Sergio Balbinot conference opening speech – 27 May 2015

Introduction

Good morning ladies and gentlemen,

I would like to thank you for joining us here today for our 7th annual international insurance conference. It's great to see so many of you here to engage in the important discussions that will be taking place.

I would also like to extend a special welcome to His Royal Highness Crown Prince Guillaume of Luxembourg, who honours us with his presence today. We are delighted to enjoy your hospitality at such an important period in the EU calendar prior to Luxembourg taking over the EU presidency in the second half of 2015.

The theme of today's conference is the globalisation of insurance. In this context we will look at global and – also regional - regulatory developments as they are shaping and impacting our business.

Insurance is a tool:

- to absorb risks from individuals and society at large, while at the same time it helps to underpin stability and,
- can also stimulate economic growth.

Insurance is, therefore, more relevant than ever before. However, our current regulatory environment makes it hard to tell whether insurance is perceived by policymakers as part of the problem, or as part of the solution.

Systemic Risk

I'll give you an example. Take the issue of **systemic risk**. If you treat insurance as a problem, you label certain companies, **in their entirety**, as being systemically relevant.

If you treat insurance as a stabiliser and part of the solution, then you sensibly apply a risk charge only to activities that could pose a systemic risk, rather than on the entire company, which includes its traditional, stabilising business.

Consequently, we welcome the recognition by the International Association of Insurance Supervisors (IAIS) that our core business model is not pro-cyclical. We are however keen to see that this recognition is correctly translated into regulatory action.

Let me therefore briefly reflect on the work of the IAIS.

Originally, one of the key aims of its project to develop a common framework for the supervision of internationally active insurance groups, or "ComFrame", was to help national insurance supervisors to cooperate and coordinate more efficiently and effectively. This is something that our industry has welcomed, as it could potentially help us to avoid problems similar to those which befell AIG. As you are all aware, an AIG subsidiary ventured into non-insurance activities without sufficient risk management. This lack of risk control remained undetected however due to a lack of effective supervisory coordination, both at sectoral and international level. Improving

the supervisory control functions and enhancing effective supervisory coordination does, therefore, make perfect sense.

However, a new focus has been placed on developing three global risk-based international capital standards.

It is important to note that – unlike in the banking sector where discussions on the first Basel Capital Accord began in the early 1980's – prudential regimes in insurance have been developed on a strictly regional or national basis and in very different ways until the announcement by the IAIS of its intention to develop global insurance standards was made in 2013. So, unlike in banking where prudential reforms around the globe have developed broadly in sync for over 30 years, in insurance the challenge is significantly bigger as fairly sophisticated regional regimes, with at times very different valuation approaches, need to be "reconciled" in such a global standardisation endeavour and within a very short time frame of three years.

There are three standards that the IAIS intends to develop by the end of 2016.
One initiative is aimed at insurers which have been designated as globally systemically-important, where the IAIS has developed a basic capital requirement (BCR). Developing the BCR over the course of only nine months has caused it to be a very rough measure, with very little risk-sensitivity. Unfortunately, such a rough measure could actually cause far more problems than it solves, and create pro-cyclical behaviour, rather than avoid it.

The BCR is intended to be used as a foundation for capital add-ons, the so-called higher loss absorbency requirements. The work on these capital add-ons for systemically relevant insurers is currently still underway, but it remains unclear whether these add-ons would – correctly – focus on the systemically risky activities only or applied for the entirety of the insurance company's business.

A further workstream focuses on the development of a more general international capital standard, which would apply to internationally active insurance groups. The IAIS remains committed to its timetable of finalising the ICS by 2016, but are now saying that this will be "ICS version 1.0" which will be refined over coming years. It appears, however, that the lack of accounting convergence does make things indeed complicated on the valuation side. Assuming that an ICS version 1.0 would be followed by revisions, the prospect for our industry – in light of Solvency II implementation challenges at European level – do not look too rosy.

Based on our current assessment, therefore, rather than help insurers to remain part of the solution, these workstreams start with the assumption that there is a problem to fix and that capital is the solution.

There is also significant concern that the shift of focus to developing international capital standards will slow down progress on areas which the insurance industry believes are most important in preventing future problems; namely high-quality group risk management and full supervisory coverage through lead supervision and coordinated supervisory colleges under ComFrame. If policymakers truly want to

protect our financial systems, economic stability and growth, then this is where they should be focussing their attention.

The old Commission

Let me now move to Europe.

Under the last mandate of the Commission and the European Parliament, again, insurers were too often perceived as a problem, in an attempt to mirror work on the banking sector.

For example, our new European prudential regime, Solvency II, has transformed from a principle-based regime to better reflect the risks of a company, into a detailed rule book that is over three thousand pages long and, at times, highly descriptive. This means that the proportionality principle, which is of particular importance to smaller and medium-sized companies, is difficult to implement under such circumstances. Consequently, smaller companies in particular will be hit by implementation and compliance burdens in the future.

Solvency II represents a huge change of paradigm compared to Solvency I and this reform has not been helped by the time pressure our industry is under to implement it. We have always suggested that the size of the reform would require our industry to be accorded 18 months of full implementation work. However, in reality, we will now receive some major elements of the reform only six months before the implementation deadline, such as Solvency II final reporting templates, that are expected to be published this July. In fact, some important elements of Solvency II – and here I refer to equivalence decisions – will not be confirmed until the autumn of this year.

Unfortunately the over 700 guidelines, that have been issued by the European Insurance and Occupational Pension Authority, EIOPA, almost entirely on its own initiative, have not necessarily helped with these implementation challenges. Again, we can return to the question of how regulators or supervisors view insurers. If you treat insurance as a problem, you prescribe every detailed implementation step. If you see insurance as contributing to a solution, you work with principle-based rules and look to achieve the right outcomes. It is, unfortunately, not difficult to see which approach has been taken here.

There is also something else being easily overlooked. As policymakers seek to develop the perfect regime, that establishes perfect convergence in a perfect single rule book, they are doing not only a disfavour to our industry as they impose - sometimes - unnecessary cost and compliance burdens, but also to our clients, who will ultimately pay the price for regulatory cost, and potentially be faced with less products to choose from.

With that in mind, let me now move from implementation challenges to content: Two areas of particular importance for our industry are long-term products and products with guarantees. And, we are already facing the first consequences of their treatment under Solvency II. A recent survey of our members confirmed that the industry is already moving away from long-term guaranteed products and indicated that this is at least to some extent due to their regulatory treatment.

This is unfortunate, as it is happening while our clients are increasingly forced to complement their social security state based pensions with private pensions, and while our economy is seeking long-term investment and investors to engage with.

This also comes at a time when in Europe - and through the Global Federation of Insurance Associations I know the same to be true for other regions of the world - our premium inflow is stagnating, and in some markets decreasing.

So let me present a win-win proposal for the prudential treatment of insurers: regulate us in line with our long-term business model, recognising our ability to match assets and liabilities and to invest in illiquid assets. This would enable the insurance sector to offer reasonable products and provide safety to future pensioners rather than shifting the entire risk on them. It would also enable us to increase our share of illiquid investment and thus play the beneficial role that is inherent in our business model.

Then, if policymakers encourage people to save prudently for their retirements, it will enable those people to maintain a certain lifestyle once they have finished work, while also minimising the burden on the public purse.

This would also mean that insurers have a continual flow of premiums which they can use to make long-term investments that, in turn, drive growth in the economy. As you can see, it is truly a win-win situation for everybody.

Given that the percentage of people in retirement is likely to only increase in the coming years and decades, it is clear that complementary retirement savings will play

an important role in the future. In this sense, we view the European debate on the establishment of a single market for Personal Pension Products with interest. This is due to the important role that adequately designed long-term pension products can play in taking risk out of people's retirement provision while providing long-term investment for our society.

Turning to the investment aspect, it is encouraging that EU policymakers, as well as policymakers around the globe, are now considering ways of increasing the ability of investors, such as insurers, to make important investments in the infrastructure of our society. This is being addressed at a G-20 level and also through regional initiatives such as the EU Investment Plan and the proposed Capital Markets Union, which seeks to make our financial system more efficient and resilient. In order to do this, the Capital Markets Union aims to bring down barriers to investment in the European Union. As insurers, this is an aim that we share.

For example, in Europe many of our concerns centre on the ability of insurers to continue making long-term investments, once the Solvency II regime comes into force on the 1st of January 2016.

Put simply, the first issue that EU policymakers need to address before Solvency II enters into force is an adjustment to the calibrations of capital charges on long-term investments to remove disincentives for insurers to make such investments. But let there be no misunderstanding. We are not asking for a reduction of calibration that would incentivise riskier behaviour. We are asking for a reduction in calibration to

align them with the underlying risk that we are running with these products. That's it, plain and simple.

While discussions are beginning to take place regarding this issue, such as the much welcomed work by the Commission to examine the possibility of an infrastructure asset class, concrete steps forward are needed to turn this from discussion, into action.

Of course, a precondition for insurers being in a better position to invest is an adequate supply of projects to invest in. This is why the EU needs to make headway in ensuring that there is an adequate pipeline of suitable long-term projects for insurers to invest in.

At the same time, the EU also needs to ensure that the private sector investment that it is calling for now is not then crowded out by public money, from sources such as the European Investment Bank or the European Fund for Strategic Investments. These should instead focus on investments that are less suitable for the private sector. In addition, the Commission should also have a specific work stream to examine the issue of political risk and how to address it in regards to these kinds of investments.

Of course, there are several other challenges for insurers making investments. The low interest rate environment makes it very difficult for insurers to make adequate returns on their investments. This situation is even more problematic since the launch of the European Central Bank's quantitative easing programme, which has put more pressure on interest rates and the availability of assets. One of the strengths of

insurance europe

Solvency II is that it rightly forces companies to manage and report their mismatches and penalises them with high capital charges. While the long-term nature of the business generally means they have many years to adapt, starting to act now is important. While there are enough transitional measures within Solvency II to support companies as they adapt their businesses, it is important that policymakers do not unnecessarily add to the challenge. This means that EIOPA and local supervisors should avoid making Solvency II even more conservative through guidelines, opinions, gold-plating and conservative interpretations of the legal texts.

So we are asking the new Commission and Parliament to scrutinise and assess what has been done - for all the best intentions under the last mandate – and to reflect correctly our long-term business and for insurers to be treated as part of the solution to the many challenges we are facing, not as a problem.

Avalanche of information

Turning back to regulation, we have welcomed the Commission's new mantra on better regulation. But as I mentioned before, I'm afraid that it is not just insurers who will have to deal with more paperwork as a result of the legacy left by the former Commission.

With the new Packaged Retail and Insurance-based Investment Products Regulation, the Solvency II Directive and the proposal for a revised Insurance Mediation Directive, consumers would end up being provided with 147 different pieces of pre-contractual information.

Just to be clear: when we talk about the need for growth, we mean economic; *not in terms of paperwork.*

Joking aside, the question is: Will this inflation of information really help consumers to make informed decision?

The evidence suggests not.

Another problem is that the new EU regulations are imposing **duplicative** requirements on us. In practice, it means that insurers will be forced to provide consumers with similar information twice, but in a different format and in a different wording.

Does this help insurers increase their transparency? I think not. What insurers really need is one clear set of rules allowing them to provide consumers with the simple and relevant information they need to shop around and make informed decisions.

As such, we welcome the EU agenda for Better Regulation which was announced last week by the Commission. EU policies should be reviewed regularly. Europe should be transparent and accountable about whether it is meeting its policy objectives, about what has worked well and what needs to change, in order to be competitive, to restore confidence and to boost jobs and growth.

Conclusion

This underlines my theme for today. Insurers, whether they are in Europe or other parts of the world, can provide a valuable contribution towards addressing the many challenges that our society faces today. But in order to be part of the solution, we

have to be treated as such by policymakers who provide us the framework in which to operate.

I now have the great honour of handing you all over to His Excellency, Pierre Gramegna, the Minister of Finance of the Grand-Duchy of Luxembourg.