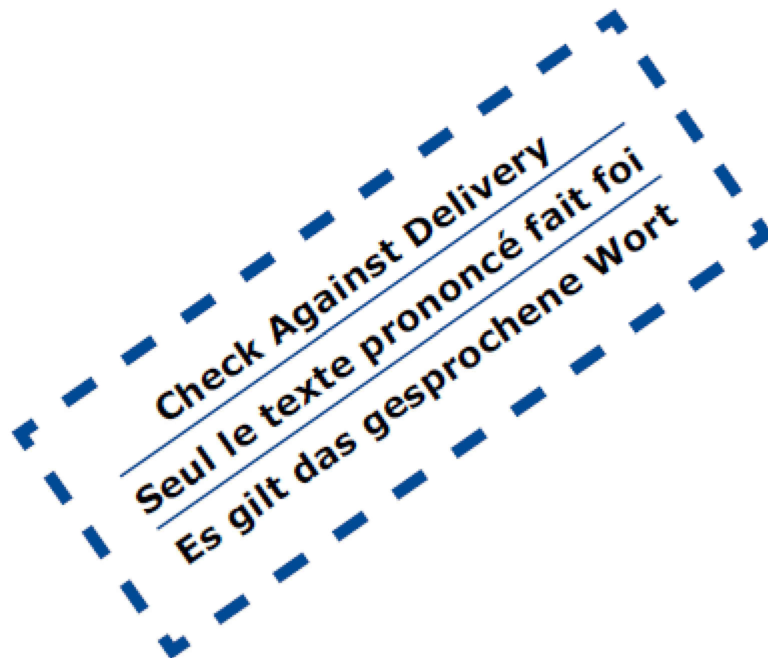
Dr. Manuela Zweimüller
Head of Policy Department
European Insurance and Occupational Pensions Authority (EIOPA)

KEYNOTE SPEECH: What will the future hold? The European insurance industry in times of major disruption



12th Annual Insurance Risk Conference

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Ladies and Gentlemen, good morning.

First of all, I would like to thank the organisers for their kind invitation to this renowned conference with already quite a long tradition to bring insurance practitioners together.

Future challenges for the insurance industry such as digital disruption, Brexit, political risk, balance sheet volatility and so on, are in the mouth of everybody nowadays. We as EIOPA, as a European supervisory authority, are keen to promote a risk-based approach across the regulatory and supervisory community. It is, however, sometimes not an easy task to distinguish fashionable and trendy from sustainable developments that will eventually have long-lasting impact. But we need to look out for both alike, risks and opportunities. In doing so, **prudential and conduct of business regulation and supervision need to cope with evolutions and should incentivise a virtuous and stable approach to developments**.

Ideally, the approach should always be towards more simple and transparent products, priced according to risks, sold through cost-efficient channels using the highest ethical standards having in mind important societal developments such as the savings and protection gap or costs of catastrophic events to citizens and governments.

Now what will the future hold? Starting first of all with "where are we today"?

From a **macroeconomic perspective** there are some positive developments: Volatility has decreased and global inflation rates are fluctuating near the 2% medium-term inflation target. Despite these positive signs, the continuing low-yield environment and the observation that market fundamentals might not

properly reflect the underlying credit risk are still important concerns. A material re-pricing of risk is a scenario that we cannot rule out, especially in the context of the current geopolitical situation. This would put an extra pressure on insurers’ asset portfolios.

From a **micro supervisory perspective**, the insurance sector in the EU is living the first years of implementation of Solvency II. Within a very difficult macroeconomic reality with historically low interest rates, the application of Solvency II was carried out smoothly as a result of timely preparation and appropriate transitional periods. In an industry with € 11 trillion of assets under management and € 8.7 trillion in technical provisions, this success is remarkable and has contributed significantly to the stability of the European financial sector. Overall, the European insurance sector is adequately capitalized. Specific transition periods are used mostly by life insurance companies with long-term guarantees business. Transitional measures form an integral part of Solvency II: They are intended to limit the procyclicality of the regulatory changes and to facilitate the entry into the new regime by giving companies the time needed to adapt to the new solvency requirements.

This leads us to believe that **today the European insurance industry is much stronger with Solvency II**: It is stronger because it has its capital better aligned to the risks it runs; because it uses a more realistic basis to assess and mitigate risks and thus can better price them; because it upgraded its governance models, with a complete different emphasis on the role of the Boards, the setting up of key functions and the implementation of the ORSA; because the updated group solvency requirements and the clear powers assigned to the group supervisor ensure a better level playing field; and with Solvency II we also have the basis for a more transparent industry, with harmonised templates for supervisory reporting and enhanced public disclosure.

Based on that, how disruptive can the future be? Let's turn to the question "Will the industry be able to turn the new challenges into opportunities"?

To start, let us speak about **Insurtech**.

All phases of the insurance value chain are being impacted by InsurTech and more broadly **digitalisation**. Insurance products are increasingly being purchased through smartphones at any time and from any place. Consumers may benefit from the design of more personalised products and services adapted to their evolving and specific needs. New products can also incentivise consumers and the society to reduce their risks and enhance insurance penetration (e.g. of micro-insurance). All of this is driven by the greater availability of data and the capacity for processing it, which also enables the development of increasingly efficient underwriting and claims management processes, reducing costs.

In order to harness the benefits of digitalisation, incumbents have embarked on ambitious digital transformation projects and increasingly cooperate with InsurTech start-ups to benefit from their cutting-edge data analysis tools and technology. Nevertheless, we should remain attentive to the possible fragmentation of the insurance value chain, which could raise a number of potential supervisory challenges.

The relevance of **Big Data** for the insurance sector is no surprise; data has always been a highly valuable commodity for the insurance sector. There are multiple potential benefits linked to the use of Big Data analytics and processes, such as the development of tailored products or more granular risk assessments. But there are also a number of risks arising, such as privacy issues, potential discrimination through price optimization and cyber threats.

The above developments have the potential to significantly reshape the insurance landscape in the coming years. The industry needs to reinvent itself!

Regulatory and supervisory authorities have a role to play, by encouraging financial innovations while, at the same time, ensuring a well-functioning consumer protection framework and financial stability. In doing so it is necessary to respect key supervisory principles such as proportionality, market integrity and technological neutrality.

InsurTech and digitalisation is of strategic importance for the insurance sector and it is therefore a topic that EIOPA is following closely. Recently in April we organised a roundtable to discuss with stakeholders the benefits and risks of digitalisation for the industry and consumers as well as potential obstacles to effective innovation. During the event, representatives from supervisory authorities, consumers, incumbents, start-ups, consultancy firms and IT experts exchanged their different experiences and points of views on the impact of digitalisation in the insurance sector. Another roundtable will be organised later this year.

EIOPA's immediate work in the area of InsurTech will focus on three main issues:

- the use of Big Data by the insurance industry; this includes ethical standards ("should everything be done that is possible to be done" ?)
- Cyber risks and
- Supervisory approaches to financial innovation, where we intend to analyse initiatives such as regulatory sandboxes and innovation hubs.

Also in our EU US Dialogue Project, which is the heart of our transatlantic cooperation we touch on topics such as cyber risks, cybersecurity, cyber coverage and Big Data.

Another challenge is **Brexit**.

In 2016 around 80 UK undertakings operated on a freedom to provide services (FoS) or freedom of establishment (FoE) into the EEA providing life and non-life insurance business amounting to about 18 billion euro gross written premiums. While some of the largest among them currently have also licensed entities in the EEA, a number of undertakings are considering establishing new entities in the EEA such as in Ireland, Luxemburg, France or Belgium. Important players have already announced their plans in this respect.

The **long term nature** of the particular **contracts** sold or the intention of the undertaking to carry out new business into the EEA after Brexit need to be taken into account in order to assess the undertakings' contingency plans including the establishment of new entities, relocation or transfer of portfolio. Most lines of business written by UK undertakings into the EEA concern, for non-life, general liability, fire and other property damages and marine, aviation and transport, and, for life insurance, with profit participation and unit-linked products for life insurance.

A detailed analysis as to the duration and nature of the contracts that are being sold by the UK undertakings into the EEA is required before drawing final conclusions, including contract continuity and portfolio transfer as well as cross-border IORPs, for example.

In a first step EIOPA published in July an **Opinion** with the aim to foster supervisory convergence and consistency in the relocation of insurance undertakings from the United Kingdom. The Opinion provides guidance and sets out principles in the areas of authorisation and approvals, governance and risk management, outsourcing of critical and important activities as well as on-going supervision including monitoring.

EIOPA expects undertakings to show an appropriate level of corporate

substance; EIOPA will not accept characteristics of an empty shells. The supervisors should carefully scrutinise any transfer of risks and require a minimum retention of risks from the authorised undertaking. As an indication, a minimum retention of 10 % of the business written could be envisaged.
Outsourcing of undertakings' important functions should be subject to the full responsibility of the management body for the outsourced activity and shall not materially impair the quality of governance, increase operational risk, impair the ability of supervisors to monitor compliance or undermine continuous and satisfactory service to policyholders.

The principles set out in our Opinion will support the national supervisory authorities to secure sound and convergent practices. Sound supervision demands appropriate location of management and key functions. Empty shells or letter boxes are not acceptable.

In a second step we are looking at elements related to possible impacts of Brexit on market stability and consumers. Issues like contract continuity, data flows and supervisory cooperation would be thoroughly analysed.

A further challenge encountered is **regulatory stability** which is an important value that we all need to preserve. After the launch of Solvency II, the review of Solvency II will follow the structured process envisaged in the legislative texts:
By 2018, the review of the **Solvency Capital Requirement (SCR)** and by 2021, the overall review of the regime, including the treatment of **long-term guarantees**.

Last December EIOPA issued an initial discussion paper on the review of the Solvency Capital Requirement (SCR) marking the first phase of the Solvency II review process. In this context during this year through a series of roundtables we have been engaging with all relevant stakeholders. This was followed by a consultation paper in summer; many thanks for all your valuable input and

feedback, which we consider seriously. As you know, we expect to deliver a first set of advice to the European Commission end October, and consult on a second set from then onwards on topics such as LAC DT, risk margin, Cat recalibration etc..

EIOPA is committed to an evidence-based policymaking. Changes must be carefully justified and clearly necessary. We are particularly interested in concrete proposals to achieve the **review objective** of more simplicity and proportionality whilst reflecting risk-sensitivity of the system and avoiding pro-cyclicality and balancing both objectives. Overall, we are not expecting major changes in the capital needs of Solvency II.

Furthermore, a relevant development impacting on regulatory stability is the elaboration of the **international capital standards**. The creation of a global, consistent international capital standard is needed to address the lack of comparability among existing group capital frameworks applied by internationally active insurance groups (IAIGs). In order to foster effective supervision and promote a level playing field it is fundamental to arrive at a situation where a group capital framework delivers substantially the same outcomes across all jurisdictions.

Ongoing work, like the field tests, is intended to lead to improved convergence over time on key elements like valuation, capital resources and capital requirements, including the use of internal models. However, an international standard should be of high quality and not a lowest common denominator between the current regional regimes. EIOPA supports the development of a robust version of an international capital standard by the end of 2019. This version should then be used during a period of 2 or 3 years by international colleges of supervisors to ensure that all supervisors are comfortable with it. A final and fine-tuned standard should then emerge from this practical experience.

Looking ahead, we also support the efforts of **High-Level Expert Group on**

Sustainable Finance towards a financial system that fosters sustainability in economic, social, environmental and governance developments.
With regard to the investments of insurers, **sustainability** can be further promoted by establishing a clear EU taxonomy for sustainable assets and by labelling sustainable assets. Additionally, comparable disclosure of insurers on their sustainability policies and investments, including ESG factors in insurers' risk and investment management, in particular in their own risk and solvency assessment (ORSA), and by public ESG-grading of insurers would contribute to sustainability.

Insurers need to hold capital to absorb losses they may incur on their investments. Ignoring these risks in capital requirements may result in misallocation of funding and facilitate boom and bust cycles. Measures taken to promote sustainability should be in line with general Solvency II principles and should not put at risk the financial stability which is a prerequisite for sustainable investment and meeting ESG objectives.

Having highlighted several important challenges – InsurTech, Brexit, Regulatory stability - EIOPA is of the view that having mastered so far the major regulatory challenge of implementing Solvency II, the **industry should be well equipped to address these challenges, by identifying the risks and opportunities brought by these new developments.**

We provided you with the toolbox; now it's up to you to make best use of it, also using long-term vision and imagination.

I am looking forward to hear your views and insight regarding the opportunities the future holds for the industry.

Many thanks for your attention.