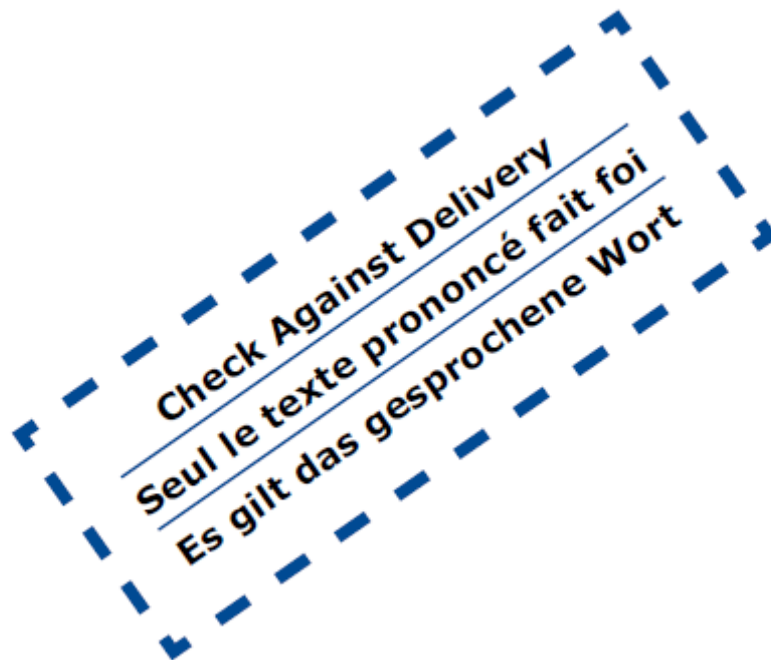




KEYNOTE SPEECH

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The future of life insurance, Solvency II and investment strategies



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Ladies and Gentlemen,

It is a great pleasure for me to be here in Munich at the Handelsblatt Conference. I would like to thank the organisers for inviting me and providing me with the opportunity to share with you some views concerning one of the core work streams of EIOPA – Solvency II.

My speech today has two major themes. I will start by addressing the current state of preparation for Solvency II implementation and those regulatory and supervisory initiatives that have been undertaken by EIOPA with regard to the upcoming regime.

The second theme I will address today is the future for Life insurance business and the link to investment strategies in a new economic environment.

Solvency II regulatory package

First of all, I am happy to state that Solvency II, the project that was launched 13 years ago, is finally becoming a reality.

We have a clear deadline for its implementation – 1 January 2016 and it is a moment of great importance. We will see a robust framework that captures the economic reality of the asset-liability position of insurers and that brings capital much closer to the insurers risk profile. Furthermore, Solvency II promotes a strong risk culture and stimulates insurers to develop strong risk management capabilities.

EIOPA is in the process of releasing for public consultation, in line with the Omnibus II Directive, its **draft implementing technical standards** (ITS) that define forms, templates and procedures for specific areas under Solvency II. The Omnibus II Directive also clarified EIOPA's role in ensuring harmonised technical approaches to the calculation of technical provisions and capital requirements. Furthermore, on our own initiative we are going to deliver several **Guidelines related to Solvency II**. These Guidelines are non-binding instruments that aim to ensure common, uniform and consistent application of Union law as well as to establish consistent, efficient and effective supervisory practices.

So far we are proceeding according to the timeline communicated at the beginning of this year. In April – June this year, we conducted the public

consultation on the first set of the ITS that relate to supervisory approval processes. Now EIOPA experts are examining the feedback from this consultation and we intend to submit this set of ITS to the European Commission on 31 October 2014.

In June, we launched the public consultation on the first set of our Guidelines, which cover different elements from Pillar 1 (Own Funds, the Standard Formula of the SCR, Technical Provisions, Group Solvency) as well as internal models; Own Risk & Solvency Assessment (ORSA) and Governance; Supervisory Review Process; Equivalence.

By the end of this year we will have launched the public consultations on the second sets of our ITS and Guidelines. They will be in consultation until March next year. I would like to use this opportunity to encourage all of you to profit from EIOPA's public consultations, to share with us your views. Only with your input we can ensure a balanced approach towards the implementation of the risk-based supervisory regime.

Solvency II preparatory phase

EIOPA strongly advocated a common European approach towards the preparation for Solvency II during the years 2014 and 2015, in order to avoid diverging approaches being taken by Member States. For this purpose we developed a framework that has a practical value for all the parties involved. Last year EIOPA issued its **Guidelines on preparing for Solvency II** that became applicable as of 1 January 2014.

The Guidelines cover elements such as system of governance, including risk management; forward looking assessment of the undertaking's own risk (based on the ORSA principles); submission of information to National Competent Authorities (NCAs); and pre-application for internal models.

I am very pleased with the **overall EU level of compliance with our Guidelines** – almost all the national authorities reported to us their compliance or intention to comply. I am particularly happy that Germany has decided to adopt the EIOPA Preparatory Guidelines, and to use them as part of the roadmap to implementing Solvency II.

The objective of our Preparatory Guidelines was, and remains, to allow both supervisors and companies to set up structures and make themselves familiar with

new requirements, a new system; to start the process of enhanced communication between NCAs and firms, and in general to use this interim period as a warm-up for the Solvency II implementation. I am convinced that if the remaining 18 months of this two year period continue to be efficiently used by all of us, we will come to 1 January 2016 with a good level of preparedness.

In order to support supervisors and undertakings in this work, EIOPA has established a dedicated Questions & Answers tool. With this tool we expect to clarify the intention or meaning of Guidelines and to provide, where appropriate, guidance on how the Guidelines should be interpreted within a particular context. The answers are published on EIOPA's website.

Proportionality

One of the fundamental principles in Solvency II is proportionality and we took it very seriously in our standards and guidelines. But proportionality does not mean 'no application'. It means to apply the principles in a way that we achieve the same outcomes with a 'tailor made' solution.

There are many examples of proportionality in Solvency II.

In the reporting requirements, implicit proportionality is embedded in the regulatory templates. Companies with simple business models, few business lines, and simple investment strategies will see their reporting requirements significantly diminished. SME's will see reduced frequency in reporting, with quarterly reporting concerning only some core elements.

In the governance requirements, the implementation of the key functions is also subject to proportionality. Simpler organisations will need simpler arrangements to implement risk management, actuarial, internal audit and compliance functions. Outsourcing can and should be used. It will be possible to accumulate more than one function if no conflict of interest arises.

EIOPA advice on the treatment of securitisations

The next step in the road towards Solvency II implementation will be the publication of the Delegated Acts by the European Commission. EIOPA has provided the EU

Commission with extensive advice on these measures, including the design and calibration of the capital requirements for certain long-term investments. As a result of this analysis EIOPA has proposed an innovative approach to financial markets risk-based regulation: a more granular treatment of securitisations. In order to identify securitisations with a better risk profile EIOPA has developed a set of criteria on structure, quality of the underlying assets, underwriting processes and transparency.

Given the complexity and poor performance of some securitisations, especially those backed by subprime mortgages, securitisations are sometimes met with a degree of scepticism. However, securitisations meeting the criteria developed by EIOPA have performed well, with low spread volatility and low default rates. We are convinced that the envisaged capital charges will allow the insurance sector to provide meaningful long-term financing within a sustainable environment.

Let me be clear: it should not be the role of prudential regulation to favour certain asset classes over others. In a risk-based capital framework, the asset risk charges should be calculated according to the underlying risk profile of the asset class, based on the risk definitions and on the data available.

Inappropriate risk charges will create the potential for mis-assessment of risks, which in turn prompts price distortions and the emergence of price bubbles. In the end these bubbles inevitably burst and create market instability.

At EIOPA we are committed to continuously refining methods and searching for better data in order to maintain the calibrations of Solvency II in line with the underlying risks. In line with this vision we welcome the insertion in the Delegated Acts of a clause allowing for the review of risk charges.

Supervisory initiatives

Besides the regulatory work, EIOPA sees a strong need to prevent regulatory arbitrage and to guarantee a level playing field in the internal market by promoting supervisory convergence and establishing a common supervisory culture.

EIOPA's work on supervisory convergence is underway through the development of a Supervisory Handbook that will incorporate good supervisory practices.

Furthermore, last year EIOPA set up a **Centre of Expertise on Internal Models**. Its aim is to enhance understanding, consistency and soundness in the validation, implementation and monitoring of internal models, and to provide the relevant support to NSAs. We conducted a peer review on internal models, during which we identified differences of supervisory practices in the pre-application process of internal models; summarized best practices and provided a number of recommendations addressed to NSAs. Currently we are monitoring the implementation of our recommendations. I think this will contribute to the improvement of another very important element of insurance supervision – the work of supervisory colleges.

In the coming years EIOPA will pay even more attention to supervisory consistency and convergence in the implementation of Solvency II.

Perspectives for life insurance and investment strategies

Let me turn now to the second part of my intervention – the future of life insurance and investment strategies.

I strongly believe that the implementation of this new risk-based framework will have a positive impact on the future of life insurers. We need a robust framework that prices correctly any options embedded in the contracts and captures the true economic reality of the asset and liability position of insurers. We need to recognise that guarantees have a price.

We believe that thanks to the long-term guarantee measures captured in the Solvency II regime, insurers will develop **new kinds of products** and **will better price the options and guarantees involved**. We need to continue to see **changes in product design** in order to adjust the mix of business. The matching adjustment regime can be used to deliver products with specific guarantees.

I believe in the future of life insurance. The increase in longevity creates a growing awareness that mitigating the risks of longer life expectancy will increasingly fall on households – we will all need to save more in order to maintain sustainable levels of living after retirement.

In the coming years we will see changes. I believe that we will see the emergence of new products, some more simple and standardized, others combining retirement,

healthcare and dependency. Insurers will use “big data” to present tailor made solutions to different customers. We will see different types of guarantees tracking the life cycle, including periods of capital preservation.

Product innovation will be more and more critical and new intermediation channels through “social media” will emerge. We will probably see new entrants in the business with a more sophisticated technological background allowing them to sell commoditised products. We will have specialized companies managing some back books of guarantees and an increased innovation in capital solutions through securitization of longevity risks.

At the same time, we are seeing some changes in the investment strategies of insurers due to the current challenging economic and financial environment. This environment is prompting some portfolio shifts in insurers’ investment policies towards corporate bonds and we see insurers exploring new asset classes. The latter development seems to reflect both a search to enhance yields and a desire for diversification. This movement should be effected in a controlled way, preserving the asset-liability management principles of the insurance industry. In particular, it is paramount that the Solvency II risk management requirements are properly implemented.

Overall, this could be a positive development, contributing to a more diversified investment policy and reducing the sometimes excessive concentration of investments in sovereigns and banks.

But insurers need to be quite aware that they are managing assets in the best interest of their clients. In a prolonged period of low interest rates, where search for yield is a reality, a robust risk assessment is essential. That’s why the Solvency II risk management requirements are now more fundamental than ever. I am sure that insurers will be careful with their risk-taking on the asset side, recognizing that the current reduced market volatility is mainly due to unusual economic and macro policy conditions.

This is why in our current stress test we test the effects of a prolonged period of low interest rates but also the consequences of a sudden snap back of risk premia with the corresponding enlargement of spreads.

Furthermore, in a period where the capital position of banks is still under repair, we will be attentive to the investment strategies pursued by insurers, namely concerning the coco's issued by banks and the possible increase of interconnectedness in the financial market.

The focus on the consumer

The crisis has taught us that all the changes in the financial markets need to be accompanied with a clear focus on the interests of the consumer.

Boards of insurance companies need to put issues such as **product governance, product suitability and appropriate selling practices** at the top of their agenda.

Board members need to make sure that product characteristics are suitable for the target market, that distribution channels are appropriate for that market segment that proper incentive structures are in place and that full transparency on costs is provided to consumers. Together with the other ESAs we produced some high-level principles on product oversight and governance last year and now we are moving forward with developing more detailed rules.

Consumers in Europe **need to be well informed**. Information to consumers prior to purchasing an insurance contract and throughout the duration of the contract should cover the basics about the contract: its risks, rewards and costs, particularly if it has a savings or investments element, the insurance benefits, complaints-handling procedures etc. Information needs to be prepared in a way that consumers can easily understand. Care should be taken to target essential consumer information. Too much information is as bad as too little.

We all know the challenges consumers face in understanding investments and savings and other complex products, particularly when information provided is overly lengthy, legalistic and full of jargon: regulators and firms must take this opportunity to do more to protect consumers in this area. This means **simplifying information** as far as possible, which is of course very challenging, let's not under-estimate it. This is where the recently agreed PRIIPs Regulation comes into play. For its part EIOPA and the other ESAs are already working together to prepare for detailed practical work on implementing measures to help address these challenges. We will – and this is vital – take the input of consumer testing into account when developing the key information

document. We need to listen to consumers if we want to develop disclosures that stand a chance of being used.

Rule number one of every provider in the financial sector should be: **The consumer is at the centre of my business, and not the other way around.**

Conclusion

Let me conclude.

In the aftermath of the financial crisis it is a clear political objective of the EU institutions to reinforce the regulation and supervision of the financial sector in order to promote financial stability and strengthen consumer protection, supporting the public confidence and the trust of citizens.

In the insurance area this political commitment is reflected in the evolution of the EU regulatory framework, in particular with Solvency II, and in the responsibilities entrusted to EIOPA as part of the European System of Financial Supervision.

The implementation of Solvency II needs to be used as an opportunity to further embed a strong risk culture in the day-to-day operations of undertakings, providing for an appropriate balance with the natural sales-driven culture. Risk considerations and their capital consequences should be explicitly taken into account in the strategic decisions of insurance companies.

All in all Solvency II will bring significant benefits for consumers: more sustainable promises and products; more accurate and fairer pricing coming from better knowledge of the risks and better data used; better governance ensuring more balanced and fairer decisions; more transparency and disclosure by insurers and better and more effective supervision through reporting requirements more adapted to risks.

EIOPA will be monitoring attentively the implementation of the new risk-based regime in order to make sure that we will reap the projected benefits for consumers and for the stability of the financial market. We count on the German insurance industry to lead the way in this direction. If you work together you will be as successful as the magnificent German football team that won the world cup.

Thank you for your attention.