Actuarial Association of Europe

Insurance Committee 11.3.2016

Nicosia, Cyprus

EUROPEAN AGENDA

Thingsies going on in Europe – a long time ago in a galaxy far, far away….

- Economic uncertainty continues
- Low interest rates
- Impact of regulation and new policies on companies, customers and the economy
- Euro-area crisis management
- Safety and data security
- Risk management and board liability
- Ageing society
- Development of e-services, digitalisation
- Developing financial literacy

Regulatory Landscape

- Impact of the crisis on the attitude of decision makers, NGOs, media
- Global regulators' influence is growing constantly
- More harmonisation – EU regulations
- Role of European Supervisory Authorities – the amount of level 2 and 3 measures grown exponentially
- More focus on consumer protection – Green Paper on Retail financial services soon
- Digitalisation – Digital Single Market affects all business lines

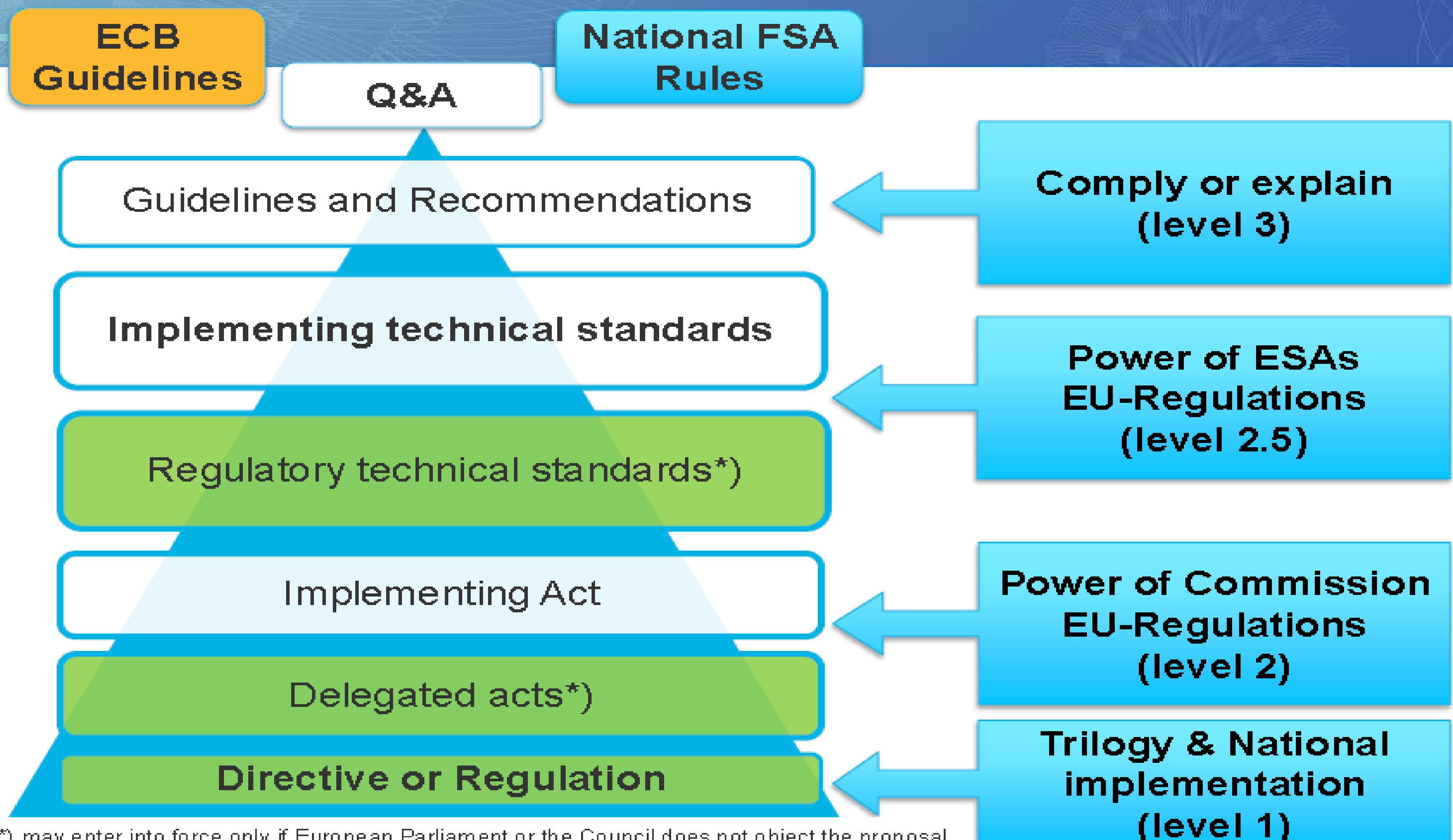
Commission Targets re: Financial Markets

Juncker: ”Big on big things, small on small things”

Fewer new legislative proposals

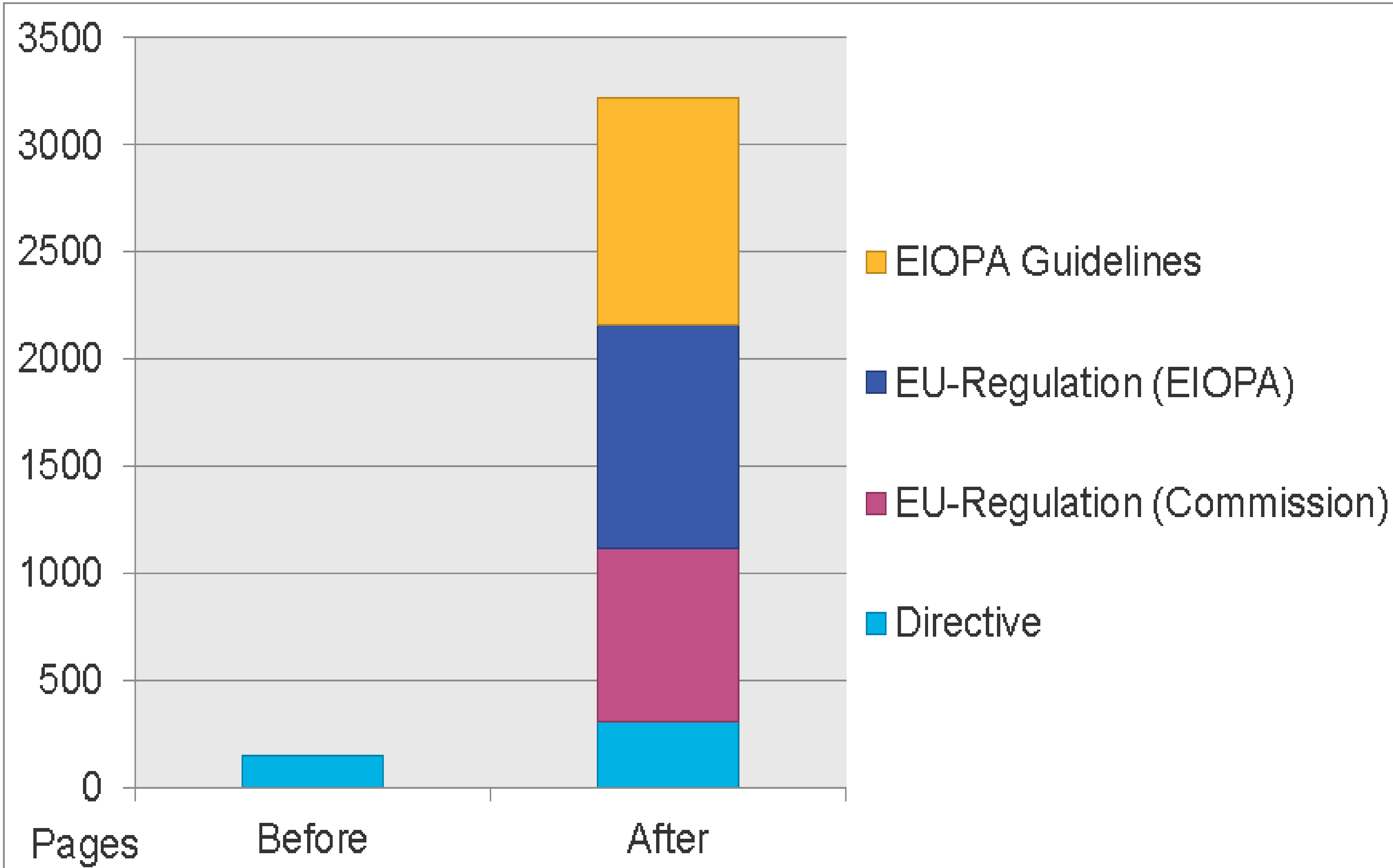
- **Implementation, enforcement and ”repair work”**
- Finalising on-going work: especially Banking Union
- **Growth and Jobs agenda** influences all proposals
- Capital Markets Union, Long Term Investments
- **Digital Single Market** as a horizontal project
- **Consumer and retail focus** – *Hill: ”Fair, transparent and affordable products”*
- New risks and shadow banking
- Global coherence – G20, IAIS, FSB, US, Asia
- **Better Regulation** and Impact assessments

NEW COMPLEX EU-REGULATION SYSTEM



*) may enter into force only if European Parliament or the Council does not object the proposal

Amount of Insurance Regulation before and after Solvency II



COMMISSION CALL FOR EVIDENCE ON CUMULATIVE IMPACT OF FINANCIAL SERVICES REGULATION – until 6 Jan 2016

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Part of Capital Markets Union

1.Rules affecting the ability of the economy to finance itself and grow

•Constraints on financing and liquidity? Proportionality?

2.Unnecessary regulatory burden

•Excessive compliance costs and complexity, duplicative reporting, barriers to digitalisation?

3.Interactions of individual rules, inconsistencies and gaps

•Cumulative impact, overlaps, duplications and inconsistencies?

4.Rules giving rise to other unintended consequences

•Risks shifted elsewhere, creating procyclicality?

MEP BALZ REPORT IN EP ECON

Stocktaking and challenges of EU financial services: Impact and the way forward

- More coordination in legislative process
- More coherence between level 1 and 2 measures
- Level 2 measures need to respect level 1 mandate
- Level 2 needs proportionality
- Need to avoid national red tape
- More regular checks on coherence and impact of regulation

POSSIBLE EXAMPLES OF POOR REGULATION IN FINANCIAL SERVICES

- Overlap in growing reporting obligations
- Investor protection rules partly conflicting
- Legislation creates barriers to digitalisation
- Risk of overregulation in data protection
- Insurance sector crisis management?
- Regulation on derivatives market too extensive
- Market Abuse Regulation disclosure requirements in conflict with market reality
- Banks' structural restrictions vs. the aims of the CMU?
- FTT?
- European supervisory authorities overextend their mandate?

Banking Union – European Deposit Insurance?

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SSM – Single Supervisory Mechanism

SRM – Single Resolution Mechanism

(EDIS – EUROPEAN DEPOSIT INSURANCE SCHEME?)

CRR / CRD IV

BRRD

DGSD

Banks and other credit institutions (over 3 500)

Bank Structural Reform

- Commission proposal: Banks would be prohibited from proprietary trading and investing in alternative investment funds (AIFs)
  - Certain trading activities (such as market making) would also have to be separated from banks to specific trading entities, if authorities so request.
- The Council reached a General Approach in June
  - Same banks in the scope as in the Commission proposal – required to separate their proprietary trading from their other business.
  - Other trading activities will also be subject to risk assessment -> additional measures may then be required (reporting, capital adequacy requirements, separation of activities).
  - If trading activities amount to more than €100bn, stricter risk assessment and heavier additional measures.
  - Aim to keep market-making activities outside of the restrictions.
- Parliament continues to pursue consensus
  - Rapporteur Hökmark (EPP) did not win over the majority in May's vote
  - Negotiations continue
    - S&D shadow rapporteur proposed additional indicators according to which banks could be grouped
    - Reversal of the burden of proof proposed to banks to relieve them from the restrictions

European Commission

EU Investment Plan: 3 pillars

1. MOBILISING FINANCE FOR INVESTMENT

- Boost investment in strategic projects and access to finance via the European Fund for Strategic Investments (EFSI) within EIB/EIF
- Cooperation with National Promotional Banks and the EIB

2. MAKING FINANCE REACH THE REAL ECONOMY

- European Investment Project Portal
- European Investment Advisory Hub: technical assistance

3. IMPROVED INVESTMENT ENVIRONMENT

- Predictability and quality of regulation
- Removing non-financial, regulatory barriers in key sectors within EU Single Market
- Structural reforms at national level

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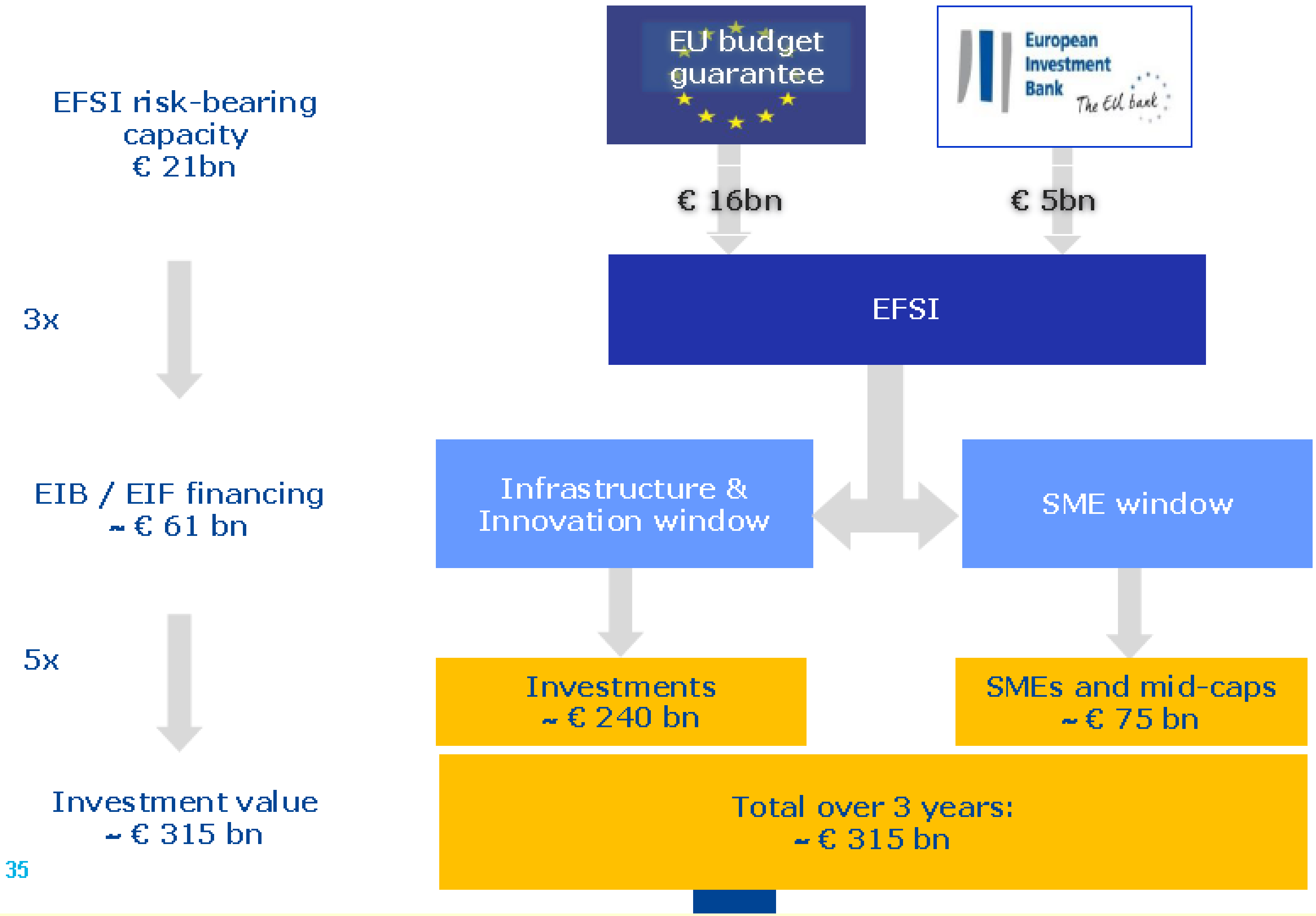
European Fund for Strategic Investments



Infrastructure and Innovation window

SOURCES OF FUNDING

European Fund for Strategic Investments

The Fund serves as credit protection for new EIB activities

TYPICAL PRODUCTS OFFERED

- Long-term senior debt for higher risk projects
- Subordinated loans
- Equity and quasi-equity

Other investors join in on a project basis

PROJECTS IN ELIGIBLE SECTORS

- Research, development, innovation
- Energy infra, renewable energy, energy efficiency
- Transport
- ICT
- Environment and resource efficiency
- Social sectors, education
- SMEs

CMU launch package

Headline actions

1. **CMU action plan** + accompanying documents on economic analysis + feedback on CMU consultation;
2. **Securitisation**: Legislative proposal for STS securitisations, amendment to CRR regulation;
3. **Solvency II delegated act on infrastructure investments**.

Consultations

- **European covered bond** framework;
- Possible modifications to **EuVECA/EuSEF Regulations**;
- **Call for evidence on cumulative impact** of recent EU financial legislation.

A key contribution to jobs and growth

- **Unlock investment:** for companies, SMEs, infrastructure, long term investment and support the Commission's Investment Plan
- **Better connect savings to growth across borders:** MS with both small and large capital markets have much to gain;
- **Make the financial system more stable:** developed capital markets can cushion the impact of a contraction in bank lending;
- **Deepen integration and increase competition:** supporting EMU, lowering costs and increasing competitiveness.

Insurance Crisis Management

Discussions on **Insurance Union** earlier on the table

No clear definition or content – not visible on the new Commission's agenda

Insurance crisis management appearing in the plans:

1) **Recovery and resolution:**

- Anticipatory and recovery measures?
- Supervisory mandates for resolution?
- Scope: Systemically important insurers or all?

2) Harmonised **Insurance Guarantee Schemes** in Member States?

- Commission focus on CMU at the moment.
- Continued pressure on low interest rates, or collapse of an insurer?

Extract from speech by Commissioner Jonathan Hill on 2016 priorities for an approach to resolution for CCPs, Centre for European Policy Studies Brussels, 9 February 2016

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- We need to consider how to approach other systemic financial institutions like central counterparty clearing houses, or CCPs. We have required more clearing to go through central counter parties. That's good for transparency and will reduce risk. But now, if we are going to rely more on CCPs, we also need to put in place a system so that we can resolve them if anything goes wrong.
- As CCPs operate across borders, it's important that we engage internationally on this issue. So, I have decided that the sensible way to proceed is to align our work on this with the work being taken forward as part of the G20 agenda. We'll table a proposal for an effective recovery and resolution regime for clearing houses towards the end of the year.
- In the insurance sector, we're working through the International Association of Insurance Supervisors on how to best manage risk. We of course expect all insurers to be ready with resolution and recovery plans. But at present, we're not convinced that new EU legislation is needed. We'll continue to closely monitor the situation very carefully. And we will take the same approach to the asset management sector.

GREEN PAPER – RETAIL FINANCIAL MARKETS

Green Paper, Fin markets

- The Green Paper seeks the views on how to improve choice, transparency and competition in retail financials services to the benefit of European consumers and how to facilitate true cross-border supply of these services, so that financial firms can make the most of the economies of scale in a truly integrated EU market. It is also looking at and discussing the impact of digitalisation on retail financial services with a view to allow for growth of innovative solutions in this area in the EU.
- Due March 18

the euro area account for less than 1% of the total household loans in the area. In insurance, cross-border provision of services accounted for only about 3% of total gross written premiums in 2011 and 2012.[20]

Green Paper on insurance

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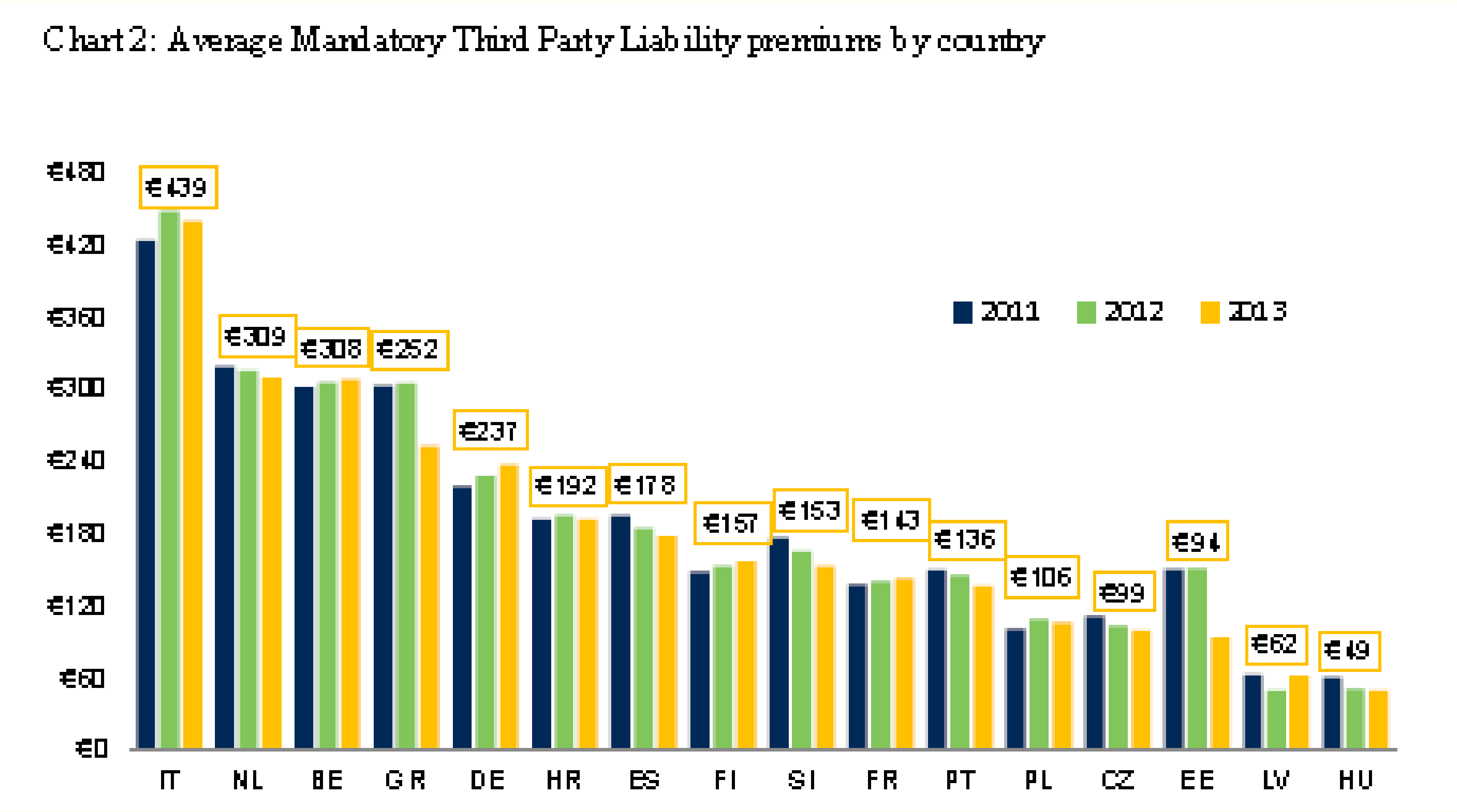
In the insurance sector, the same policy holder with a similar risk profile can pay twice as much for a similar policy depending on his place of residence. Information collected by the FSUG indicates that monthly premiums for a comparable non-investment 25-year term life insurance product ranged from €10 per month in Slovakia and €12.40 per month in Spain to £65 per month in the UK. In the case of motor insurance, for example, quotes vary even for the same car model (Chart 2).[24]

Differences in prices can be attributed to factors such as varying conditions in domestic economies, uneven levels of purchasing power, financial or institutional structures (e.g. taxation, regulation or supervision), or differing funding costs, value propositions (sometimes related to product tying or packaging) and pricing structures in local markets. For insurance (specifically motor insurance) variations in the costs and risks of providing cover can vary substantially between the different Member States, which can justify some price differences. However, there is no apparent objective justification for the scale of the price difference in products that are less tied to geographical location or local risk characteristics, such as life insurance (even if life expectations may not be identical in every Member State). These factors do not always sufficiently explain the degree of price fragmentation across the EU.

Green Paper on insurance



Green Paper on insurance

<u>Questions</u>

9. *What would be the most appropriate channel to raise consumer awareness about the different retail financial services and insurance products available throughout the Union?*

10. *What more can be done to facilitate cross-border distribution of financial products through intermediaries?*

11. *Is further action necessary to encourage comparability and / or facilitate switching to retail financial services from providers located either in the same or another Member State? If yes, what action and for which product segments?*

Green Paper on insurance

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find that they are not eligible for services if they do not reside in the provider's country.[92] In insurance, consumers' places of residence, rather than their individual risk profiles, define the options available, as insurers will draw up policies based on the risk pool as determined by local demand. On-line suppliers may apply 'geo-blocking' techniques by blocking access to websites, rerouting to other websites or by not allowing for the conclusion of the transaction by requiring specific data formats limited to particular countries (e.g. postal codes or payment information). These practices prevent consumers from applying for their chosen products.

Questions

14. What can be done to limit unjustified discrimination on the grounds of residence in the retail financial sector including insurance?

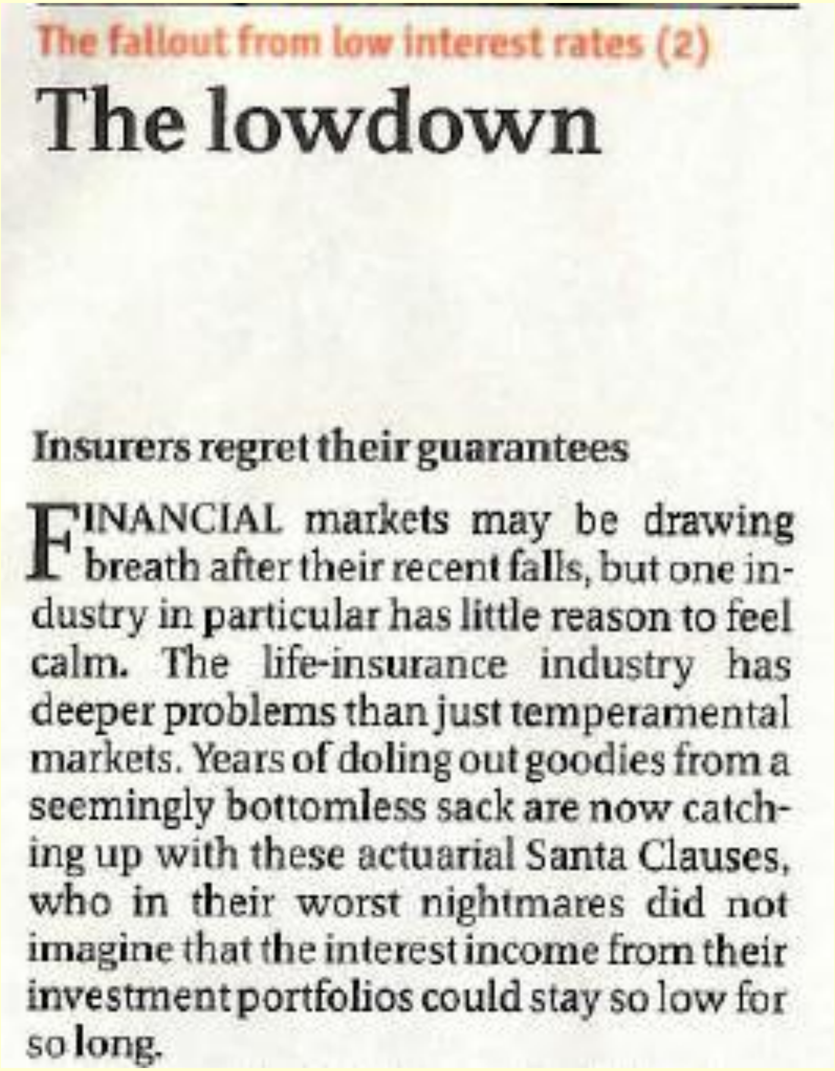
Questions

15. What can be done at EU level to facilitate the portability of retail financial products – for example, life insurance and private health insurance?

Questions

20. Is action needed to ensure that victims of car accidents are covered by guarantee funds from other Member States in case the insurance company becomes insolvent?

LOW INTEREST RATE ENVIRONMENT


The fallout from low interest rates (2)

The lowdown

Insurers regret their guarantees

FINANCIAL markets may be drawing breath after their recent falls, but one industry in particular has little reason to feel calm. The life-insurance industry has deeper problems than just temperamental markets. Years of doling out goodies from a seemingly bottomless sack are now catching up with these actuarial Santa Clauses, who in their worst nightmares did not imagine that the interest income from their investment portfolios could stay so low for so long.

Ironically this de-risking creates a different danger: that the industry becomes irrelevant. By removing the key selling point of an insurer over a mutual fund—the assurance that a policy will pay out no matter what—the industry risks negating its business proposition to investors looking for security. (It does so, moreover, at a time when pension funds are watering down their long-term financial commitments, says Daniel Hofmann of the Geneva Association, who worries about the consequences for society and the economy.) The big question is whether new customers will buy savings-based insurance products at all in this shaky market environment, says Benjamin Serra of Moody's.

To survive, the life-insurance industry will need to address the question of what it is for. Most premium income for life insurers comes from the savings business, where guarantees play a central role. The classic model thrives on short-term interest rates of between 2-6%, government bonds yielding at least 4% and no worries about defaults. "That's when we can sell policies cheap and generously," sighs one nostalgic underwriter.

INTERNATIONAL CAPITAL STANDARD

The Basic Capital Requirement (BCR)

- Foundation of the HLA. Together, they will constitute a group-wide capital requirement, applying to G-SIIs only. G-SIIs started reporting the BCR to their supervisors confidentially in 2015.
- The BCR is intended to reflect major categories of risk affecting G-SIIs, split between insurance and non-insurance.

International Capital Standard

Higher Loss Absorbency (HLA) Requirement

- HLA capacity will be added to BCR to constitute a consolidated group-wide capital requirement for G-SIIs. It is intended to ensure that G-SIIs are required by their supervisors to hold higher levels of regulatory capital than would be the case if they were not designated as G-SIIs. The G20 endorsed HLA at its annual summit in November 2015.
- Beginning in 2016, the HLA is to be reported on a confidential basis to group-wide supervisors and be shared with the IAIS for purposes of improving the HLA. It is expected that it will be applied to G-SIIs from January 2019.

International Capital Standard

- The ICS is part of ComFrame and will apply to all Internationally Active Insurance Groups (IAIGs) and G-SIIs. When it is implemented, it will replace the BCR as a foundation for the HLA for G-SIIs.
- The ICS is a detailed risk-based capital requirement: the December 2014 consultation document is 159 pages long and covered valuation, capital resources, approaches to measuring risk and set out a standard method for calculation.
- IAIS announced its plans to launch a further consultation on the ICS in June 2016. The ICS has been divided into two versions. IAIS aims to adopt V. 1.0 (for confidential reporting) in May/June 2017 and to adopt ComFrame, including ICS V. 2.0, at its 2019 General Meeting.

Is ICS a CCL Standard or not?

- Only for IAIG’s including G-SII’s, is it important to engage?
- But Bernardino says S II needs to be adapted to the ICS and asks for European actuarial involvement
  – If S II will be adapted in 5-10 years and we have problems, we are told that we were warned but it is too late to react any more
- So, should ICS be in our priorities or should we only trust the IAA to be active (where apparently IAIG people are more active than others?)
- What to drop out of current priorities – or where to find new resources?
- If we have a CRO event this spring, should this be among the topics?

IRSG

Key messages from the IRSG:

- New stakeholder group announced. Composition of group has changed with slight reduction in number of participants representing professional associations (from 6 to 4)
- Ongoing developments relating to SII of interest
  – SII final delegated regulation by EP end of March
  – EIOPA stress tests 2016 aim to test resilience of the insurance sector to adverse market developments and to extract valid conclusions to support the stability of the financial system
  – Review of UFR will take place in 2016, changes will at the earliest be introduced in 2017
  – Review of standard formula will take place during coming couple of years

Key messages from the IRSG:

- International Capital Standards (ICS) to be implemented 2019, expected to be on the agenda for next IRSG with more focus than this year
- Consumer protection in focus
  - Core focus area for EIOPA - as stressed in (close to) all of Gabriel Bernardino speeches
  - Initiatives of relevance Insurance Distribution Directive (IDD), PRIIPs and Product Oversight & Governance (POG)
- Currently input requested through a questionnaire on equity dampener, deadline 18 March. Comments welcome

NOTES FROM THE EIOPA ROUNDTABLE ON INFRASTRUCTURE INVESTMENTS ON 12 FEBRUARY 2016

Notes from the EIOPA Roundtable on Infra-structure Investments on 12 February 2016

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- New Approach to calibrate the SCR for Infrastructure Investments is to look on the volatility of equity of listed companies close to the infrastructure business, like energy, transportation or even communication companies. EIOPA has identified a short list of 67 European entities excluding telecommunication and 35 telecommunication entities. The idea was to look whether this index has a lower volatility than the European equity market as a whole, and use this difference to justify a respective lowering of the SCRs. EIOPA was looking for feedback on this approach in general and on this list specifically.
- The industry presented some infrastructure projects where insurance companies typically are involved. These projects comprise typically housing, construction, wastewater plants, highways, etc.

Notes from the EIOPA Roundtable on Infra-structure Investments on 12 February 2016

- The industry estimates that only 15 % of their infrastructure involvement is based on utilities, but on the other hand the index EIOPA introduced consists to 80 % of utility companies. So the feedback from the industry was rather negative and EIOPA seemed to be very disappointed and helpless how to proceed.
- The planned next steps are to publish a consultation paper early April and to have another stakeholder event end of May/ beginning of June. Final advice to the European Commission is proposed for end of June after their Board meeting.