Gabriel Bernardino
Chairman
European Insurance and Occupational Pensions Authority (EIOPA)

Keynote Address
Sustainable long-term investments and the Pan-European Personal Pension Product

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Ladies and Gentlemen,

It is a great pleasure for me to present the regulator's view on long-term investment and how the evolving landscape of financial regulation can support "Financing Long-Term Europe".

In my intervention today I would like to point out

- First, the **EIOPA's work** linked with long-term infrastructure investment
- Second, EIOPA's work on a **Pan-European Personal Pension Product**, the PEPP, in the context of the **Capital Market Union**

To my *__first__* point, about EIOPA's work linked with long-term infrastructure investment

Solvency II is a huge step forward in policyholder protection but also a game changer on the capacity of insurers to invest long-term. In fact, the implementation of a risk-based capital regime comes with profound changes in the way investments are treated from a regulatory perspective.

First, the prudent person principle eliminates regulatory restrictions and limits on investments but creates the onus to insurance undertakings to establish their own limits and investments restrictions.

Second, there are now granular capital requirements for individual investments. They reflect the underlying risks and are calibrated to the overall confidence level established in the Solvency II Directive. While differences in risk charges based on differences in the risk profile can influence investment behaviour they are not "designed" to provide incentives for any specific asset.

Concerns were raised that the standard formula calibration did not contain enough granularity and so it was not reflecting the lower risk profile of infrastructure investments. EIOPA looked into the matter and performed a very thorough and evidence-based analysis. We consulted representatives of public authorities, insurance undertakings, investment managers and academics in a very transparent process.

As a result, EIOPA developed a pioneer approach with the creation of a separate asset class under Solvency II standard formula for investments in infrastructure projects allowing a specific treatment for qualifying infrastructure project debt and equity.

The qualifying infrastructure investments need to satisfy conditions relating to the predictability of the cash flows, the robustness of the contractual framework, and their ability to withstand relevant stress scenarios. Regarding calibrations, EIOPA recommended changing the spread risk charge within the Solvency II standard formula for qualifying infrastructure debt investments according to a modified credit risk approach resulting in a reduction of around 30% in the risk charge for BBB rated qualifying infrastructure. Risk charges for infrastructure equity investments were proposed to be in a range between 30% and 39%. In terms of risk management, insurers should in particular conduct adequate due diligence prior to the investment; establish written procedures to monitor the performance of their exposures and regularly perform stress tests on the cash flows and collateral values supporting the infrastructure project.

This has been incorporated in the Solvency II legal framework. In a next step EIOPA recommended to extend the new asset class in two ways:

First, to allow certain infrastructure corporates to qualify for the treatment for infrastructure projects provided that there is an equivalent level of risk.

Second, to create a separate differentiated treatment for equity investments in high-quality infrastructure corporates.

In this work we followed an important principle: asset risk calibration in Solvency II should not be used to privilege or incentive any specific asset class. If the regime creates incentives that are not properly aligned with risks we will see the emergence of price distortions and vulnerabilities that ultimately will create financial stability risks.

I believe that Solvency II brings the right approach to investment by insurers. The risks arising from a mismatch in the duration of assets and liabilities are reflected in a higher regulatory capital requirement. This can be seen as an incentive for investing longer term. Moreover, asset diversification is recognised as a key prudential element.

EIOPA will closely monitor the consequences of the Solvency II implementation on the asset side in order to ensure that long-term investments in infrastructure are made on a sustainable basis.

To my *second* point, EIOPA's work on a Pan-European Personal Pension Product, the PEPP, in the context of the Capital Markets Union

One of the major challenges for countries in the European Union is the provision of safe, adequate and sustainable pensions to their citizens. While there is a broad consensus that both private occupational and personal pensions can play an important role in diversifying the sources of retirement income on top of the public pension regimes, the context of labour and demographic changes and the prolonged low interest rate environment creates particular challenges also to private regimes.

At the same time, particularly in the area of long-term retirement savings, it is evident that the European Union internal market is far from delivering its full potential. There is a huge fragmentation of products available to consumers, from low-performing deposits, to very often too complex and costly life insurance and mutual funds, many of them not truly retirement saving products. Also consumer protection rules are very different in the various European Union Member States. This fragmentation is a serious obstacle to cross-border business, increases the costs, reduces the average returns for savers and ultimately undermines consumer confidence in private pension provision.

This year, in February, EIOPA submitted to the European Commission its final technical advice on a Pan-European Personal Pension Product, the PEPP, a safe, transparent and cost-effective personal savings product. In our view the PEPP could be the catalyst for efficiency gains through economies of scale and opportunities for risk diversification as well for competition and innovation for the benefit of consumers.

We proposed a number of standardised and flexible features for the PEPP:

- Standardised information provision

- Standardised limited investment choices, with one core „default" investment option, where the investment strategy takes into account the link between accumulation and decumulation
- Regulated, flexible caps on costs and charges
- Flexible biometric and financial guarantees

The PEPP should have a long-term perspective in its investment policy to better reflect the long-term nature of retirement savings. This is particularly welcomed from a macro-perspective because long-term investors are needed to provide stable funding to the European Union economy. In order to allow this long-term investment horizon, the PEPP should envisage minimum holding periods to mitigate the surrender risk. Sustainable investment in illiquid assets should match liabilities with a correspondent illiquid profile.

The analysis conducted brought us to the conclusion that the PEPP, enacted through a 2nd regime, is a powerful tool to close the pension savings gap in Europe. This conclusion has been supported by the vast majority of stakeholders that responded to our public consultation.

From the development of a Capital Markets Union the PEPP can be one of the most tangible outcomes and benefits for European Union citizens. Together, we have to do everything to regain the trust of Europe's citizens in the European Union and its financial services industry. Europeans request concrete solutions to their very pertinent problems such as the lack of adequate retirement savings. With the PEPP European citizens could see the benefits of building a true single market for capital.

EIOPA stands ready to continue to work on PEPP, namely in the design of „product pilots". We intend to explore pure individual Defined Contribution Schemes but also collective Profit Sharing Products.

While pure individual Defined Contribution Schemes can be designed to adjust investment risk throughout the live of the contract, thus reducing risk for members, the development of collective Profit Sharing Products could allow the pooling of investments with the smoothing of returns across members of the pool, so that all members benefit from average long-term returns of the fund and are protected from extremely negative outcomes in stressed market situations.

The design of the PEPP “product pilots” need to ensure conditions to allow European Union citizens to invest in a balanced portfolio that should include assets such as equities, property, infrastructure and green technologies. With the appropriate safeguards, this will provide a good chance to accumulate a pension that outperforms inflation and grows to levels that can provide a decent standard of living.

Provided that by design these collective Profit Sharing Products avoid the exposure to short-term market volatility the regulatory treatment in Solvency II could be aligned to the risks effectively incurred, resulting possibly in lower capital requirements.

Finally, the PEPP “product pilots” need to be designed in a way to ensure the highest standards in transparency, fairness, governance and risk management.

Very importantly, in my view, the Capital Markets Union can only succeed if we are capable of regaining confidence of the European Union citizens in the financial markets. In this sense I strongly believe that supervisory convergence needs to be a high level priority of the Capital Markets Union. The implementation of the CMU needs to be accompanied with an evolution in the powers and tools available to EIOPA. To break the current market fragmentation and to increase cross-border provision of services we need to ensure that there are proper arrangements to achieve high quality supervision across the European Union. This should entail an appropriate mix of centralised powers and tools and a clear mandate to reinforce supervisory convergence.

Ladies and gentlemen,

Financing long-term Europe needs to be a common objective; an objective that preserves sustainability of businesses; an objective that benefits citizens.

Thank you very much for your attention.