**SPEECH**

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# Stability and consumer protection – The EIOPA view

Central Bank of Ireland Stakeholder Conference
**Dublin, 27 April 2012**

Good afternoon Ladies and Gentlemen,

Let me start by congratulating the Central Bank of Ireland for the initiative to organize this conference and for the invitation to be one of the speakers. It is a privilege to participate in this event and share with you some thoughts about the future of financial regulation with a particular emphasis on insurance and pension stability and consumer protection.

To think about the future of financial regulation in Dublin reminded me one of my favourite U2 songs: "I Still Haven't Found What I'm Looking For".

And what are we looking for? Are we searching for the perfect regulatory system that will prevent all possible future crises? Are we trying to find the "Holy grail"?

Ladies and gentlemen, the reality is that there is no perfect regulatory system. Risks are always evolving. They are responsive to changes in society and in consumer attitudes, they move according to the economic environment and, most importantly, they are correlated. There is no regulatory requirement that can capture all this complexity.

Does this mean that we should give up? No, this just means that we need to be pragmatic, accept a certain level of imperfection in regulation and diversify the tools used to deal with the increased complexity that we face.

Are we on the right track on reinforcing stability and consumer protection in the insurance sector? Well, I believe so, but many steps still need to be taken.

Let me start with Solvency II.

One of the main lessons that we learned from the financial crisis was the importance of a realistic assessment and pricing of risk. It is not the role of regulation to abolish risk or set its price. However, regulation can provide the appropriate incentives for risk to be adequately managed and priced. This is one of the purposes of the Solvency II regime. By being based on a consistent economic valuation of all assets and liabilities and on a consistent measurement of risk, Solvency II will definitely contribute to this objective.

Furthermore, by having capital requirements based on the risks incurred by the undertaking, Solvency II will deliver one important and economically sound principle: more risk implies more capital.

Consistent with the diversification of regulatory tools, Solvency II is also focused on governance and transparency elements. It requires the European insurance industry to critically analyze its risks, and in the process, assess the true costs attached to them. The ORSA (Own Risk and Solvency Assessment) is the central instrument to perform this cultural change. Within the ORSA, undertakings are required to properly assess their own short and long term risks and the amount of own funds necessary to cover them.

The ORSA aims at enhancing awareness of the interrelationships between the risks an undertaking is currently exposed to, or may face in the long term, and the internal capital needs that follow from these risk exposures. The matching of the own funds to the risk profile should help promote a strong culture of risk management, which in turn is a key underlying feature of the ORSA process and, more widely, in soundly running the business. Thus, the ORSA really represents the heart of the Solvency II regime.

Introducing the ORSA is a demanding task for the boards of insurance undertakings. Unfortunately, or not, there is no mechanical way of conducting an ORSA and often a cultural change is needed both at board level and in the organization.

For supervisors, the important element is to obtain confidence that the board knows what company it is running and that the company can "afford" it's strategic plan 3-5 years ahead, including bumps on the way. Models cannot replace leadership!

I believe that for the EU insurance sector the focus of Solvency II in the risk management area is of particular relevance in the present crisis situation, and for the challenges ahead. Now, more than ever, insurers need to rely on strong risk management capabilities in order to deal with the different challenges posed by the economic slowdown, financial market volatility, the stress on sovereign debt, demographic changes and the evolving pattern of natural catastrophes.

During the last decade, partly due to the push from Solvency II, not only risk management itself but also its practical application underwent a major transformation. Improvements in modelling methodologies, significant development of new internal control instruments, increasing investors' and analysts' pressure, as well as a new

generation of risk managers with a more holistic view arriving in companies also triggered change. Companies which invested, early and continuously, in establishing an effective and well integrated risk management are now taking the benefits from that strategic decision.

Finally, Solvency II will increase considerably the information disclosed to the public by insurance undertakings, providing a level of transparency that will reinforce market discipline.

Is Solvency II then the perfect system? No, certainly not. Some unintended consequences have been pointed out and deserved appropriate attention.

Will Solvency II penalize small and medium size undertakings and promote a massive concentration of the market?

One of the fundamental principles in Solvency II is proportionality. This concept is applied to the quantitative requirements, through the possible use of simplifications, to the qualitative requirements and also to the reporting, disclosure and supervisory process. Smaller or less complex undertakings will have less to report due to their size or less complex risk profile and will be exempt from quarterly reporting.

How will Solvency II deal with long-term guarantees?

These types of products are under pressure relating to their sustainability. The low interest rate scenario creates further challenges for them. Being based on market consistent valuations, Solvency II will necessarily reflect the underlying market volatility on the insurers own funds and will make these challenges more transparent.

I believe that the current efforts to devise an adjustment in the valuation of long-term illiquid and predictable, matchable commitments may be a pragmatic solution to deal with this volatility. This solution could also be applicable in the revision of the IORP Directive, allowing for a consistent valuation of pension liabilities.

However, this should not be used to support the maintenance of unsound and unsustainable products and practices that ultimately will penalize policyholders.

Will Solvency II be pro-cyclical?

Solvency II will incorporate various tools to deal with pro-cyclicality, namely the establishment of two capital requirements and of a supervisory ladder of intervention and the definition of extended recovery periods.

Furthermore, Solvency II will introduce a dynamic symmetric adjustment on the capital requirement applicable to equity risk and spread risk. Effectively, these risk charges will increase when markets are booming and will decline when markets are in stress.

Solvency II will bring a better alignment between risk and capital, promoting good risk management practices and fostering transparency. Regulatory regimes are always a result of a balancing act between different objectives. Solvency II will provide an appropriate basis for increased policyholder protection and will contribute to reinforce financial stability, allowing insurance companies to continue to play their natural counter-cyclical role in times of stressed markets. Achieving this goal in the current volatile market circumstances is the ultimate challenge.

We have highlighted to the EU political institutions the importance of proceeding with the efforts to arrive at a final decision on Omnibus II in time to start the implementation of Solvency II in the 1st of January 2014.

Let me be clear: The crisis has only reinforced the need for Solvency II.

EIOPA has been working on Solvency II, advising the EU Commission on the level 2 implementing measures. We have also been developing draft standards and guidelines on around 40 different areas of Solvency II. We are doing this in a transparent way by informally consulting with key stakeholders. We plan to publicly consult as soon as the legal framework will allow us to do that.

In this work we combine the experience and expertise of our staff and the staff of our members. Our member's involvement is fundamental for the success of EIOPA. In this context I want to thank the Central Bank of Ireland, and particularly Matthew Elderfield and his colleagues, for the excellent contribution to EIOPA's work and for the commitment to develop a truly European approach.

But Solvency II is not the only area where EIOPA has been active.

On the regulatory side we delivered our advice to the EU Commission on the revision of the IORP Directive. Stability and consumer protection were at the core of our

advice. We advocate the use of a consistent and realistic measurement of all assets and liabilities and proposed the adoption of a Key Information Document containing the fundamental elements about performance, costs, charges and risks of defined contribution schemes. I believe that this will help to increase the confidence of consumers in this type of plan.

On the financial stability area, we coordinated the first EU-wide stress test on the insurance sector, assessing resilience to major shocks and identifying the main market vulnerabilities. A separate exercise tested the adverse effects of a prolonged period of low yields.

On the international area, EIOPA delivered to the EU Commission its assessment of the equivalence with Solvency II of the Swiss, Bermudan and Japanese regimes. Furthermore, EIOPA has joined the IAIS has a full member and is actively engaged in the development of international regulatory projects like ComFrame and Global Systemically Important Insurers.

Let me elaborate a little bit more on this last issue.

The discussions under the umbrella of the FSB will result in the identification and regulation of Globally Systemically Important Insurers.

Financial institutions are usually considered to pose systemic risk if their failure leads to the possible failure of other financial institutions or the freezing of financial markets. This risk imposes a negative externality on the financial system as a whole and needs to be adequately regulated.

Traditionally systemic risk was a banking concept. However, the recent crisis showed us that certain activities developed under the insurance sector can also pose systemic risk. Insurance companies or groups that engage in non-traditional or non-insurance activities (for example: CDS, financial guarantees or leveraging assets to enhance investment returns) are more vulnerable to financial market developments and, importantly, more likely to amplify, or contribute to, systemic risk.

Of course, this assessment may change over time, depending on the innovations and changes in insurance business models, especially in life insurance, as well as in the complex interactions between insurance groups and financial markets.

As a consequence, the identification of a systemically important insurer as such, should be a direct reflection of its source of systemic importance. While the size of traditional insurance activity is still an important factor, it should not be the dominant factor in the identification process. Clearly the non-traditional and non-insurance activities and the degree of interconnectedness with the other components of the financial system are more relevant from a systemic viewpoint.

Consequently, the differences between insurers and banks in the impact of failures suggest that requirements for loss absorbency and resolution regimes for insurers should accept these salient differences and propose solutions that differentiate accordingly.

Let me now turn to the impact on supervision.

A major change introduced by Solvency II is that the supervisory review process should also be risk-based. This will ensure that supervision takes the risk profile of all undertakings into account, provides a further incentive for undertakings to better measure and manage their individual risks, optimizes supervisory resources and ensures an appropriate level of policyholder protection across their market.

The development of a common framework and best practices for the supervisory review process is a key element in achieving a more convergent risk-based supervisory regime across the European Union, given it provides a common basis for supervisory intervention and for the exercise of supervisory powers. This will be one of the essential objectives of EIOPA for the years to come.

The crisis showed that supervision of the governance systems needs to be reinforced. Under the supervisory review process of Solvency II, the undertaking should be required to demonstrate to the supervisor that it has a robust risk management system which is capable of identifying, monitoring, and mitigating both current and future risks in line with its set risk tolerance/risk appetite. One fundamental element in this context is evidence of the use of stress testing and scenario analysis.

The objective of the assessment by supervisors is to evaluate whether this process is adequate and delivers a prudent picture of the risk profile of the undertaking.

Supervisors need to reinforce their assessment of the risk management systems implemented by undertakings and should act swiftly when they found deficiencies in

this area, imposing repair and monitoring its implementation. Capital is not the answer for poor risk management.

The move towards a single rule book like Solvency II has an inherent value for the EU single market. However, let us not fool ourselves; this needs to be accompanied by an improvement in the quality and consistency of supervision.

More complex and risk-based regulation without an enhancement on the effectiveness of supervision simply will not work. Supervisors need to recruit and maintain a sufficient number of skilled and experienced staff to properly supervise the new system. We need supervisors that understand the business and the associated risks in order to put the right questions and challenge the management of the undertakings.

In particular, the challenges of supervising the most large and complex institutions call for the pooling of resources. This is a domain where the ESA´s can play a fundamental role, fostering the convergence of the supervisory practices and the creation of a truly European supervisory culture.

Finally I would like to talk about consumer protection, an issue that we cannot underestimate in the current regulatory agenda.

Beyond defining appropriate general principles of financial consumer protection, I believe that we should rethink the policy tools used under consumer protection regulation.

We need to reconsider the tools that we traditionally used to deal with information asymmetries, conflicts of interest and market inefficiencies. We need a paradigm shift.

On the information side we need to reinforce standardization and comparability. However, information should not be used to shift responsibility from the providers to consumers. We cannot take for granted that consumers always make rational decisions. Furthermore, it is not all about transparency. Disclosure is a relevant tool but alone cannot deliver the full results for consumers.

On the provision of advice we need to take a closer look at conflicts of interest. Unfair practices leading to consumer detriment in the financial sector are often due to situations of conflicts of interest. Agency incentives can be the main driver of the kind

of product to be sold. Sometimes these results in the sale of products which are not suitable for the consumers concerned. This necessarily entails that selling practices, whether through intermediaries or direct writers, should meet certain high standards.

Finally we also need to pay further attention to product suitability. The governance system of insurance providers should include a framework for early detection of unfair products, clauses or selling practices. I believe that this can usefully include the request of an independent opinion on the product design and characteristics by the internal governance functions. Furthermore, supervisors need to have the powers to oversee this process and intervene when necessary.

EIOPA is taking consumer protection as one of its priorities.

We publicly consulted on a set of guidelines on complaints-handling by insurance undertakings and issued recently a Report on good practices for disclosure and selling of variable annuities, which is part of our own initiative work on consumer protection and financial innovation. The publication identifies which type of information customers should receive in order to be able to take informed decisions when considering buying a variable annuity and refers to good practices regarding advice to be given to customers in this context. Most importantly we indicate that variable annuities should be only sold with proper advice.

EIOPA's strategy on consumer protection aims to reinforce confidence by enhancing fairness, simplicity and transparency in the insurance and pension markets.

Ladies and gentleman, I will close my intervention by referring to a song of one of my favorite bands which happens to be Irish: The Corrs. This song reflects on one side the traditional catholic roots of the Irish people and on the other the importance of keeping your memory fresh and taking the right lessons from history. Like The Corrs, in thinking about the future of financial regulation, we need to "Forgiven Not Forgotten".

Thank you for your attention.