EUROPEAN INSURANCE
AND OCCUPATIONAL PENSIONS AUTHORITY

KEYNOTE SPEECH

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Global Capital Standards: laying down the future for global insurance supervision

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

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Ladies and Gentlemen,

It is a pleasure for me to give the keynote address at this seminar organized by the Actuarial Association of Europe. I sincerely congratulate Malcom Campbell, Ad Kok and all the members of the AAE for the new branding of your association. It is an inspiring, fresh look for an institution established in 1978.

EIOPA has always had a very fruitful cooperation with the Groupe Consultatif Actuariel Européen and I am sure that this will continue with the Actuarial Association of Europe.

The work of actuaries is crucial for both insurance and pensions business. And, from the regulatory point of view, the opinions that the Association provides to different institutions, including EIOPA, are fundamental for our overall goal – to create a common supervisory culture across Europe.

Let me also congratulate you on the organization of this seminar that touches on a very important subject of the global regulatory agenda.

International developments

The financial turmoil of the last years demonstrated to us an urgent need for an integrated network of supervisory authorities, for a close cooperation and information exchange between supervisors as well as consistent supervisory practices. At the European level, steps in this direction have been made with the creation of the European System of Financial Supervision (ESFS) and EIOPA being part of this system.

But the high level of integration of financial markets does not allow us anymore to think only in a European dimension. Many European insurance groups already have a significant presence worldwide, with businesses in a number of emerging markets.

At the same time, risks arising from emerging markets are also increasing and in order to timely identify and mitigate those risks, there is a growing need of risk-based supervision.

In the EU, the development of Solvency II represents a major step towards risk-based supervision. Solvency II is a modern, comprehensive risk-based regime that captures the specificities of the insurance sector, incentivises the development of sustainable business and ultimately better protects policyholders and beneficiaries.

Worldwide, the evolution in the regulatory standards in insurance has been remarkable in the last 15 years. In many countries all over the world, risk-based regulation and supervision is already being enacted, with different nuances, but with lots of commonalities. In all the continents, some countries can be used as examples of good practices being implemented, risk-based capital requirements, stronger emphasis on good governance and risk management and improvements in public disclosure.

The development of Solvency II has been a catalyst for this international movement and the Solvency II equivalence process has been instrumental. In 2011, EIOPA provided final advice to the European Commission on the Solvency II equivalence assessment of the Swiss, Bermudan and Japanese supervisory systems. And, in the course of last year, we assessed 8 further supervisory regimes - in Australia, Chile, China, Hong Kong, Israel, Mexico, Singapore and South Africa.

Furthermore, the EU-US dialogue project has been essential in reinforcing the mutual understanding of the solvency regimes on both sides of the Atlantic, paving the way to more effective supervision.

EIOPA’s work on equivalence assessment will certainly help to facilitate the implementation of Global Capital Standards in the future, but this is not sufficient. It is fundamental to achieve more comparability and a truly level playing field between the main competitors in the world insurance market. This can only be done if we work at the worldwide level in developing a more convergent global regulation and supervision. This is not only the understanding of EIOPA; the Financial Stability Board (FSB) has recently called for the development of a global capital standard and we welcome this call.

Benefits of a global capital standard

The crisis exposed shortcomings in the areas of cooperation, coordination, consistent application of supervisory measures and trust between supervisors. Global capital standards will be beneficial for everybody.

The introduction of global capital standards should help prevent regulatory arbitrage, increase financial stability, guarantee a level playing field and strengthen international supervisory coordination, for the benefit of the economy at large, including financial institutions, consumers and employees.

Another important advantage of global capital standards is that they will reinforce the supervisory network by providing competent authorities with a common system. Global capital standards will facilitate the work of the colleges of supervisors that play an important role in an increasingly globalized market. With global capital standards, supervisory authorities present in the colleges will obtain a common understanding of qualitative and quantitative requirements for insurance groups, which is fundamental for the college's efficient, effective and consistent functioning.

What to start with?

The development of global supervisory standards is a highly ambitious project and in order to deliver it, we need to have a clear understanding of the objectives and who is going to drive it, what and how is it going to be done and when it will be there.

Who

The key role in this very challenging piece of work is given to the International Association of Insurance Supervisors (IAIS) and this is absolutely right. For almost 20 years of its existence, the IAIS has managed to build up a very solid platform for common work and information exchange between more than 190 jurisdictions in over 140 countries. The Insurance Core Principles developed by the IAIS have set the basis for enhanced insurance supervision around the globe. But times have changed and now we need stronger convergence for international active players.

The development of supervisory standards for insurers should benefit from the relevant knowledge and expertise of insurance supervisors around the globe and should be backed by political commitment from the FSB and the G20.

The IAIS made a very ambitious commitment to deliver the global supervisory standards and this commitment must be fulfilled if the Association intends to fully assume its role as an international standard-setter. Nevertheless, this work requires the IAIS to make some organisational and governance improvements, in order to increase effectiveness.

What and how

Let me first focus on the Basic Capital Requirement (BCR).

The BCR is being developed with the main objective of creating comparability at global level, allowing its use as a basis for the calculation of Higher Loss Absorbency (HLA) for the Global Systemically Important Insurers (G-SIIs).

In my opinion, the BCR should be kept simple and straightforward in its presentation, therefore relying on a factor-based approach. However, I believe it is inappropriate to use a single factor solution, similar to the banking sector Leverage Ratio. Insurance balance sheets are far more complex than banking ones.

In the development of the BCR, we should avoid too much granularity, complexity and risk sensitivity, but it is fundamental to use as a basis the best estimate of liabilities and the market-based valuation of assets and other liabilities. The "devil is in the detail", as we know from Solvency II, but this is the only way to build consistency worldwide for solvency purposes.

In terms of calibration, I see the BCR being somewhere between the MCR and the SCR in Solvency II.

The future role of the BCR, if any, needs to be seen in the context of the future development of the Insurance Capital Standard (ICS), which should be applied by all IAIG's.

As for the development of the ICS, I believe in an evolutionary approach. There is a need for more consistent qualitative and quantitative frameworks that will ensure comparability and ensure a level playing field. The road to build these new international frameworks will be a difficult one, but it is the right thing to do and I am sure it will happen!

I am convinced that the appropriate way to do it is to accept a step-by-step approach that will progressively create more commonality. This will facilitate the efficiency of supervision and increase financial stability and consumer protection. This approach should provide jurisdictions with sufficient time to prepare the necessary changes without causing significant disruptions in the markets. And, of course, this should be done in close consultation with the different stakeholders.

From our side, I would like to emphasize that EIOPA is highly committed to contribute to the establishment of global standards. In particular, we see EIOPA's mission in ensuring a strong European supervisor's voice within the IAIS by developing a consistent position of the EU representatives. This work is included in EIOPA's strategic direction and the relevant structures to implement it are already in place. I believe that having one European voice instead of a cacophony of 28 different ones will already facilitate the work of the IAIS. It is the task of EIOPA to promote the convergence of the approaches of the EU National Supervisory Authorities towards different regulatory and supervisory issues.

Now, when the Solvency II supervisory framework enters into its final phase before the full implementation, I think the EU is significantly influencing the international debate with regard to the development of a risk-based supervisory framework. I am convinced that the basic sound principles of Solvency II will be applied internationally. This means that the international capital standards should incorporate the fundamental principles underlying Solvency II: a total balance sheet approach, clear and transparent target criteria for calibration of capital requirements, explicit recognition of risk diversification and consideration in capital requirements of all the material risks to which the group is exposed. The objective should be to foster global convergence and consistency of supervisory practices, through the implementation of a sound risk-based supervisory framework, allowing Solvency II to be one of the practical implementations of the international standard.

That does not mean that the global capital standards will mimic Solvency II. I do not think that the global capital standards will need to be as granular as Solvency II.

Nevertheless, going forward we should be open to make adjustments to our system if that is needed. Companies should be subject to only one capital regime.

When

The IAIS has committed to a challenging timeline for the development of a set of global insurance capital standards: by the end of 2014 to develop Basic Capital Requirements, as the foundation for Higher Loss Absorbency; in the course of 2014, to decide whether the Basic Capital Requirements will also apply to Internationally Active Insurance Groups and, if so, when.

By end of 2015, IAIS plans to develop the Higher Loss Absorbency for Globally Systemic Insurance Institutions (to apply from 2019). By the end of 2016, IAIS intends to develop the Insurance Capital Standard for Internationally Active Insurance Groups (which include all Globally Systemic Insurance Institutions) – these are also to apply from 2019.

When the Insurance Capital Standard is developed, the IAIS will consider the need for backstop measures for all Internationally Active Insurance Groups and review the construction of the Higher Loss Absorbency in light of the development of the Insurance Capital Standard. A backstop measure for all Internationally Active Insurance Groups might include some, all or none of the elements of Basic Capital Requirements as initially developed for Globally Systemic Insurance Institutions.

Despite such an ambitious plan, I believe the stated objectives are achievable, as long as insurance supervisors in the IAIS work effectively, the FSB and the G20 are clear with the objectives and steer the project in the right direction and the different stakeholders deliver constructive comments and suggestions.

Conclusion

Ladies and Gentlemen,

Actuaries have a role to play in the development of insurance global capital standards. Your opinions and advice will definitely be considered and the Actuarial Association of Europe can play an important part in this evolution by sharing with the international actuarial community its experience and knowledge on how to deal with economic balance sheet valuations.

The cross-border activity of insurance groups is a growing reality. The development of global supervisory standards can serve as an important element for effective and efficient supervision of these groups. I know that it will not be easy, but it’s worth our common efforts – their prize will be the new era of insurance supervision with a level playing field for the key players of the world insurance market, with much better mechanisms of preserving financial stability and enhancing consumer protection worldwide. Let’s make this effort together.

Thank you for your attention.