conducive to the underestimation of technical provisions.

Proportionality and long-term nature of business models

Proportionality has always been an important element in Solvency II. Looking at the experience in the practical implementation of the regime, EIOPA believes that further steps can be taken to increase it, both on the requirements and in the supervisory process.

That is why we have consulted on possible changes in reporting and disclosure:

increasing the application of risk-based thresholds that will reduce substantially the reporting requirements for less complex and less riskier undertakings; streamlining and standardising the public disclosure with a clear separation of the information for market participants and simple and short information for consumers; simplifying requirements for captives.

We are now working on ways to increase the effectiveness of the proportionality embedded in the supervisory review process.

But the review also gives us an opportunity to work on sound adjustments to allow insurers to better develop long-term products and long-term investments.

On the top of the consulted material we have been working on a number of elements that hopefully will be tested in the holistic impact assessment in March.

On the volatility adjustment, we are looking at the recalibration of application ratios with the aim that insurers are rewarded for holding illiquid liabilities rather than been penalised for holding liquid liabilities.

On the risk margin, we are exploring ways to reduce its size and volatility, especially for the long-term liabilities, based on the fact that the future capital requirements are not fully independent.

On equity risk, we are reviewing the criteria for the ability to hold equity long-term, by making a link with long-term illiquid liabilities and taking into account that equity investments are managed on a portfolio basis rather than on an individual asset basis.

We are also exploring ways to include a better recognition of non-proportional reinsurance as a legitimate risk-mitigation technique.

All of these adjustments will improve risk-sensitivity, facilitate the design of truly long-term illiquid liabilities and incentivise long-term investments.

Completing the regime

By introducing a macro-prudential dimension we will equip supervisors with better tools to monitor the building up of possible systemic risk in line with the recently approved international framework.

Another important area is the freedom of establishment and to provide services in the Single Market. While this freedom provides clear benefits to policyholders, we have also witnessed an unfortunately growing number of failures and near misses of insurers, many of them doing business on cross-border basis.

We need to act to stop misuse of these freedoms that has the potential to undermine trust in the Single Market.

Furthermore, we believe that the existing fragmented landscape of national recovery and resolution frameworks could cause significant barriers to the orderly resolution of insurers, particularly in the case of cross-border groups.

Similarly, there is the need for a minimum harmonised framework for insurance guarantee schemes in terms of scope, coverage and funding to protect policyholders in case of failure. This is a question of trust and confidence of European consumers in the insurance sector.

What are EIOPA's next steps?

We are analysing very carefully the feedback received and engaging extensively with the different stakeholders.

In March, we will follow up with a holistic impact assessment.

This is an important step for us as it will enable us to collect information on the combined impact of our proposals. It is likely that the holistic impact assessment will still contain some options but I assure you it will be much more streamlined.

By then, we will be reaching the final leg of this part of the journey. Our Opinion to the European Commission is due by 30 June 2020 and we will keep that date.

In conclusion

Europe's insurance sector is significant part of the financial sector. It finances the economy, it provides a large number of jobs and, most importantly, it provides peace of mind and protection for policyholders.

And ultimately, this is why we have Solvency II. So that we can better protect the policyholders.

So, to maintain a robust and credible Solvency II that is part of a Europe that

protects and a Europe that puts finance at the service of the economy and citizens. That is our challenge.

Ladies and gentlemen, thank you for your time. Enjoy the debate.