Interview with
Gabriel Bernardino, Chairman of the
European Insurance and Occupational Pensions Authority (EIOPA)
conducted by
Ferdinando Giugliano, La Repubblica
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How concerned are you about the impact of the bout of market volatility since the start of the year on the European insurance sector?

This extra volatility is a concern from a regulatory point of view. It is one of the two big risks we had identified, and which we are going to test: "the double-hit scenario", i.e. a sudden asset values decrease and lower risk free rate. Another risk is the low yield environment. However, thanks to the push from Solvency II, insurance companies are much better equipped to deal with these risks. Solvency II takes a forward looking approach and requires companies to take remedial action if their business model is becoming unsustainable, for example increasing provisioning and avoiding dividend payments.

In a low-interest rate environment, companies will be searching for higher yields in riskier products. How worried are you that they may get into trouble?

The problem is not the search for yield per se, that's a natural reaction to this low-interest rate environment and, in any case, portfolio diversification is a good thing. What I am worried about is when insurance companies take on too much risk, beyond their risk-bearing capacity, or when they don't have the knowledge to get into certain asset classes. Companies should only invest in asset classes they understand and can manage.

Italy needs more infrastructure spending to boost growth. With a high public debt, the hope is that this investment will come from the private sector, including insurance. Are you against that?

We have analysed infrastructure as an asset class very thoroughly. It is a complex one to understand, but in the end we developed criteria for high quality infrastructure projects that have a better performance and given it a lower capital charge than for other risk assets. My question is more about smaller insurance companies: do they have the capability to understand the risk? The question of investment in infrastructure goes beyond the capital treatment: it involves the standardization of projects, the availability of appropriate due diligence.

How should we treat sovereign debt on the balance sheet of insurers?

This debate has a technical and a political component. The political component is for the European Parliament, European Commission and Governments to decide. At a technical level, there is a simple principle: in a risk-based regime you need to recognize that assets carry different risks. The concept of "risk-free" has changed. My objective is to give incentives to reduce concentration, so that if something goes wrong, you are not too exposed.

In concrete, what are you thinking about?

I am not thinking of imposing a hard limit on how many sovereign bonds an insurance company can hold, but of making refinements to the regime, that give an incentive to diversify. This is only preliminary thinking, but we have concentration risk formulae which could be used for sovereign debt too. In the euro area, one is matching assets against liabilities in euro, so there is no good argument for only buying Italian sovereign debt in terms of matching. We will need a good debate and an appropriate transition period. The important thing is that it is consistent everywhere. One can't have banks having one approach, and insurance companies having another, that would cause regulatory arbitrage. That's why we are having already discussions between regulators.

In this environment of prolonged low rates, is there a future for guarantees in the life insurance business?

Guarantees are a fundamental part of the market, but we need a different kind of products. For example, guarantees with a fixed rate over 30/40 years have a significant cost. Does this mean it is impossible to provide guarantees? Not at all. One possibility is to have products offering different kinds of liquidity, which at the moment has a huge cost. Life insurance is not dead, we just need different products.

Is it fair that older policyholders can enjoy very high returns while younger generations will not do so well?

This is a problem, particularly in occupational pensions. We need to analyse the sustainability of the promises that have been made and this analysis should also look at who is going to bear the cost. We need a system that treats all generations fairly. Instead we were building a system where older people were receiving a good pension funded by contributions by younger workers, who were not sure the system would be stable enough to pay their pensions in the future. It is time for the private, but also the public sector to deal with it; otherwise you risk an intergenerational conflict, as you can't put the entire burden on young people.

The industry complains that the new Solvency II regime, which is affective as January 1st, is too burdensome. How do you respond to that?

Solvency II is a change in the risk culture, involving changes in governance, capital requirements and transparency. We can now talk about risk in a way which was impossible ten years ago. Of course, there is no perfect system and Solvency II was also a product of political compromise. But Solvency II is a huge step forward.

Smaller companies complain that Solvency II is too burdensome for them?

There is a place for everyone, which is why we have a principle of proportionality. If you are a small company and you sell simple products your regulatory burden, i.e. information to be provided and governance requirements will be lower than if you are a large insurer selling complex products.

Is it right to continue to drive integration forward at a time when voters are proving sceptical of the European project?

The European project is facing continuously challenges but we have to move forward and succeed. Look for example at the banking union. I am a true believer in the European project. I am proud to be Portuguese but we can only succeed in a global world by sticking our countries together. I trust that the political leadership will continue making this project work. This European construction has also consequences for insurance. Within EIOPA, our members of the Board of Supervisors have all a positive attitude towards setting up a stable and sound European insurance system.

Italian insurers face a combination of challenges: low growth, low rates and a banking turmoil. Are you worried about the Italian insurance system?

The situation in Italy is not so different from other European countries. The challenges are everywhere; we monitor these issues and have a preventive attitude towards the risks involved. We can't kick the can down the road; we need to be more preventive than repairing. There is not something particular in Italy versus other markets, we need to keep pushing the idea that the financial sector needs reforms. We are now better prepared to talk transparently about the risks and that is the fundamental first step to avoid that something bad comes up unexpectedly.