



SPEECH

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Solvency II – Where do we stand? Consumer Protection – Where do we go?”



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Ladies and Gentlemen,

Before I start I would like to thank the German Federal Financial Supervisory Authority, BaFin, in particular Frank Grund, for inviting me to today's conference held in this impressive building of the Rheinisches Landesmuseum, one of the oldest museums in the country. The topic of today's conference is about Solvency II and where do we stand with its implementation. It is a great pleasure for me to contribute to today's discussions on *Solvency II – Where do we stand? Consumer Protection – Where do we go?*"

Therefore, my intervention will be divided in the following two parts:

- In the first part, I will give an update on the **status of Solvency II**. Afterwards, I will highlight the **importance of moving towards supervisory convergence**
- In the second part, I will answer the question, **where do we go in the area of consumer protection?**

To my first point: Solvency II – Where do we stand?

Solvency II implementation is a **huge step forward in the protection of policyholders**. But in order to ensure the protection of policyholders and beneficiaries all supervisory authorities in the European Union should be provided with the necessary mandate and means. They need the relevant expertise and capacity to execute this mandate in full independence. In a single market, where cross-border business plays an increasing role, it is fundamental to ensure that the supervisory system has **no weak links**. The European Union supervisory system will only be as strong as its weakest link.

Solvency II implementation is therefore **the tremendous opportunity** for supervisory convergence and all National Competent Authorities (NCAs) need to be part of the collective effort to develop **a common European supervisory culture**.

A stronger and more coordinated supervision at the European level is needed. This implies a **common interpretation of the laws and regulations**, a **common understanding of supervisory objectives** and a **common view on the key characteristics of good and effective supervision**.

Why supervisory convergence is so important? Because it will achieve three strategic objectives:

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

EIOPA has a **number of tools and has undertaken actions** to properly delivering the supervisory convergence programme.

We are building up 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.

For short, it will **reinforce the quality of both micro- and macro-supervision in the European Union**.

Another important work stream related to convergence is the **Supervisory Handbook EIOPA** is developing on a step by step basis. The Handbook sets out risk-based supervisory good practices covering different areas of Solvency II. It already covers areas such as:

- 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
- Monitoring of internal models

EIOPA **strongly encourages national competent authorities (NCAs) to implement these good practices in the supervisory processes and will implement a training program for supervisors.**

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 ensures a more consistent calculation of technical provisions by companies throughout the European Union.

EIOPA devotes a special attention 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 is **prioritising the on-going monitoring of internal models**, by working on consistency reports on issues like the treatment of sovereign debt and the modelling of the volatility adjustment as well as market and credit risks. We are conscious that potential material differences due to diverse interpretations by National Supervisory Authorities could have a huge impact in the level playing field and policyholder protection.

And we will continue with other appropriate activities towards the supervisory convergence:

- EIOPA will continue to **engage in bilateral on-site activity with the National Supervisory Authorities**, by providing independent feedback and by challenging supervisory practices. Following recent failures with high impact on cross-border business, EIOPA is reinforcing the exchange of information between National Supervisory Authorities and has a key and crucial coordinating role to ensure proper cooperation

and effective supervision. Cooperation and exchange of information should be reinforced starting at the authorization process.

- EIOPA is **supporting improvements in national supervision** in exercises such as the conduct of Balance Sheet Reviews as it was the cases of Romania and now Bulgaria. We have been instrumental in setting up and designing these reviews, providing in-depth sector expertise and knowledge and continuously following its implementation. These exercises add credibility to the market and ultimately enhance consumer confidence.
- **EIOPA's "peer reviews"** will 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.
- I should not forget to mention **EIOPA stress tests**, the tool to assess risks and vulnerabilities and to develop common and coordinated responses to the persistent low interest rate environment.

Let me make a reference to some **challenges** related to the Solvency II implementation and the expectations from the supervisory side:

- **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. **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, to communicate and to 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. This will also require a change in culture by supervisors:

with the analysis of the ORSA they should focus more on “what can go wrong” and not only on “what went wrong”. A forward looking perspective is needed.

Another challenge:

- **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. In particular, it is fundamental to be fully transparent on the use and impact of transitionals and the long term guarantee measures; transparency can work for you if you embrace it. Don't be afraid of transparency.**

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.

- **Proportionality**

All **Solvency II requirements need to be applied in a proportionate way.** There are various examples of proportionality embedded in the Solvency II texts (Directive, Implementing Acts, EIOPA Guidelines). But proportionality needs to be lived in a day to day implementation and supervision of Solvency II. EIOPA is very interested in understanding how proportionality is considered in the different countries. We are launching a peer review on “key functions” of the system of governance with a particular focus on proportionality.

Furthermore, on the SCR Review envisaged for 2018, we are particularly interested in **concrete examples of simplifications** that can make the regime more proportionate. We will have a first discussion paper out before the end of 2016 and welcome the engagement of the German market.

And to my second point: Consumer Protection – Where do we go?

EIOPA places consumer protection, both through prudential and conduct of business regulation, at **the centre of its strategy**. Failures in consumer protection not only harm individual consumers, but may also have a wider prudential impact, posing a threat to the stability of the sector.

In order to prevent that, EIOPA is **implementing a strategy on preventive risk-based conduct supervision** to spot outliers and upcoming problems, investigate the root causes and develop supervisory or regulatory responses. EIOPA uses tools such as market monitoring, Consumer Trends Reports, Thematic Reviews and indicators of Retail Risks to provide a snapshot of existing and emerging or potential cases of consumer detriment. This allows targeting issues that go beyond one national market, building a coordinated understanding, and a sharing of best practices and emerging challenges.

A key element of the Strategy is "**smart regulation**", which focuses on outcomes that are relevant to consumers and moves away from a legalistic, "tick-box" approach. More specifically, "smart regulation" is based on a two-pronged approach, which is:

- **Risk-based**, i.e. identifying the depth and scale of issues and focuses priorities and resources where they matter most; and
- **Preventive**, i.e. anticipating consumer detriment early and, thereby, tackling the problems of the future, rather than of the past.

Both aspects depend on supervisors developing and using effective tools for monitoring the markets, so problems can be identified and assessed in a robust and systematic manner. But this needs to be implemented in a proportionate and focused way.

Central to both of these aspects is also the development of a transparent dialogue between supervisors and firms, rooted in firm's internalisation of a consumer- centric culture, with supervisors routinely capable of challenging firms on their culture as well as their "bottom line".

There is a need to **better integrate conduct of business concerns** in the **institutional governance arrangements** of companies 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 – a tick-box approach.**

When putting in practice the fundamental sound governance basis of Solvency II and IDD, special attention should be devoted to companies' processes related to the manufacturing and distribution of products – so-called Product Oversight and Governance rules.

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.

Another significant project which I would like to highlight here is **the Insurance Distribution Directive (IDD)**. EIOPA has already consulted on its draft technical advice to the European Commission on possible delegated acts on issues such as **Product Oversight and Governance, Conflicts of Interest, Inducements and Assessment of suitability and appropriateness**.

Our aim with the technical advice is to ensure that the interests of the customers are taken into consideration throughout the life cycle of a product, that distribution activities are carried out in accordance with the best interests of customers and that customers buy insurance products which are suitable and appropriate for them.

Detrimental impact occurs when an inducement or structure of an inducement scheme provides an incentive to carry out insurance distribution activities in a way which is **not in accordance with the best interests of the customer**. It is then fundamental to identify criteria to assess if and when inducements are considered to have a high risk of leading to a detrimental impact on the quality of the relevant service to the customer.

Let me be clear here: **our intention is not to create a *de facto* ban on the payment or receipt of inducements**. It is clear that this was not the original intention of the legislator. Our objective is to provide guidance to market participants in assessing inducements and to point out specific circumstances where a detrimental impact is most likely to occur. This assessment would be subject to supervisory scrutiny.

Our intention is also **not to single out commissions**. Conflicts of interest, which are damaging to customers' interests, can arise from any kind of remuneration model, not just commissions. Our mandate from the European Commission focusses on third party payments.

Going forward, with the implementation of the IDD, a stronger supervision of intermediation activities is needed throughout the EU. In Germany, it is my opinion that Bafin should be granted further supervisory powers on the supervision of the intermediation activities.

We also want to ensure that customers can make informed decisions when buying non-life insurance products. Too often, we know that customers do not

read the policy documents they read and focus only on price, rather than terms & conditions. The draft Implementing Technical Standards we are currently developing regarding the format of the so-called **Insurance Product Information Document** will help to improve comprehension and comparability of non-life products by ensuring more standardised information is provided to customers.

Conclusion

On the regulatory side, we have made a huge step forward. On the supervisory side, we are pretty much at the beginning of our journey.

Ladies and Gentleman,

In the coming years not only EIOPA but all of us, have an important task to achieve. This is a **European supervisory culture**. A culture that promotes consumer protection and enhances stability. A culture that is forward looking and challenging, that privileges the dialogue with market participants and takes early action to protect consumers.

A culture that embraces innovation while maintaining a high level of consumer protection.

A culture where supervisors are also more transparent.

Thank you for your attention.