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European supervision in a changing environment

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Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

Supervision and Regulation of the Financial Sector in the European Union and Worldwide – 2018 and beyond

CIRSF Annual International Conference 2018

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Ladies and Gentlemen,

A good morning also from my side. It is a great pleasure to speak at today's CIRSF Annual International Conference. I would like to thank all the organisers for setting up this annual interesting and stimulating conference, in particular Prof. Luis Morais, the Chair of CIRSF, the Research Centre in Regulation and Supervision of the Financial Sector.

The topic of this year's annual conference is "Supervision and Regulation of the Financial Sector in the European Union and Worldwide – 2018 and beyond".

My intervention will focus on the "European supervision in a changing environment".

The European System of Financial Supervision is now in place for seven and a half years. In 2011, the establishment of this structure was the right response on how to strengthen the European regulation and supervision in light of the failures of financial supervision exposed by the financial crisis. Looking back, I think we should be very much satisfied with what has been achieved so far.

In insurance, for example, before 2011, the European Union insurance market was faced with an outdated and fragmented regulatory regime and with limited cross-border supervisory cooperation. Solvency I was not risk sensitive, it contained very few qualitative requirements regarding risk management and governance and did not provide supervisors with adequate information on the undertakings' risks. With the implementation of Solvency II in 2016, as you all know, this is the past.

Ten years after the emergence of the financial crisis, we have Solvency II in place applicable all over Europe. We are now in a different phase of the regulatory cycle naturally influenced by the new political priorities of increasing investment and economic growth.

While in my view it makes perfect sense to evaluate and review the recent reforms in order to mitigate any unintended consequences and increase proportionality, I strongly believe that we should not abandon the core values of stability and consumer protection that presided to these reforms. We cannot forget that the post-crisis regulatory agenda was the right response to restore the loss of confidence in the financial sector. To build up sustainable long-term investment and economic growth we need a stable and strong insurance sector that adequately prices risks, applies robust risk management strategies and treats customers fairly.

In view of the changing environment, let me mention three top priorities we at EIOPA are focusing on:

- **Further enhancing supervisory convergence**
- **Reinforcing consumer protection in an era of digital transformation**
- **Maintaining financial stability in a changing environment**

Supervisory convergence in the European Union insurance market

The main objective of supervisory convergence is to ensure that all European Union's policyholders benefit from high-quality and consistent supervision. This is a joint effort from EIOPA and all National Competent Authorities (NCA's).

We are working both on supervisory culture and practices.

Last year we published a document with the basis for a **common European supervisory culture**, identifying the key characteristics of high-quality and effective supervision:

- Risk-based and proportionate
- Forward-looking, preventive and proactive
- Challenging, sceptical and engaged
- Comprehensive
- Conclusive

Recently we published EIOPA's 2018-2019 **Supervisory Convergence Plan** which covers three main areas:

- **Development of common supervisory tools and benchmarks**
    - Supervisory risk assessment
    - Application of proportionality
    - Common benchmarks for supervision of internal models
    - Supervisory assessment of conduct risks

- **Supervision of cross-border business**
    - Detection of unsustainable business models

    - Sufficiency of technical provisions in cross-border business
    - Fit and proper analysis

- **Supervision of emerging risks**
    - Supervisory practices on IT resilience and cyber risks
    - Usage of big data
    - Brexit

The supervisory convergence process on prudential supervision started already two years ago. We are now focusing also on conduct of business supervision in face of the Insurance Distribution Directive and the Packed Retail and Insurance-based Investments Products implementation. In this context, we need to put more focus on conduct of business supervision in view of the new rules on conflicts of interest, product oversight and governance and transparency.

EIOPA's expectation is that NCA's reinforce their market monitoring activities, deepen their knowledge about the products sold and effectively take measures to stop bad practices that potentially create consumer detriment. Conduct of business supervision needs to be taken more seriously and this also requires a change in the culture of supervisors.

Another important element is the coordination between different supervisors, namely in crisis situations. The public confidence and trust in the financial sector and its supervisory institutions is weakened when there is the public perception that the coordination is not effective.

Reinforcing consumer protection in an era of digital transformation

EIOPA maintains a forward-looking perspective to regulation and supervision aiming at the early identification of significant trends that can affect the market and consumers. In this sense, the growing use of new technologies, digitalisation, Big Data and machine learning have the potential to change significantly the insurance value chain, creating new opportunities to improve customer experience and generate lower costs but also bringing up new risks.

On one hand, it allows the design of more **personalised products and services adapted to consumers' evolving and specific needs**. New products can also incentivise consumers and society to reduce their risks.

This is driven by the greater availability of data and an improved capacity for processing it, which enables the development of increasingly efficient underwriting and claims management processes, and thereby reducing costs. Better analytics mean companies can profile customers in order to personalise products and services, enhance their own internal processes and improve their fraud detection capabilities. This change has the potential to produce **better outcomes for customers and better management of risks or fraud situations.**

Weighing both the benefits and the risks associated with this innovation, we, the three European Supervisory Authorities decided that **any legislative intervention at this point would be premature**, considering that, the existing legislation should mitigate many of the risks identified. Furthermore, we will **continue to closely monitor any future developments** in this area and call upon financial firms to develop and implement good practices on the use of Big Data.

Maintaining financial stability in a changing environment is another focus of EIOPA.

From a regulatory perspective: One of the lessons learnt from the recent financial crisis is the need to have in place **adequate recovery and resolution tools which will enable national authorities to intervene in failing institutions and resolve failures in an effective and orderly manner**.

At present, there is no harmonised recovery and resolution approach for insurers in the European Union and the emergence of national specific solutions will increase fragmentation in the internal market and create additional difficulties when dealing with cross-border cases.

In July last year EIOPA published an Opinion calling for a minimum degree of harmonisation in the field of recovery and resolution for insurers consisting of four building blocks: preparation and planning, early intervention, resolution and cross-border cooperation and coordination. Furthermore, this framework should be aligned with Solvency II and be applied in a proportionate manner.

Beyond recovery and resolution regimes, insurance guarantee schemes can contribute to increase the **overall protection of policyholders and beneficiaries**. However, in the European Union this area is still significantly fragmented, with the existing schemes differing quite substantially in terms of financing, functions, mandate and coverage. This fragmentation creates particular problems in the presence of failures involving cross-border business.

I believe that in the medium-term it is fundamental, both for consumer protection and the proper functioning of the internal market, to build a minimum harmonized approach to insurance guarantee schemes in the European Union. As indicated in its Regulation, EIOPA is assessing the need and the possible elements of such a framework and intends to issue a discussion paper before summer.

The financial crisis has shown the need to further consider the way in which systemic risk is created and/or amplified, as well as the need to have proper policies in place to address those risks. So far, most of the discussions on macro-prudential policy have focused on the banking sector due to its prominent role in the recent financial crisis. Given the relevance of the topic, EIOPA has initiated the publication of a series of papers on systemic risk and macro-prudential policy in insurance with the aim of contributing to the debate and ensuring that any extension of this debate to the insurance sector reflects the specific nature of the insurance business.

The first paper identifies and analyses the sources of systemic risk in insurance from a conceptual point of view, illustrates the dynamics in which systemic risk in insurance can be created or amplified and proposes a flexible macro-prudential framework specifically designed for the insurance sector.

The second paper identifies, classifies and provides a preliminary assessment of the tools or measures already existing within the Solvency II framework, which could mitigate the systemic risk sources.

We are now working on the third and final paper focusing on the assessment of the need for further tools to address the identified risks.

From a supervisory perspective, in order to assess the resilience of the EU insurance sector to adverse market developments, EIOPA launched in May the 2018 European Union-wide insurance stress test.

The Insurance Stress Test 2018 comprises the following three scenarios:

- **Yield curve up shock combined with lapse and provisions deficiency stress:** a sharp and sudden rise in interest rates triggered by both an upward shift in risk free rates as well as a significant increase in inflationary pressures.
- **Low yield shock combined with longevity stress:** a protracted period of extremely low interest rates.
- **Natural catastrophe scenario**: A series of natural catastrophes (e.g. storms, earthquakes, flooding) occurring in Europe.

Furthermore, for the first time, we included a questionnaire on **cyber risk,** where we will get information on the impact of identified cyber-attacks on the 42 participating groups over the last four years in terms of frequency and of economic losses. Furthermore, we will collect information on the exposures held by those groups coming from their cyber risk underwriting activity (amount of gross written premium and claims) distinguishing between affirmative and non-affirmative exposures.

Conclusion

The post-crisis regulatory reforms were designed to build more stable, fair and transparent financial markets along with stronger and better governed players. By developing a strong single rulebook we are half way through.

Going forward, **further enhancing supervisory convergence through consistent application of supervisory practices across the European Union will contribute to mitigating risks and thereby improve the protection of beneficiaries and policyholders as well as safeguard financial stability for the benefits of all European citizens**.

Therefore, I support the proposals of the European Commission to reinforce integrated supervision in Europe, with the proposed stronger role of EIOPA on supervisory convergence.

To me, the priorities identified by the European Commission on the financial sector are the right ones:

- The Banking Union
- The Capital Markets Union
- Foster Fintech

- Sustainable finance

We have developed harmonized European Unions' regulation in most of the areas of the financial sector. We need now to focus on ensuring effective implementation and consistent supervision and enforcement.

In order for European businesses and consumers to benefit from the single market we need two main things:

- **Remove the remaining barriers and obstacles to cross-border business** in order to reap the benefits and the cost-efficiencies of the EU scale (we still have too many national specific requirements)

  That is for example the idea of the PEPP.

- **Ensure that all consumers in the European Union benefit from high-quality and consistent supervision and enforcement in the financial sector**, be it through centralised supervision or ensuring concrete powers to foster supervisory convergence (in the internal market, supervision is as strong as its weakest link)

  That is the purpose of the review of the ESA's.

Unfortunately, the political times are not conducive to European solutions. We are living in times of populism and exacerbated nationalistic positions.

So, in spite of having some "stones in the road" we need to be patient, pragmatic and continue to be self-critical but also optimistic about the European project.

Like the great Portuguese poet, Fernando Pessoa once wrote:

"Stones in the road? I save every single one, and one day I'll build a castle."

Thank you for your attention.