

Crisis and recovery: Challenges and opportunities for the insurance sector

Speech by Gabriel Bernardino at the Croatian Insurance Days

Delivered virtually, 12 November 2020

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SPEECH
DATE:
12 Nov 2020

Ladies and gentlemen

Introduction

Thank you for inviting me to this year's Croatian Insurance Days.

Needless to say, I would have much preferred to be able to join you in person in Croatia, but like everyone else we are having to adapt to our new situation.

And I think that it is fair to say that continuous adaptation is going to be with us for some time as the COVID-19 pandemic continues to evolve.

Without doubt, COVID-19 has been one of the most globally disruptive events of the century and its impact has been far-reaching, with implications for insurers and insurance supervisors.

What started as a major health crisis, rapidly escalated causing havoc to people's households, their finances and to our economy.

As cities and then countries went into lockdown, everyone had to adapt.

It was no different for the insurance industry, or for supervisors for that matter. We all had to react quickly.

Insurance companies had to navigate difficult market conditions while ensuring their own business continuity and services to their customers at the same time as

making sure that their staff remained protected.

Supervisors had to identify and implement measures to minimise the impact of the pandemic on insurance and pensions sectors while also facing similar operational challenges.

Today, I will outline some of the measures taken by supervisors in response to the crisis, and the steps to take us from crisis to recovery.

Mitigating the impact of COVID-19

Throughout the crisis, from a supervisory perspective, all of our actions have centred on three main priorities:

- To ensure at the early stages of the crisis that there was business continuity;
- To ensure stability of the sectors; and
- To mitigate impact on consumers.

In terms of ensuring business continuity – both at supervisory level and at EIOPA – like everyone else we put measures in place to ensure the safety of our staff, while also continuing to fulfil our core business.

It was clear that businesses needed to do just the same: keep their operations going and keep their staff safe. So in recognition of this, and to make sure that businesses could focus on serving their customers, we put in place measures to alleviate the burden on them, in particular on the reporting side.

And overall, these measures were well received and have worked well.

To date, we have not yet seen any major disruption in insurance services and the quick adoption of new digital tools was essential to this outcome.

In this regard, the initiative of the Croatian Insurance Bureau to introduce an online option as an alternative dispute resolution mechanism, enabling insurance undertakings and consumers to interact without meeting physically is one of many examples that we have seen of organisations adapting to the digital world.

It was also immediately apparent that ensuring the stability of the market was critical.

The insurance sector was in a good starting position, thanks to Solvency II.

Overall, insurers entered the crisis with a robust capital position because of the work done during years following the implementation of Solvency II, a risk-based regime designed to make sure that there is sufficient capital to absorb losses during shocks.

Solvency II was also designed to adjust to short-term volatility. With tools such as the volatility adjustment, the matching adjustment and the equity dampener, the regime caters for these periods of extreme volatility.

In addition, with Solvency II, supervisors have some degree of flexibility to allow companies to recover their solvency ratios when faced with adverse developments in the market.

As the Coronavirus crisis unfolded, EIOPA gave very clear guidance to supervisors on the use of the flexibility embedded in the regime in a consistent way.

And it is fair to say that the regime has remained stable throughout the crisis until now and proved itself capable of withstanding this shock.

This positive outcome is both good for insurers and for consumers. After all it is consumers that the regime is designed to protect.

As a supervisory authority with a mandate to maintain financial stability and ensure the protection of consumers, we advised caution. We issued statements asking insurance companies to be aware of their capital position and recommending the temporary suspension of dividends considering the high level of uncertainty.

And while the effect of this statement has been reasonably positive, it is true that there we have seen some differences in approaches by some market players and also by some supervisors. This is an issue and it is a lesson from which we can learn: how do we strengthen the enforcement powers of national supervisors and how do we strengthen EIOPA's powers to ensure a common outcome across Europe, in short to ensure supervisory convergence – the very heart of our mandate.

EIOPA and national supervisors also increased the monitoring of the liquidity situation of insurers. To the present moment, major liquidity concerns have not

materialise.

From the beginning of the crisis, we were also very clear that consumers had enough to worry about and that concerns about insurance policies should not add to their anxiety. We engaged extensively with industry and again issued statements asking providers to exercise flexibility and be clear in terms of coverage. Moreover, we were very clear that while we expected insurers to promptly pay all the claims due, imposing retroactive coverage of claims not envisaged within contracts could create material solvency risks and ultimately threaten policyholder protection and market stability, aggravating the financial and economic impacts of the crisis.

So this is what we have done so far.

But we cannot be complacent. The crisis is not over and the level of uncertainty is still very high. The full economic impact is still far from clear and insurance business models will continue to be challenged, both on the asset and on the liability side.

2020 review of Solvency II: keeping the regime fit for purpose

We must take every opportunity to create the right conditions for the insurance sector to play a fundamental role in the recovery.

And this means taking stock of our review of Solvency II.

The main purpose of the review has been to make sure that the regime remains fit for purpose. In doing so, we are also making sure that the regime can underpin the recovery.

Before I talk in overall terms about the review, let me say a few words about one area that is of particular interest to insurers in Croatia. I am talking about the treatment of the Croatian government bonds issued in euro.

After a thorough analysis of the risks and in the interest of cross-sectoral consistency, EIOPA will propose a grandfathering clause, so that all these types of bonds will not be penalised in terms of capital requirements. This will surely contribute to the continuous stability of the insurance market in Croatia.

Now, looking at the overall review.

The crisis has shown us that Solvency II proved effective in protecting the sector from market turmoil.

In fact, this recent experience has reinforced our approach to the review of Solvency II: an evolution rather than a revolution.

We chose to delay our Opinion to the European Commission to the end of the year, so that we could take into consideration the impact of COVID-19 on the sector and the economy.

This means taking into account the current low interest rate environment. And, looking at the massive intervention measures from central banks, it is clear that the 'low for long' scenario will continue for a long time yet.

We have to recognise that this situation is much different to when Solvency II was conceived. The current approach to interest rate risk in the Solvency II standard formula clearly underestimates the real interest risk rate in a negative yield environment.

We are therefore proposing changes to the treatment of interest rate risk, as well as to discount curves used by insurers, in particular regarding extrapolation.

Proportionality has always been an important element in Solvency II. Looking at the experience in the practical implementation of the regime, we believe that we can increase the use of proportionality.

We will therefore propose concrete changes to increase proportionality across the three pillars of Solvency II, especially regarding low risk undertakings, as well as to increase the effectiveness of proportionality embedded in the supervisory review process.

Through the review, we must make sure the regime sufficiently takes into account the nature of the long-term insurance business.

Our review proposes changes to the following:

- The volatility adjustment: the recalibration of application ratios so that insurers are rewarded

for holding illiquid liabilities.

- The risk margin: reducing its size and volatility, especially for the long-term liabilities, based on the fact that there is diversification of risk over time.
- Equity risk: 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.

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

Finally, we need to supplement the current micro prudential framework with the macroprudential perspective (including the introduction of specific tools and measures), as well as the need to develop a minimum harmonised recovery and resolution framework and achieve a minimum harmonisation in the field of insurance guarantee schemes.

We are not changing the fundamentals of the framework. That was never our intention. The regime works well, but if we are to emerge from this crisis with a strong insurance sector that fulfils its role in society, we have to make sure that regime continues to work well in the “new normal”.

Fostering a sustainable recovery

This brings me now to the topic of recovery.

The European Union’s Next Generation EU recovery plan is built on green and digital transitions and fostering a Capital Markets Union.

All three are natural partners for the insurance sector.

The link with the Green Deal is clear.

We have to make sure that our recovery is a green recovery and that initiatives designed to kick start the economy have sustainability at their heart.

This means investing to mitigate the impact of climate change, investing in new technology to facilitate the transition to a more sustainable and resilient economy.

As the pandemic evolved, it became clear that people’s relationship with technology changed. People rapidly embraced technological solutions to get

through their day.

At EIOPA, we have been watching digitalisation increase across the insurance value chain, all the way from product design to claims handling and everything in between.

COVID-19 is accelerating the digital transformation.

This is a good thing. Digitalisation can provide better products and data services, often at lower cost to the consumer.

And the digital first approach is what consumers want today. So we should build on the accelerated adoption of digital technology to develop more simple but scalable products that make it easy for people to save for the long-term.

Products like the Pan European Personal Pension Product, or PEPP.

This is precisely the type of digital-first product that has been designed with today's consumer in mind. A savings product that is portable, transparent and cost effective.

It is this type of product that will help to build a Capital Markets Union that truly works for the people. Where they have access to the products they need and they experience the benefits of a single market that is built on a level playing field and underpinned by a common supervisory culture.

This means we must focus on the demand side, creating products that not only meet the needs of today's consumers, but products that consumers trust.

Maintaining consumer trust

Because we need to make sure that we maintain the trust and confidence of consumers. Because without trust in the sector, we will not recover from this crisis.

Throughout the crisis, we have seen many insurance companies put in place measures to support their customers. But we have also seen too many people disappointed because their policies – whether for travel, business interruption or event cancellation – did not cover pandemics.

We have to be crystal clear about what is and is not included as part of a policy and it is our duty to make sure that consumers fully understand what they are buying, what they can expect to receive and what is covered and what is not covered.

This is particularly important when it comes to complex products.

The low interest environment has put pressure on insurance companies, increasing the cost of guaranteed products and accelerating the shift from products with guaranteed returns to unit-linked products where the risk lies mostly or entirely with the consumer.

This raises concerns that consumers do not fully understand the risks, and terms and conditions associated with these types of products.

COVID-19 has also caused consumers to question the need or usefulness of their products.

Take travel insurance as an example.

We interviewed a number of consumers across Europe as part of our forthcoming report on consumer trends.

Some consumers gave travel insurance as an example of a product that did not deliver as they thought, because against expectations pandemics were not covered by insurance.

Or that they had travel insurance that they no longer needed as they could not travel.

The pandemic has also changed people's risk profiles.

That's why we released a statement requesting insurance companies to assess their products, and if they see signs of unfair treatment as a result of the impact of the crisis then to implement remedial measures.

Product oversight and governance – making sure that the interests of the consumer are front of mind throughout the product lifecycle from design to distribution – is an important part of our conduct of business supervision strategy.

In supervising this area, we aim to ensure that insurance manufacturers and distributors always take a 'consumer-centric' approach so that in turn we can ensure good consumer outcomes.

This is fundamental for the trust in the sector.

Building a resilient society

Finally, before I close, I want to say a few words about resilience.

The pandemic has shone the spotlight on protection gaps once again: in this case business interruption insurance.

Again, in the wider context, COVID-19 has demonstrated that we need to strengthen society's resilience to severe shocks as a whole, whether these are health-related, such as this pandemic, natural catastrophes – such as earthquakes or climate change, or large-scale sophisticated cyber attacks.

We need to look at the role of insurance overall in dealing with these kinds of more systemic risks. Risks where insurers cannot shoulder the burden alone.

We recently published a paper on shared resilience solutions with proposals on how we can use insurance and reinsurance to build better solutions to strengthen the resilience of the society.

In short, we need more public private engagement – which is why we call these shared resilience solutions. Because these sudden, far-reaching and indiscriminate shocks are increasing. And we need solutions as a society. And insurance, while not being a silver bullet, can and should be part of the solution – not part of the problem.

In conclusion

Ladies and gentlemen, these have been difficult days – for people, for businesses, and for governments.

But, like the pandemic, we are evolving.

Some valuable lessons from the crisis are already clear.

The regulatory frameworks set up to protect the financial system and consumers have until now, by and large, withheld the shock of COVID-19.

We – insurance companies, supervisors, governments and consumers – have demonstrated our capacity to adapt quickly. And we have seen the value of solidarity and working together.

And it is this – our ability to adapt and our willingness to work together – that will be at the heart of our recovery.

Talking about working together, let me take this opportunity to thank the colleagues from the Croatian Financial Services Supervisory Agency for the excellent cooperation with EIOPA and for their leadership and commitment towards ensuring market stability and consumer protection in Croatia and in the EU.

Ladies and gentlemen, thank you very much and I wish you a successful event.