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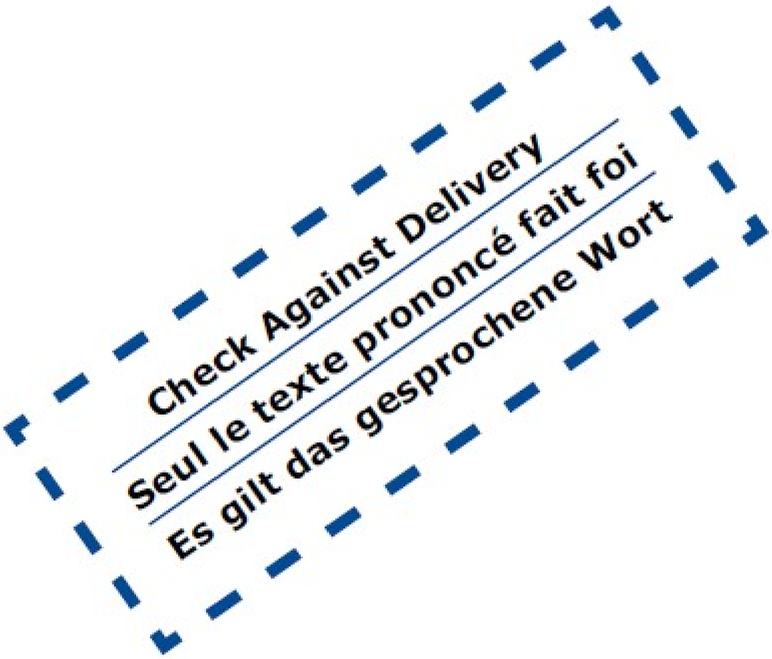
SOLVENCY II REVIEW, PROPORTIONALITY AND SUPERVISORY CONVERGENCE



International Conference on Insurance Regulation of the German Insurance Association – Gesamtverband der Deutschen Versicherungswirtschaft e.V. (GdV)

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Thank you very much, President Weiler for inviting me to this year's International Conference on Insurance Regulation organised by your Association and your kind introduction. It is always a pleasure to come to Berlin and contribute to your conference.

Today's conference covers important topics looking at insurance regulation from a national, European and international perspective. In this context it is fundamental to talk about Solvency II.

Since nearly three years, Solvency II is in place all over the European Union, undoubtedly the biggest change to European Regulatory framework in the insurance sector in the latest years.

This regulatory change brought a number of positive changes for the insurance industry, in particular better alignment of capital to risks, better risk management and governance and an increased transparency.

A big regulatory change like Solvency II is to be appropriately monitored to understand what are the areas that deserve further reflection in order to maintain it fit for its purpose and to achieve the fundamental objectives, the protection of policyholders and market stability.

We should not forget that the post-crisis regulatory agenda was put in place to restore citizens' confidence in the financial sector.

Therefore, while it makes perfect sense to review and evaluate the recent reforms to mitigate any unintended consequences and increase proportionality, I firmly believe as said earlier the main values of market stability and policyholder protection that were at the centre of these reforms cannot be abandoned.

As part of good regulation, there are merits in reviewing the practical implementation of the regime and that is the purpose of the two reviews envisaged.

Furthermore, the objectives mentioned could only be achieved by ensuring that the regulatory regime is implemented consistently and in a proportionate way and that we achieve a high degree of supervisory convergence.

So, in my intervention today, I will focus on three main points: The Solvency II Review, Proportionality and Supervisory Convergence.

1. Coming to my first point: The Solvency II Review

Already last year, EIOPA advised the European Commission on possible targeted adjustments to the regime focussing on reducing complexity, increase proportionality, removing technical inconsistencies and making corrections where this was necessary.

- 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 material differences in the implementation in different member states were observed.
- 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 announced that it will take most of our advice into account in their forthcoming proposals.

I understand that the European Commission decided to postpone the review of the interest rate risk treatment for the 2020 review, but then I would expect that a similar decision is taken regarding other areas like the treatment of equity risk and the risk margin.

Regarding the 2020 review, EIOPA believes that it should ensure that Solvency II is adapted to the new market conditions without fundamentally changing the basic principles of the risk-based regime: **An Evolution, not a Revolution.**

Let me mention a few areas that we will work on:

1. ***The Long Term Guarantee measures, including the volatility adjustment.*** We will revisit their design and calibration in light of the experience collected. I believe that it is possible to fine-tune these measures to ensure that they work properly under different market conditions.
2. ***The treatment of long-term illiquid insurance liabilities and the assets that back them***
3. ***The reporting and public disclosure requirements to ensure that they continue to be relevant and proportionate***
4. ***The supervisory tools and measures needed to reinforce the macro-prudential nature of Solvency II***
5. ***The way sustainability is considered in Solvency II***

In this context, we are also attentive to market evolution, namely regarding the change in business models, especially in life insurance, with the move towards contracts with lower and more flexible guarantees and, in some countries, the significant increase of pure unit-linked products.

While this is a natural management reaction to ensure long-term sustainability of the insurers commitments and optimise capital, it also increases the transfer of risks to policyholders, putting more pressure on conduct risks.

We will thoroughly analyse the evidence available on the characteristics and risks of different long-term life insurance products, especially concerning the illiquidity characteristics of the liabilities and the ability of insurers to mitigate short-term volatility by holding assets throughout the duration of the commitments, even in times of market stress. A first discussion paper will be published in the coming weeks.

We are going to look at the regularity treatment of the spread and equity risks of assets covering this type of liabilities. This will also be very relevant in the context of the future implementation of the Pan-European Personal Pension Product.

2. Coming to my second point: Proportionality

Proportionality is an important element of Solvency II and key for its proper implementation. Therefore, EIOPA focused its advice to the European Commission on the 2018 Solvency II Review on a number of areas where we could ensure increased proportionality and to reduce complexity:

- We advised to simplify further calculations for a number of sub-modules of the Solvency Capital Requirement (SCR) such as natural, man-made and health catastrophes, in particular fire risk and mass accident.
- We simplified the use of external credit ratings in the calculation of the SCR (an issue especially relevant for small insurers).
- We reduced the burden of the treatment of look-through to underlying investments.
- We developed simplifications in the assessment of lapse and counterparty default risks.

- We recommended the use of undertaking specific parameters for reinsurance stop-loss treaties.

Furthermore, we prioritised a Peer Review on the supervisory practices for the application of the proportionality principle on the governance requirements regarding key functions. The results will soon be published with concrete recommendations towards the National Competent Authorities (NCAs).

Finally, proportionality should also be applied to the exercise of supervisory powers. Supervision should be risk-based and proportionate. So, we are very much interested in achieving proportionality in the supervisory practices.

In this context let me mention a concrete case that the German Insurance Association - GDV - brought to EIOPA's attention relating to the possible application of the proportionality principle in the calculation of the SCR.

In fact there are situations, especially for small and medium size insurers, where some sub-modules of the standard formula calculation have an immaterial weight in the overall SCR and the corresponding risk does not materially change over time. In these cases it should be possible to find a proportionate treatment that would avoid the burden of performing repeatedly complex calculations.

We analysed the suggestion and will discuss it with the NCAs next week in our Supervisory Steering Committee. Our view is that a proportionate approach makes sense and that under certain conditions this could indeed be applied.

I hope to find a positive solution soon and publish a Supervisory Opinion in the coming months.

EIOPA is open to further concrete suggestions on how to ensure proportionality in the supervisory practices.

3. Coming to my third and last point: Supervisory convergence

In a single market with cross-border activities and a passport system supervised by the home country, the supervisory system is as strong as its weakest link.

That is why ensuring high quality and consistent supervision is fundamental to the proper functioning of the single market.

The Solvency II harmonised regulatory framework creates the conditions for this supervisory convergence.

EIOPA devotes a high priority to supervisory convergence and has been actively working to foster a common European Supervisory Culture and to ensure consistent supervisory practices. This a marathon not a 100 meters race.

In April, we published our 2018/2019 supervisory convergence plan in which we identified three main areas:

1. ***Development of common supervisory tools and benchmarks***
   - Application of proportionality
   - Common benchmarks for supervision of internal models
   - Supervisory assessment of conduct risks
2. ***Supervision of cross-border business***
   - Detection of unsustainable cross-border business models
   - Sufficiency of technical provisions in cross-border business
   - Fit and proper analysis
3. ***Supervision of emerging risks***
   - Supervisory practices on IT resilience and cyber risks
   - Usage of big data
   - 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 insufficiencies in technical provisions, deficiencies in the data available 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 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.

These activities also show the limitations of the current EIOPA powers. That's why EIOPA has been advocating for concrete amendments to the EIOPA Regulation in order to build a stronger framework for EIOPA's independent assessment of supervisory practices and further powers and preventive tools regarding cross-border business, namely through the right of initiative to set up cooperation platforms.

Ladies and Gentlemen,

By reviewing the Solvency II framework and taking concrete steps on supervisory convergence, we will ensure that the European insurance sector will be properly regulated and supervised, ready to face the huge challenges of economic uncertainty, digitalisation and climate change.

- A sector that will be instrumental in closing societal gaps, like the pension gap (where the PEPP is an instrumental tool) and the protection gap on natural catastrophes
- A sector that will use its underwriting and investment activities to foster a gradual transition to a more green economy
- A sector that will apply the highest ethical values, acting customer friendly and, by that, achieve increased trust

Solvency II is an achievement that should make us all extremely proud. It is up to all of us to continue to make Solvency II a success.

Thank you for your attention. I stand now ready to answer your questions.