Foreword by Gabriel Bernardino, Chairman of EIOPA,
for the Handelsblatt Newsletter

"The future of life insurance, Solvency II and investment strategies"

Dear readers,

The current economic and financial environment creates a number of challenges to the insurance industry. In particular, long-term interest rates are of critical importance to life insurers, since these institutions typically have long-term obligations to policyholders that become more expensive in today's terms when market rates are low. Consequently, the financial position of these firms typically deteriorates under such conditions, especially where the duration of liabilities exceeds that of assets. This problem is even more pronounced where guaranteed rates of return have been offered to policyholders.

The issues surrounding the impact of low interest rates are a very good example of the need to use more realistic valuations for solvency purposes, especially when accounting regimes continue to use historic cost. We all know that the fact that the effects of low interest rates are slow to emerge in balance sheet terms does not mean the problem is not there and there is a real risk that firms could build up hidden problems. Examination of market value and historic cost balance sheets can provide useful comparative information while analysis of cash flows provides an insight into emerging imbalances.

In this sense, Solvency II has become even more relevant than before. It is a modern, robust framework that captures the economic reality of the asset-liability position of insurers and brings capital much closer to the insurers risk profile.

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.

Furthermore, Solvency II creates a clear incentive for insurance executives to promote a strong risk culture in their organisations. Within Solvency II, the Own Risk and Solvency Assessment (ORSA) is a tool that brings together, in a comprehensive way, risk and capital management. Insurers will rely more and

more on strong risk management capabilities to deal with different economic challenges.

As we know, Solvency II will include appropriate transitional mechanisms to deal with the solvency issues of the low interest rate environment. Nevertheless, the period before the implementation of Solvency II is crucial to deal seriously with the problem and actively implement measures to mitigate the worst case scenarios.

We need to continue to see changes in product design in order to adjust the mix of business. And we need to see those changes preserving policyholder's rights and avoiding any mis-selling cases.

But the current economic environment is also prompting changes in insurers' investment policies, with some portfolio shifts towards corporate bonds, as well as insurers exploring new asset classes.

This latter development seems to reflect both a search to enhance yields and a desire for diversification. This movement should be done 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 on sovereigns and financial entities.

Finally, Solvency II will require the executive boards of insurance companies to put the risks related to such issues as product governance, product suitability and appropriate selling practices on the top of their agenda. Insurers need to change the nature and design of some products, to come with products that are more sustainable under the current economic environment and to make sure that distribution channels are properly approaching consumers.

"Rule number one" in the financial sector business should be: the consumer should be at the heart of the provider's business, not the other way round.