

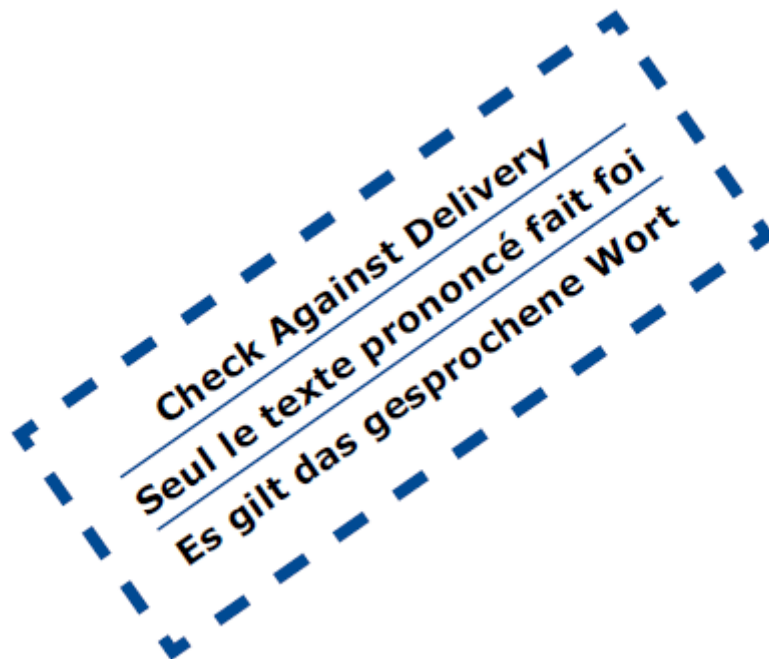


KEYNOTE SPEECH

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Solvency II implementation - beyond compliance



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Ladies and Gentlemen,

Introduction

Before I start I would like to thank the Italian Insurance Supervisor – IVASS - and its president Salvatore Rossi for organising this conference and for hosting it in this beautiful setting.

It is a great pleasure for me to be here today to contribute to the discussion on one of the milestones in the history of EIOPA – the implementation of Solvency II.

Summary

The title chosen for this conference is particularly relevant for EIOPA because the word “launch” perfectly reflects our current frame of mind.

- I will start by explaining why this is, and EIOPA’s role in the implementation of Solvency II.
- I will then focus on some important challenges related to the implementation of the new risk-based regime, and what should be done in order to deliver on the intended objectives of Solvency II.
- Finally, I will share my views on the post-evaluation process that will guide us to the Solvency II review.

Background

The first regulatory journey of EIOPA was completed in 2015. So on 1 January 2016 a new, more challenging and much more important supervisory journey began.

This is the convergent implementation of the new risk-based regulatory framework across the European Union.

This is EIOPA’s mission, and I am confident that our unique position as a European Authority, working together with the National Competent Authorities (NCA’s), will allow us to provide a good level of consistency of supervisory approaches and practices.

We have been preparing for this journey for the past two years.

From regulation to supervisory convergence

Why is supervisory convergence so important? Because it is essential in order to achieve three fundamental objectives:

- Firstly, to ensure that European Union regulation is applied in all Member States;
- Secondly, to guarantee a level playing field and prevent regulatory arbitrage in the internal market;
- Thirdly, to safeguard a similar level of protection to all policyholders and beneficiaries in the European Union.

Given the current differences of supervisory cultures and practices between Member States, I appreciate that our new journey might turn into an "Odyssey". But it is the right "Odyssey" for us to be undertaking.

The European Union has to have a common supervisory culture and this is precisely why EIOPA and the European System of Financial Supervision (ESFS) were created. We are decisive and fully committed to enter this new journey for the sake of a more coordinated and more robust financial supervision in Europe.

In the coming five years one of our main priorities will be to increase convergence towards a European supervisory culture. A risk-based culture that:

- Aims to ensure strong but fair supervision;
- Is based on a forward-looking approach to risks;
- It takes into account that it is always better prevent than repair.
- Prioritizes the dialogue with market participants in order to better understand their business models, strategies and underlying risks;
- Promotes early enough awareness and supervisory action in order to protect policyholders and mitigate possible disruptions in the market.

EIOPA's actions and tools

So how exactly is EIOPA building a common supervisory culture? Let me mention a number of examples.

Firstly, EIOPA is building a comprehensive information system based on the data collected under the new harmonized Solvency II reporting templates.

With this system, the insurance supervision in the EU will have a new vital asset:

- It will further develop the capacity to provide reliable risk analysis and early warning indicators, both at individual, group and system-wide level;
- It will improve the supervisory understanding of cross-border groups;
- It will provide NCAs with peer group comparisons, increasing supervisory capabilities at the national level.

In one word, it will reinforce the quality of both micro- and macro-supervision in the European Union.

Secondly, EIOPA is developing on a step by step basis a Supervisory Handbook setting out good risk-based supervisory practices on different areas of Solvency II. In the Handbook we have already covered areas like: risk assessments; how to supervise board responsibility within the Solvency II governance system; business model analysis; supervision of technical provisions; prudent person principle in investment policies and monitoring of internal models. And we encourage NCAs to implement these good practices in their supervisory processes.

Thirdly, a special attention is devoted to the on-going monitoring of internal models, an area where material differences can have a huge impact in the level playing field and policyholder protection. EIOPA already issued in 2015 a couple of supervisory Opinions with recommended practices to NCAs and this work will continue this year by prioritizing the areas where different approaches lead to a material impact. Going forward we will focus on the development and testing of sound on-going appropriateness indicators and benchmarking for internal models. This work will be fundamental to ensure that internal models will continue to fulfil the required standards and avoid that they become a capital optimization tool. A race to the bottom will kill the underlying idea of an internal model.

And we've done much more over the past two years:

- EIOPA delivered the Solvency II Implementing Technical Standards and Guidelines. Some Guidelines concern the basic alignment of supervisory processes while others provide clarity to firms on what supervisors' expectations are. I am convinced that without Solvency II Guidelines, undertakings would have faced hundreds of pages with different national solutions and it would have been much more complicated to achieve supervisory convergence.

- Colleges of supervisors across the EU have been fundamental to increase the exchange of information and to move towards a more common analysis and measurement of risks.

As of January 2016, we are publishing on a monthly basis the risk free interest rate term structures to be applied by all insurance and reinsurance companies in the calculation of their technical provisions. The use of harmonised discount rates will ensure a more consistent calculation of technical provisions by insurers and reinsurers throughout the European Union.

Going forward, “Peer reviews” will continue to be used to compare and assess the quality of implementation of Solvency II and corresponding supervisory practices, followed by concrete recommendations to address the issues identified.

Furthermore, EIOPA’s Oversight team will continue the bilateral engagement with NCAs, providing independent and challenging feedback on supervisory practices, facilitating cross-border discussions and supporting improvements in local supervision. In this context, the 2015 balance sheet review done in cooperation with the local supervisor in Romania proved to be essential to increase the credibility and enhance consumer protection and confidence in the Romanian insurance sector. A similar exercise is currently being organised in Bulgaria. EIOPA’s oversight work is already starting to prove its vital importance in ensuring strong but fair supervision and a forward-looking approach to risks.

Challenges in Solvency II implementation

Let me now turn to three main challenges related to the Solvency II implementation and the expectations from the supervisory side.

These are:

- the use of the Own Risk and Solvency Assessment (ORSA)
- Solvency II public disclosure, and
- the creation of a more consumer-centric culture

Challenge 1: The use of the Own Risk and Solvency Assessment (ORSA)

A crucial element in Solvency II is the new risk management requirements and, in particular, the Own Risk and Solvency Assessment (ORSA).

Insurance undertakings should make full use of the ORSA to set up a strong risk culture. Insurers should increasingly use robust risk management capabilities to deal with the different challenges posed by the economic slowdown, the low interest rate environment, the financial market volatility and the stress on sovereign debt.

But the time of “box ticking” is over. Risk management requirements and specifically the ORSA cannot be taken as a compliance exercise. This requires a clear tone from the top. We expect Boards of insurance companies to set, communicate and enforce a risk culture that consistently influences, directs and aligns with the strategy and objectives of the business and thereby supports the embedding of its risk management framework and processes. Supervisors will need to be very attentive to this issue.

Challenge 2: Solvency II public disclosure

One of the cornerstones of the new regime is transparency. With Solvency II undertakings need to publically disclose essential information on their solvency and financial condition. For most parts of the European insurance and reinsurance market this is a novelty and a paradigm shift in terms of communication with the outside world. This should be used as an opportunity. An opportunity to address stakeholders' perception on perceived opaqueness and inadequacy of publically disclosed information. We encourage insurance and reinsurance undertakings to embrace this opportunity and to actively engage in consistent, comparable and high quality communication with their stakeholders on their solvency and financial condition.

Here I would also like to highlight the importance of a good understanding of the Solvency II disclosure by those who shape the public and market opinion about companies – financial analysis, researchers and journalists. A collective effort is needed to ensure that the Solvency II metrics and their sensitivities are properly understood, in particular because they will be more volatile than in the past.

Challenge 3 – creating a consumer-centric culture

The new governance requirements as a paradigm shift towards a more consumer-centric culture. There is a need to better integrate conduct of business concerns in the institutional governance arrangements in order to ensure that companies reliably place the interest of their customers at the heart of their business.

But it is not only about designing and putting in practice appropriate governance structures and controls. It is now time to ensure that they are effective and that they deliver the desired outcomes. We do not want a move to a culture of formal compliance; rather we all need to promote a culture based on strong ethical values.

When putting in practice the fundamental sound governance basis of Solvency II, special attention should be devoted to the companies' processes related to the manufacturing and distribution of products.

When designing products, insurers have to identify the target market of the product, analyse its characteristics and ensure that the product meets the identified objectives and interests of that target market.

The distribution channels selected also have to be appropriate for the target market and clear, accurate and up-to-date information has to be disclosed to distributors.

In effect, companies need to establish processes so that they and their senior management and boards can take more responsibility for ensuring their products are only sold to those they are designed for. Consumers need to be placed at the heart of companies' business. This is good for consumers and good for the business.

The review of Solvency II

Now that Solvency II is in place we need a period of stability of the regulatory framework. But financial regulation and supervision cannot exist independently from economic reality. A sound process of post-evaluation of the new regime is an integral part of good regulation. Therefore, the foreseen review is a logical and reasonable way forward. EIOPA is already preparing the relevant project plans in order to ensure a rigorous, evidence-based and transparent review of the framework.

Our work will assess possible cumulative effects and unintended consequences, privileging principles like simplicity and proportionality. Special attention will be given to procyclicality and effects on insurance investment behaviour and product availability to consumers.

From this year till 2020 EIOPA will perform a yearly assessment of the implementation of the long-term guarantee measures.

By 2018 we need to revisit the calibration of different asset classes under Solvency II, and this should include sovereign bonds. The recent financial crisis has demonstrated

to all of us that sovereign bonds are not always risk-free. So, a risk-based regulatory framework should take this into account.

In April 2015 EIOPA issued an Opinion on the preparation for Internal Model applications, recommending that risks related to sovereign exposures should be appropriately taken into account in internal models. Going forward, we will monitor the practical implementation by the insurance market in the European Union.

The subject of a possible consideration of sovereign risk in the Pillar 1 standard formula is a more complex one. In my opinion, to avoid regulatory arbitrage, it is particularly important that we work on an approach towards sovereign risks that is consistent for the entire financial sector, covering banking and insurance.

Moreover, from a prudential perspective, I believe that the regulatory treatment should focus on building appropriate incentives to avoid excessive concentration on a specific sovereign. This work should be part of a comprehensive process that includes public consultation, a rigorous impact assessment and the definition of appropriate transition measures to avoid unintended consequences.

Furthermore, the future review of Solvency II should also benefit from the progress achieved at an international level. EIOPA will continue to give the European Union a strong voice in international fora and will further strengthen its successful participation in the development of the insurance International Capital Standards.

Conclusion

Solvency II represents an enormous opportunity to improve risk management, embed a risk culture in the organisations and develop sustainable business models putting customers at the centre of the undertaking's strategy. It also creates an opportunity to improve the functioning of the internal market, in particular by ensuring a high, effective and consistent level of supervision, preventing supervisory arbitrage, guaranteeing a level playing field and ensuring a similar level of protection to all policyholders.

I am confident that if both the insurance market and supervisors remain faithful to the sound, basic principles of the Solvency II framework, the results for enhanced consumer protection and financial stability will be very positive.

I would like to re-phrase Julius Caesar who said that "It is easier to find men who will volunteer to die, than to find those who are willing to endure pain with patience".

Well, we all need to become a legion of those rare men that stand ready to endure the pain of learning and reforming our financial system with patience. Trust me the reward will be big. We are given the chance to create the basis for a more stable future for the next generations of European Union citizens.

If we proceed in this spirit, work together, learn from each other and listen to each other, in the end we all will become the winners of this battle! Fortune favours the brave!

Thank you for your attention.