Annual Report 2017–2018

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Glossary

EC	European Commission
EIOPA	European Insurance & Occupational Pensions Authority
GAAP	generally accepted accounting principles
GDP	gross domestic product
IAIS	International Association of Insurance Supervisors
OECD	Organisation for Economic Co-operation & Development
SMEs	small and medium-sized enterprises
WTO	World Trade Organization

Contents

Foreword

Sergio Balbinot
President (2011–18)

As a convinced European, it has been my privilege to serve as Insurance Europe president since 2011, representing the views of insurers to EU decision-makers and providing the European institutions with the expert input they request in order to develop a strong and appropriate regulatory framework for the benefit of Europe's citizens and its economy.

Over my seven years as president, Insurance Europe, under the leadership of director general Michaela Koller, has continued to make high quality, fact-based and representative contributions to European debates. Looking back, I recall some intensive discussions with policymakers: meetings with Commissioners Barnier and Hill and Vice-President Dombrovskis; with many MEPs, in particular Burkhard Balz as the rapporteur for Solvency II; with Council presidencies; and, of course, with EIOPA chairman Gabriel Bernardino. The overarching aim on both sides in those — at times — robust discussions has always been to support the strong, innovative insurance industry that Europe needs.

This last year has been no exception. There have been new challenges but also some welcome improvements to EU plans that affect insurers, many of which you will read about in this Annual Report. Let me highlight just a few.

In our increasingly connected world, access to data will be crucial for the future of the insurance industry. In the area of connected and automated vehicles, rather than being bound by agreements pre-negotiated by vehicle manufacturers, the Commission's C-ITS Platform rightly recognised that consumers should be free to choose with whom they share their data. We now appeal to the Commission to take the necessary legislative action.

Likewise in relation to the Insurance Distribution Directive, we welcome improvements to the new rules, as well as the delay the legislators accorded to stakeholders to implement them. As with the PRIIPs Regulation, the inconsistencies and duplications that remain will, nevertheless, create implementation challenges and we fear increased compliance risk and customer confusion. There will be significant work during the upcoming review(s) to turn these into genuinely useful frameworks.

I would be remiss not to mention Solvency II, our industry's regulatory framework, on which we have worked intensively over the years. We have two necessary reviews coming up to address long-identified shortcomings. I want to use this opportunity to create the links here with the work on a global insurance capital standard. Insurance Europe is calling strongly for a Solvency II that appropriately reflects the actual risks of long-term products to be the implementation of the global standard in Europe.

After this busy year, I leave safe in the knowledge that my successor Andreas will continue with Michaela and her team to work in the best interests of both the industry and Europe.

Andreas Brandstetter
President (2018–21)

Insurance Europe's achievements under Sergio's presidency have created long-lasting, positive benefits for Europe's insurers. And the best way to thank him for his service to the industry is, I believe, by building on his impressive legacy.

Like my predecessor, I consider myself a committed European. I experience the benefits of an integrated Europe in my working and my private life every day. I am therefore in no doubt of the positive effects of the EU single market. As head of an international insurance group, however, I also face daily the increasing challenges resulting from well meaning but at times inconsistent or exaggerated EU regulation and the accompanying compliance challenges. Tackling these will be the foremost aim of my presidency.

Turning to the 12 months ahead, the EU agenda remains as busy as ever. I will confine myself to briefly mentioning just two of the upcoming challenges for the European industry.

Firstly, the all-important reviews this year and in 2020 of the Solvency II rules that govern our industry. Back in 2016, when this paradigm shift in insurance regulation was introduced, legislators recognised that the new framework still contained imperfections. These reviews are the welcome opportunity to fix them. The targeted 2018 review should take steps towards addressing some technical inconsistencies and flaws, and introducing some simplifications. The full 2020 review should then adjust Solvency II to correctly reflect the long-term nature of insurers' business and their investments, correcting the mistake of treating insurers as though they trade all their assets and liabilities at all times.

Secondly, the coming year will, regrettably, see the UK leave the European Union — with all the implications that brings for cross-border insurance and reinsurance between the UK and the remaining 27 EU member states. Insurance Europe will continue to provide the vital link between its members and the Commission's Brexit taskforce, seeking to minimise as far as is possible any detrimental effects on policyholders and the industry.

More generally, I look forward to working with Michaela Koller and her team, as well as all the member associations of Insurance Europe, in continuing our discussions with policymakers to ensure that the particular characteristics of our specialised industry and the unique benefits it brings to society are recognised and that the dangers of well intended but disproportionate or excessive regulation are understood. We will watch with interest to see the effect of the Commission's new taskforce on subsidiarity, proportionality and "doing less more efficiently", which started work at the beginning of 2018.

Insurance Europe's members, the secretariat and I are firm in our belief that robust and appropriate regulation and supervision are essential for a healthy, innovative European insurance industry.

OPINION

Antonio Huertas
Chairman & CEO, MAPFRE

UNDERINSURANCE

Closing the gap

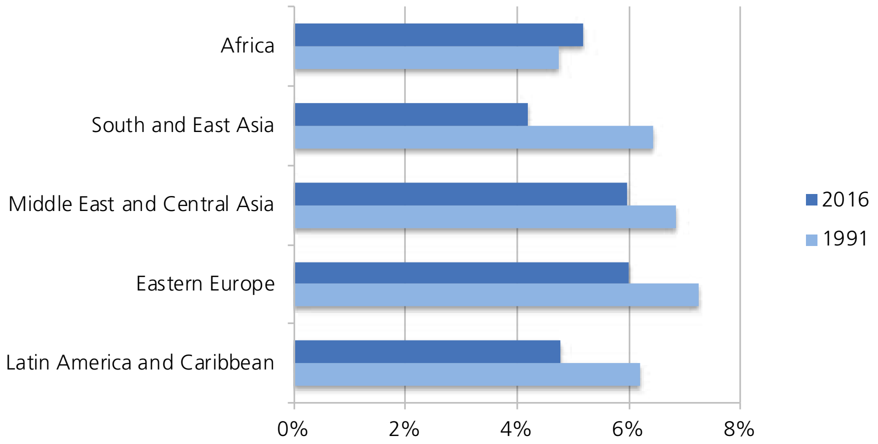
Antonio Huertas sets out the sobering size of the global insurance protection gap and insurers' role in closing it

Insurance drives social and economic development in several ways. As an instrument that mutualises risk, insurance rights the material wrongs provoked by adverse events, so bringing stability to the workings of the economy. Additionally, as institutional investors, insurers help to manage savings and investment over the medium and long term, contributing to the process of capital formation and counter-cyclical stabilisation. As such, it can be said that when insurance operates effectively in a society it brings certainty, dynamism and efficiency to economic performance, boosting wealth creation and underpinning a healthy sense of community.

The world has benefited from the growing presence of insurance for many years now, and the industry itself has had to continuously adapt to shifting conditions both in the economy and society at large. However, significant underinsurance, or the "insurance protection gap", is still very evident, especially in the emerging regions.

Put simply, the insurance protection gap is the difference between the amount of insurance coverage that is economically necessary and beneficial for society and the amount of such coverage that is actually in place. Going beyond merely quantitative estimates, this gap represents that space where greater insurance penetration could make the functioning of the economy more efficient and dynamic, and thereby raise overall societal well-being. That is

Figure 1: Insurance protection gap in selected emerging regions — 1991 and 2016 (% GDP)



Source: MAPFRE Economic Research (with Swiss Re data)

why, today, from the standpoint of the insurance sector's contribution to economic development, closing this gap is the key challenge facing global society.

Stark figures

Over the past quarter-century, insurance penetration around the world has increased, approaching optimal levels in some advanced economies and diminishing the protection gap in the developing world. Measured against GDP, from 1991 to 2016 the insurance protection gap narrowed by 17% in emerging markets, and far more in the non-life segment (-23%) than in the life segment (-13%). Other than in Africa (where the gap has widened over that timeframe by 0.4 percentage points), the tapering of the insurance protection gap has been broadly similar across all emerging regions (see Figure 1).

However, although the protection gap in the developing world has decreased as a proportion of GDP, it has risen in absolute terms, as has what that gap represents in relation to the worldwide insurance market.

"Greater insurance penetration could make the functioning of the economy more efficient and dynamic, and thereby raise overall societal well-being."

Using 2016 figures, the insurance protection gap in emerging markets is approximately $1.4trn, or 29% of the global insurance market, as against 20% a quarter of a century ago. Another element is how the internal make-up of the gap has evolved over the same period, with a greater share now accounted for by the dynamic economies of South-East Asia, while there has been a relative reduction in Eastern European and Latin American economies (see Figure 2 on p8.)

Partnerships for progress

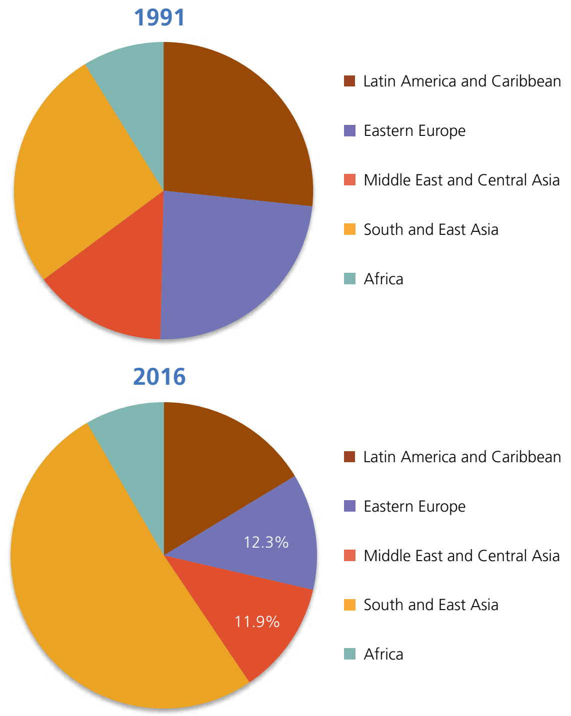
Despite the advances made, closing the insurance protection gap globally remains a major challenge. The European insurance industry — present in most of the emerging markets through its international groupings — has a key role to play here by partnering with financial authorities to design and implement public policy aimed at raising insurance penetration around the world.

This effort entails dealing with structural factors such as economic growth and income distribution, both of which are vital to strengthen the presence of insurance in the economy. And there are also other elements that can reinforce these efforts. Swifter innovation, for example, so as to bring insurance closer to the needs of widely diverse and ever-changing societies, and the search for new and improved distribution channels that will enable insurance to permeate through to where thus far it has not reached. These are areas of concern in which insurers should take the initiative.

Standards of financial education and inclusiveness need to be improved as well. Schemes can be devised that stimulate the use of insurance (such as tax incentives and compulsory insurance laws), while accessing markets and launching new products should be made more flexible, with regulatory frameworks being adapted as required. The insurance industry must join forces with the financial authorities so that together they can create an environment that facilitates the making of progress on this key challenge for our industry.

When one speaks of the need to close the insurance protection gap, the implications go far beyond merely enlarging the size of the insurance industry itself. From a social responsibility perspective, closing the gap means engaging in public policy mechanisms that allow the benefits of protection and the offsetting of risks to be extended to a greater proportion of overall economic activity. This, in turn, raises wealth creation capacity and hence societal well-being around the world.

Figure 2: Insurance protection gap structure: selected emerging regions — 1991 and 2016 (%)



Source: MAPFRE Economic Research (with Swiss Re data)

Michaela Koller
Director general, Insurance Europe

CLIMATE CHANGE

Winds of change

Insurers are the perfect partners for policymakers as the world adjusts to the effects of climate change, says Michaela Koller

In Europe in 2017, economic losses from natural catastrophes and man-made disasters totalled $23.7bn (€19.3bn), according to figures from Swiss Re. Only half ($12bn) were covered by insurance, creating a massive gap in protection against catastrophes.

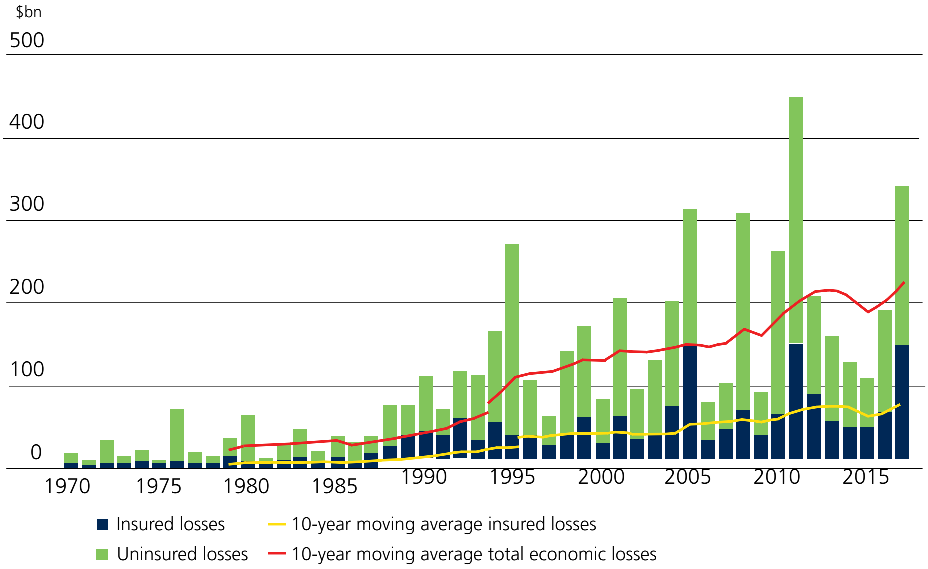
The links between extreme-weather events and climate change are many and complex, but 2017's record cat losses make it clear that adaptation to and increased resilience against such events need to be top priorities for national and local governments, companies and individuals. Insurance policies and insurers' risk management knowledge can play a crucial role here.

EU action

The EC's 2013 Strategy on Adaptation to Climate Change has three key objectives: promoting action by member states to adopt comprehensive adaptation strategies; "climate-proofing" (in vulnerable sectors such as agriculture, to make infrastructure more resilient and to promote the use of insurance); and addressing adaptation knowledge-gaps to improve decision-making.

In 2016, the EC started an evaluation of the implementation and performance of its Strategy, which will run until the end of 2018. This included, in 2017, a study of the insurance of weather and climate-related risk to which European (re)insurers contributed significantly. Its conclusions include a number of useful

Insured vs uninsured losses — 1970–2017 ($bn at 2017 prices)



Source: Swiss Re, sigma *No. 1/2018*

recommendations. These include increasing the requirements for member states to assess their insurance penetration rates and events covered, as well as to report on how they use (re)insurance as a mechanism for managing risks. They also include promoting the use of (re)insurance mechanisms that will support damage prevention in member states.

Role of insurance in adaptation

Insurers have long campaigned for policymakers not only to take measures to mitigate the effects of climate change, but also to invest in preventing and adapting to its consequences.

The insurance sector is often regarded solely as a provider of compensation for losses. This function is, of course, of vital importance to the economy, yet the role of insurance goes much further. Insurance is an integral part of the whole risk-management cycle, from risk identification to risk transfer and recovery. The (re)insurance industry:

- contributes to a better understanding of risk through, for example, the development of forward-looking risk models;
- contributes to risk awareness through risk-based terms and conditions and advice to customers, and offers incentives to increase prevention and other risk-management measures;
- helps policymakers to guide society with tools such as risk-mapping, land-use planning and building codes; and,
- provides victims with compensation for their economic losses faster than *ex post*-financed schemes.

It must be understood, of course, that insurance is neither a substitute for other adaptation measures nor an instrument for funding adaptation or mitigation measures; it is up to national, regional and local authorities to spearhead these efforts.

Avoiding moral hazard

Prevention and adaptation must be embedded in member states' socio-economic environment. This is often severely hampered by states' and citizens' overreliance on post-disaster relief. If relief does not come with minimum prerequisites, a vicious circle of moral hazard occurs, meaning that there is a tendency to behave in a riskier manner if those affected do not suffer fully from the consequences of their behaviour. In response to the consultation on the EU Adaptation Strategy, Insurance Europe strongly advised the Commission to offer support to member states that have repeatedly failed to implement preventive and adaptation measures following disasters.

Insurance is an instrument to manage "peak", ie unforeseen and volatile, risks. To tackle more foreseeable risks, government action is essential, such as protection measures and land-use planning rules that address rises in sea levels.

2017: record year for the wrong reasons

Natural catastrophes and man-made disasters made 2017 a year of record losses. According to Swiss Re, insured losses were the highest ever recorded at $144bn (€118bn), largely due to Hurricanes Harvey, Irma and Maria, which hit the Caribbean and US, but also because of record wildfire losses in California.

Economic losses were well over twice the insured losses, totalling $337bn. This was significantly above the 10-year average of $190bn and almost entirely due to natural catastrophes ($330bn). This meant that the global catastrophe protection gap was a massive $193bn.

Government investment in adaptation and prevention measures is important for bolstering the EU's adaptive capacity. By modernising infrastructure, particularly in areas prone to severe windstorms or river or coastal flooding, public authorities can minimise the impact of climate change. Such efforts can take the form of climate-proofing buildings or providing incentives (eg through taxation) for climate-resilient development.

Public authorities should maintain dialogue with insurers, who can help policymakers identify the appropriate areas in which public-private cooperation can be beneficial. They can provide research, encourage prevention measures, deliver financial solutions and apply expertise to track trends and define the problems created by climate change.

Tackling the protection gap

High insurance penetration rates led to little need for public authority intervention after 2017's California wildfires (see box above). Penetration rates of under 50% in some French overseas territories in the Caribbean, meanwhile, mean that the cost of Hurricane Irma will be largely borne by the state.

In the EU, the recent increase in weather-related events has highlighted the need to address problems with underinsurance in several regions. This is an issue that member states must make a priority in order to ensure their citizens are adequately protected in the face of increasing catastrophic events.

What is important to keep in mind is that there can be no "one-size-fits-all" approach to natural catastrophe insurance at European level. This is due to differences not only in risk exposures in different regions, but also in levels of public awareness about potential risks, levels of government intervention, liability regimes and adaptation practices. This results in a highly diverse insurance market across the EU, ranging from optional, private-market solutions to compulsory insurance pools. It is the reason there is no single solution at European level for insuring natural catastrophes. In fact, imposing an EU-wide system could have a severe impact on well-functioning markets in which risks are already insurable.

Member states must implement the solutions that are best for their circumstances and these can include everything from targeted awareness-raising campaigns to the abolition or reduction of taxes on certain types of insurance (eg natural catastrophe policies in the Italian Budget Law of 2018).

As Europe's largest institutional investors, insurers are also, of course, at the forefront of sustainable investment strategies, as Aviva's Mark Wilson sets out in the next article.

Mark Wilson
Group CEO, Aviva, UK

SUSTAINABLE FINANCE

Best behaviour

Insurers must use their influence to promote sustainable behaviour, insists Aviva's Mark Wilson

Insurers are in the eye of the storm on climate change. Our industry is more exposed than most to the destructive power of extreme weather but, as asset owners, we also have the power to make a difference. By working together, and encouraging action from policymakers and supervisors, we can collectively manage this existential risk.

Climate change is already affecting our industry. In 2017 alone, economic loss caused by global natural disasters exceeded $330bn (€267bn). Insurers can help build resilience to the effects of climate change around the world, but there are still significant gaps in protection and these will only increase. We know that a temperature rise of four degrees makes our current business model defunct.

A study Aviva commissioned from the Economist Intelligence Unit found that of the world's current stock of manageable assets, estimated at $143trn, nearly $14trn discounted to present-day value is at risk if global temperatures rise by an average of six degrees. As long-term investors, we insurers need to protect and grow our investments, while also ensuring we contribute to the broader improvement of the world we live in. So, we have to do everything we can to bring about a smooth transition to a "well below two degree" world and meet the promises we have made to our customers.

EU High-Level Expert Group recommendations

The European Commission established an independent High-Level Expert Group on Sustainable Finance in late 2016, comprising experts from civil society, finance and academia, as well as observers from European and international institutions.

The Group's report and recommendations, published in January 2018, form the basis of the EC's March 2018 Action Plan on Financing Sustainable Growth.

The Group's insurance-specific recommendations were:

- To encourage greater adoption of the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures.
- To assess the need to incorporate climate risk more explicitly into assessments by insurers.
- Four proposals to investigate how Solvency II could be adapted to facilitate further long-term investment while maintaining its strong risk-based nature (see p14).
- To ensure IFRS 17 (see p53) safeguards the link between insurers' liabilities and assets.

To do that, we all need to understand and focus on all types of risk — physical, transition and liability — now informed by the Financial Stability Board's Task Force on Climate-related Financial Disclosures. Aviva was one of the first insurers to begin disclosing in line with the Task Force's recommendations, and is working to expand those disclosures. In fact, I believe they should be made mandatory.

Influencers of change

We can all use our influence over the companies in which we invest to promote sustainable behaviour. This is why Aviva is one of the co-founders of the World Benchmarking Alliance, together with the United Nations Foundation and Index Initiative. The idea is simple; the Alliance will measure and rank companies on their performance on sustainability. This information will be freely available and will help harness the power of competition to encourage a race to the top. The idea is one of the key recommendations in a Business and Sustainable Development Commission 2017 report, which identified a $12trn economic opportunity for companies that pursue sustainable and inclusive business models and provided a critical catalyst for the creation of the Alliance.

The Alliance's rankings will be aligned to the United Nations' Sustainable Development Goals, which include one on climate action. We are already exploring how to develop a "corporate climate action benchmark", which would track how companies are performing against the objectives of the UN's 2015 Paris Agreement on climate change.

"A temperature rise of four degrees makes our current business model defunct."

Pushing policymakers

Finally, our industry has to focus much harder on encouraging policymakers and supervisors to correct the market failure on climate change. For example, they should support the recent recommendations of the EU High-Level Expert Group (see box above). These identified ways policymakers could change relevant financial regulation, notably Solvency II (see p14), to better incorporate long-term climate risk and encourage more sustainable, long-term investments in key infrastructure.

Managing risk is our business, and climate change presents the mother of all risks, both to our own insurance business and to society more widely. We have the means and the opportunity to limit the damage. Let's seize our chance before it is too late.

Olav Jones
Deputy director general, Insurance Europe

SOLVENCY II

Review views

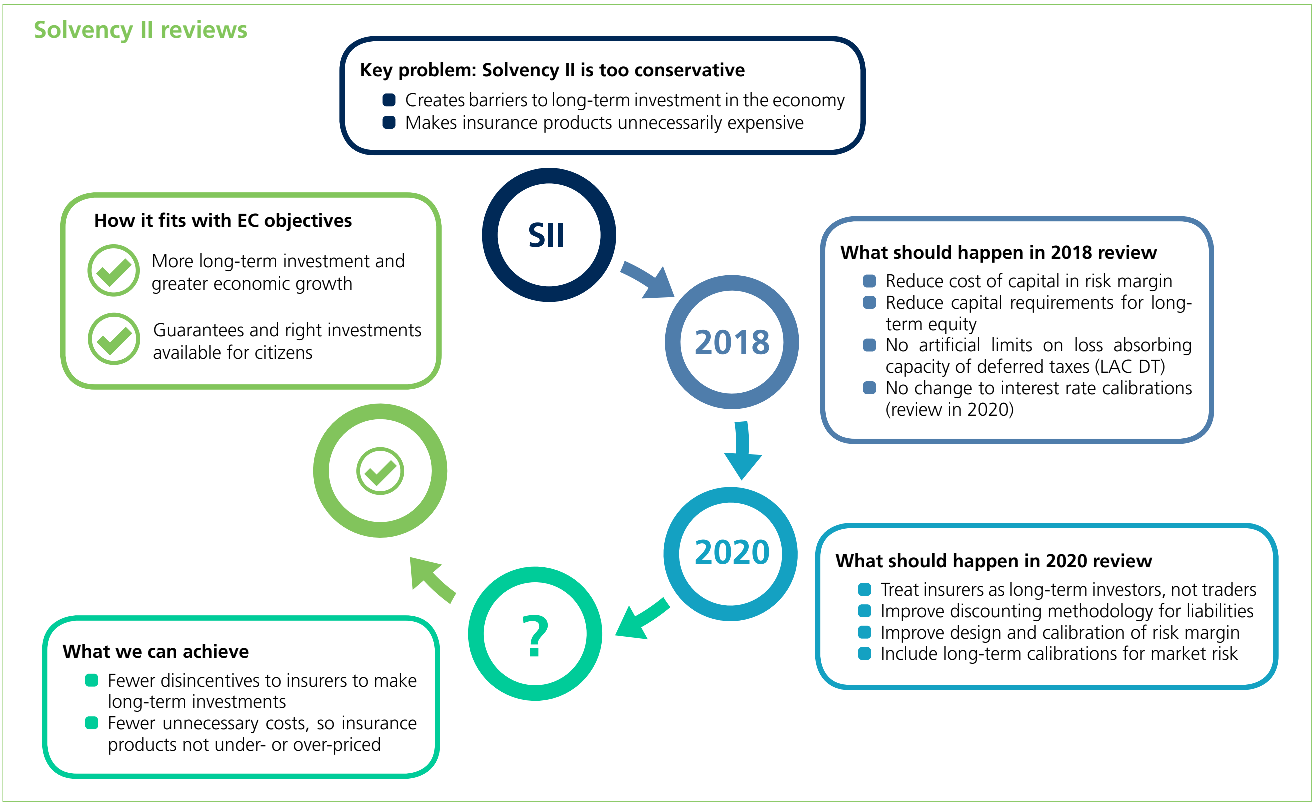
Olav Jones explains what issues should and should not be tackled in two reviews of Solvency II and why the reviews are so important to European growth

Since January 2016, the EU's (re)insurers have been required to follow arguably the world's most sophisticated set of risk-based capital requirements and risk-management principles: Solvency II. Companies have managed this seismic shift in regulation very smoothly and are demonstrating strong solvency positions — indeed, in 2017 their average solvency capital ratio was 240%.

Overall, Solvency II is a strict, solid and comprehensive framework that is probably the most conservative in the world. When the legislators introduced it, however, they were aware that it still contained some imperfections and so they built in the requirement for two key reviews early in its existence.

The first review, due by the end of 2018, focuses mainly on simplifications and fixing technical issues with capital calculations (in the Level 2 delegated regulation). The second review, due by the end of 2020, is much wider; it allows for more fundamental changes and the addressing of broader issues (through the Level 1 legislation), including the concerns that Solvency II places unnecessary constraints on long-term guarantees and investments.

In addition to these reviews, the Commission has, in work related to its Capital Markets Union project, made welcome and appropriate improvements to calibrations for a number of specific asset classes of importance to European growth. These include infrastructure,



securitisations, unlisted equity and unrated debt. The two reviews, however, provide the opportunity for the Commission to make a wider set of improvements with a far greater impact.

Based on the advice EIOPA has given to the Commission, the 2018 review is approximately estimated to release €5bn to €10bn of industry capital through improved calibrations and simplifications. While welcome, these improvements would be vastly outweighed by the estimated tens of billion euros that would be tied up by the requirements in two proposals EIOPA has made on its own initiative in the areas of interest rate risk and the loss absorbing capacity of deferred taxes (LAC DT).

In addition, these two EIOPA initiatives would have a disproportionate effect on certain jurisdictions and companies and they would go against the spirit of the political agreement reached during the original Solvency II negotiations. Decisions on such initiatives should be considered in 2020, when the full Directive is reviewed.

Can the 2018 review make a difference?

The Commission is due to propose amendments by December 2018 and has the opportunity to include further steps towards removing disincentives for long-term investment and to enhance insurers' ability to support the EU's growth objectives (see box on p16). While EIOPA's advice includes helpful improvements to smaller issues, these are overshadowed by advice that not only ignores the EU's growth objectives but actually conflicts with them. Disappointingly, EIOPA's impact assessment has several weaknesses and ignores effects on the cost and availability of products and on long-term investment. Before the EC finalises its views and makes proposals to the European Parliament and Council, it should undertake a comprehensive impact assessment of the cumulative impact of EIOPA's proposals.

At the EC's high-level public hearing on the 2018 review in March 2018, it was noteworthy that — with the exception of EIOPA — none of the speakers representing the broad range of stakeholders was calling for increased calibrations or security levels. Instead, there were strong calls for improvements in calibrations and simplifications, and opposition to the EIOPA proposals on interest rate risk and LAC DT.

What should change in 2018

There are two concrete steps in particular that the Commission should take in the 2018 review that have sound prudential justification and would support the European growth and investment ambitions of the Juncker Commission.

Firstly, it should reduce the cost of capital in the risk margin,

Why Solvency II matters to EU objectives

Getting Solvency II measures wrong matters to consumers because it can lead to higher premiums, lower benefits and less choice. It matters to the economy because it limits the ability of insurers to support the EC's growth agenda.

Solvency II calibrations have an impact on the cost, design and availability of insurers' products and on their investment decisions. Excessive capital requirements can increase prices for customers or even make it uneconomic for insurers to offer some products.

Excessive requirements also restrict insurers' ability to invest their assets — of which they have €10trn — most of which could be long-term. Stimulating sustainable long-investment is a key plank in the EC's project to create a Capital Markets Union, which seeks to address regulatory barriers to institutional investors' ability to support economic growth.

Similarly, barriers to long-term investment are implicitly barriers to sustainable finance (see p12). The need to improve Solvency II's measurement of long-term business and related investments was highlighted in the January 2018 report of the High-Level Expert Group on Sustainable Finance set up by the Commission.

And the EC's proposed pan-European pension product (see p22) is a long-term product that should rightly be subject to Solvency II's solid prudential treatment, but currently the regime overstates the risks of long-term products and challenges insurers' ability to offer long-term guarantees.

recognising the impact the currently excessive margin can have on insurer's long-term products and their ability to invest long-term. The risk margin is not needed to pay customer claims. It is a theoretical concept that requires thousands of insurers to set aside substantial amounts of capital to facilitate the unlikely run-off of a failed insurer. It is intended to represent the extra amount an investor would require if it were to take over an insurer's liabilities in the rare case of failure. It currently removes over €200bn of real and potentially productive capital from insurers' balance sheets. For some long-term products, it has the same effect as doubling the solvency capital requirements.

There is extensive evidence that the cost of capital, a key element in the calculation of the risk margin, should be significantly lower than the current 6% and this evidence should not be ignored. Given the size of the problem, which affects insurers in many member states, some improvements should be made in the 2018 review. Wider questions on the need for and design of the risk margin can then be addressed in 2020.

Secondly, the EC should reduce the capital requirements for long-term investment in equity, not just unlisted equity. These are currently excessive for the real risks, ignoring completely the impact of dividends, for example. They add to the disincentives to increasing the equity investment within a diversified portfolio that is required, for example, by pension products to help provide good long-term returns. Equity investment can also be a driver for growth and employment.

What should not change

EIOPA's two own-initiative proposals would put unnecessary additional capital strain on insurers, conflict with the EC's growth objectives and should not be taken forward.

There should be no change to the calibration of interest rate risk. Interest rates are directly related to fundamental questions on valuation methodology and should be dealt with in the 2020 review. What EIOPA is suggesting now is a very unlikely scenario under which interest rates would remain negative on average until 2029. In addition, the proposal is based on the assumption that all European insurers would invest all their assets in these negative rates and lock them in over the entire period. Again, this is a completely unrealistic assumption.

Solvency II includes an interest rate approach that is already conservative, so the current calibration of interest rate risk should not give rise to prudential concerns. Moreover, EIOPA's stress tests cover extreme scenarios of negative rates and the 2016 test demonstrated the resilience of European insurers to a prolonged period of extremely low rates.

Any changes to interest rate risk now would have a negative impact on insurers' long-term products and long-term investment, as well as on their ability to invest in non-fixed duration assets, such as equity. EIOPA's impact assessment was based on simplifications and proxies and it underestimates the negative impact of changes. The EC had good reasons not to ask EIOPA for advice on this now because of the links with the wider interest rate issues that will be covered in 2020.

Likewise, no arbitrary limits should be imposed on LAC DT, which relates to the tax recovery that can be used to offset capital requirements. Solvency II already requires high standards of evidence to support the use of LAC DT, and supervisory dialogue between companies and national supervisors should be encouraged, not discouraged by artificial limitations. The EC should reject artificial and conservative limits proposed by EIOPA under the pretext of convergence.

Solvency II's already high level of regulatory harmonisation across Europe is expected to increase as companies and supervisors gain experience of the framework. Several considerations dictate decisions on LAC DT, including the nature of the business, the profile of the undertaking and the tax regime. There are thus legitimate reasons for keeping the current principle-based approach that encourages supervisory judgement and dialogue, rather than applying arbitrary limits that would make the framework significantly more conservative and put further unnecessary capital pressure on insurers.

What should change in 2020

The full 2020 review needs to take a holistic view of improvements that would allow Solvency II to correctly reflect the long-term nature of insurance business and investments. The design of the risk margin and the discount rates for liabilities should be key priorities in 2020, when wider issues related to the valuation of liabilities will be addressed.

Overall, a number of elements of Solvency II, including capital requirements for investment, need adjustment as they are based on the mistaken assumption that insurers trade all their assets and liabilities at all times. This means that the wrong risks are being measured, leading to excessive capital requirements and artificial balance-sheet volatility. In reality, insurers can and do invest long-term and, unlike traders, they are rarely — if ever — forced to sell their entire portfolio at a bad time.

As it stands, Solvency II is an unnecessarily conservative framework, which needlessly ties up significant capital, especially for long-term business, that could be put to productive use. The two reviews are the opportunity to put this right.

Cristina Mihai
Head of prudential regulation & international affairs
Insurance Europe

GLOBAL INSURANCE CAPITAL STANDARD

Testing time

Four years since the ICS project was launched, the ambitions of the world's supervisors remain high but timelines are becoming more realistic, says Cristina Mihai

The EU has Solvency II and other jurisdictions have their own prudential regulation frameworks, but there is no common, global capital standard for insurers.

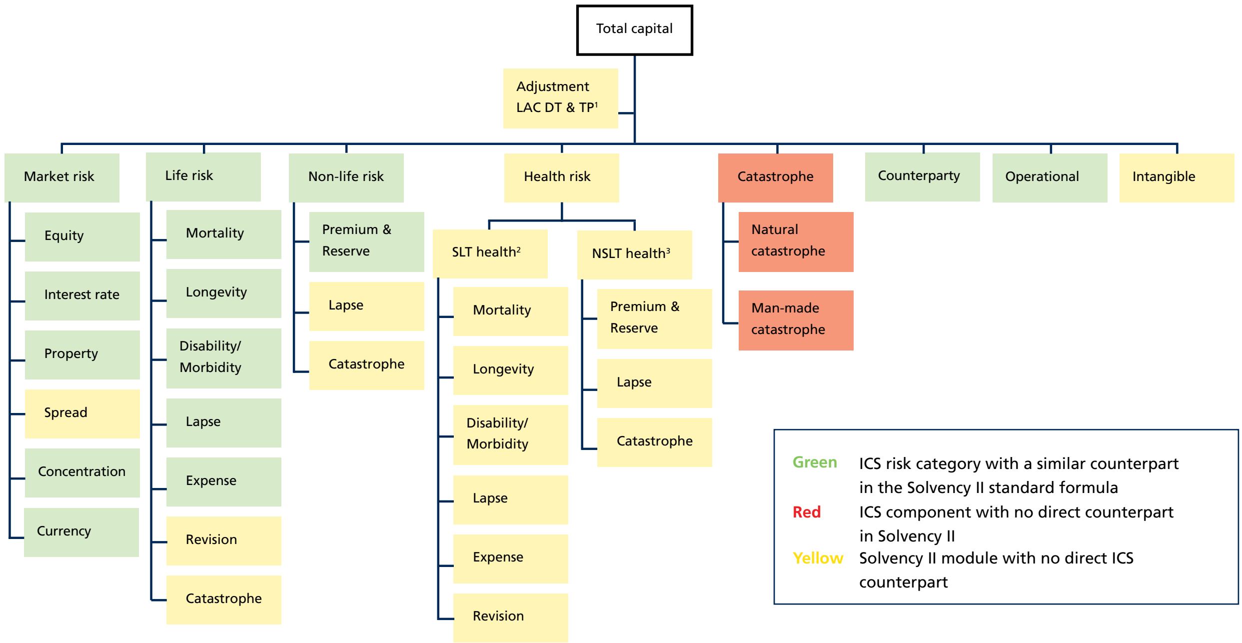
The IAIS has been working on a global insurance capital standard (ICS) for four years, but developing a single capital framework that is appropriate and accepted across the world's heterogeneous insurance markets is no easy task. Indeed, developing Solvency II for the EU alone took 15 years.

The first milestone

The adoption of "version 1.0" of the ICS in mid-2017 was a key milestone in what is a long-term process of understanding the world's various prudential regimes and investigating if and how we can agree on and converge towards a single framework that achieves comparability between jurisdictions.

ICS 1.0 is the result of more than three years of discussions between supervisors on key issues such as the measurement of insurers' balance sheets and capital. ICS 1.0 is intended as a package of technical proposals for testing by volunteer companies. It includes a range of options and alternatives to prudential rules and supervisors agreed that significantly more time is needed to discuss, test and ultimately agree on how to streamline these.

ICS 1.0 and Solvency II risk categories compared: similar but not identical



1 Adjustment for loss absorbing capacity of deferred taxes and technical provisions
2 Similar to life techniques health
3 Not similar to life techniques health

Back in mid-2017, the plan was to follow up with a final standard, ICS 2.0, that was to be adopted in 2019 and implemented immediately across jurisdictions. This raised major concerns among insurers. For Europe, one of the key lessons of the 15 years of Solvency II development was the fact that sufficient time must be allowed to design, calibrate and thoroughly test measures that, if not appropriate, can have severe unintended consequences for the ability of the sector to offer appropriate products to consumers and make long-term investments in growth.

In November 2017, the IAIS met in Kuala Lumpur, Malaysia and agreed to move to a phased approach to implementing the ICS, which will start with five years of confidential supervisory reporting between 2020 and 2025. Insurers welcomed this announcement, as it creates a significant period during which both the industry and supervisors can better assess the ICS and its suitability as a global measure. Further improvements have not been ruled out after or even during the five-year period.

Avoiding competitive disadvantages for Europe

A key objective of the European insurance industry is to be able to preserve its competitiveness in a post-ICS environment. Indeed, a fundamental aspect of having a global capital standard is the concrete translation of that standard in all jurisdictions. An international standard can achieve its aims only if it is implemented consistently across jurisdictions, and the European industry would not support any situation in which European insurers end up at a competitive disadvantage to their non-European peers because Europe decides to implement the ICS and other key jurisdictions do not.

While divergent views among supervisors and regulators remain — in particular between those in the EU and the US — the Kuala Lumpur agreement confirmed the overall commitment by supervisors around the world to continue work aimed at delivering a global ICS. However, discussions are going on in some jurisdictions about the political commitment to implement the ICS.

Solvency II = implementation of ICS

For Europe, it is key that its own Solvency II regulation — as

> **"An international standard can achieve its aims only if it is implemented consistently across jurisdictions."**

IAIS activity on systemic risk

In Insurance Europe's view, traditional insurance is not systemically risky and systemic risk from individual insurers can only originate from a very limited number of activities if they are undertaken on a large scale, in very rare conditions and with no management or supervisory mechanisms to prevent contagion of the economy.

Despite this, after several years of discussions, in 2013 the IAIS — following a similar approach to that for banks — issued a list of global systemically important insurers identified using an entity-based approach (EBA). The list has since been published annually and (also as for banks) is to be the basis for automatic capital add-ons.

In 2017, the IAIS announced that it would develop an activities-based approach (ABA) to systemic risk. Such an approach assesses the impact of potential sector-wide distress, looks at common exposures causing correlated actions and focuses on activities at a sector-wide level. The IAIS launched a pre-consultation on its work at the end of 2017, to which Insurance Europe responded.

The IAIS's work is at an early stage and many aspects still need clarification. Nonetheless, a proportionate and properly-designed ABA could focus on both the unlikely failure of individual insurers and their potential knock-on effects, as well as on whether firms (even if individually solvent) could propagate or amplify shocks to the rest of

updated in the upcoming reviews (see p14) — is considered an appropriate implementation of the ICS. Today, Solvency II is probably the most conservative and sophisticated prudential regime in the world. While it is positive that many of the elements of the ICS resemble those of Solvency II, it is equally important that the improvements that are expected from the Solvency II reviews, in particular related to long-term business, will also be reflected in the ICS.

Grand designs

From a European perspective, now that the timing concerns have been to some extent addressed, the focus is on ensuring that the ICS is appropriately designed and calibrated.

In Kuala Lumpur, the IAIS agreed to start from a "baseline scenario" of a standard formula for capital and a market-adjusted valuation (MAV) for the balance sheet. This focus on the MAV approach is supported by the European insurance industry because it is compatible with Solvency II. Also important for the European industry, is the fact that the use of internal models (individually approved company models) for calculating regulatory solvency capital requirements was accepted as an optional additional calculation (see box opposite).

> **"It is important that the improvements that are expected from the Solvency II reviews will also be reflected in the ICS."**

Key technical elements of the ICS for European insurers:

- **Market-adjusted valuation (MAV)** is welcomed by the European industry, however not just any form of MAV would work for companies. It is key that discount rates for liabilities reflect the long-term nature of insurance business and the reality of asset/liability management. ICS 1.0 does not provide satisfactory solutions for the valuation of long-term liabilities, so more work is needed as part of the development of ICS 2.0.
- **Capital requirements** need to reflect the actual risks to which insurers are exposed. Recalibrations to the requirements for a number of risks identified in ICS 1.0 are needed, including market-related risks.
- **Internal models** should become a permanent element of the ICS.
- **Margin over current estimate (MOCE)** is an element of the framework intended to ensure a failing insurer can transfer its liabilities to a third party if needed. It is not needed to cover any claims/liabilities and there is a real

the financial system and the real economy through their collective risk exposure. If appropriately designed, the ABA could be a more suitable overall approach tailored to the insurance industry and could make a separate EBA redundant.

The EBA is simply not appropriate for assessing systemic risk in insurance because this risk should always be determined holistically rather than by using EBA indicators, which are biased towards measuring the size of an insurance group. This is why a holistic ABA should guide the development of any appropriate policy measures, with a particular focus on risk management and preventive actions, including supervisory intervention.

An assessment of systemic risk should go beyond merely identifying whether activities exist that give rise to potential vulnerabilities. It should also consider whether the risk stemming from those activities can be transmitted to the global financial system and how the risk is mitigated in practice. Any channels of transmission to the financial system should be clearly identified and a group perspective should be taken on levels of diversification.

Finally, the materiality of the potential systemic risk transmitted to the financial system should be an essential consideration. Additional mitigating factors should be taken into account to ensure that the assessment of an activity's systemic-risk potential is accurate.

risk that it will lead to a significant level of excessive and unproductive capital. More work is needed to investigate whether MOCE is actually needed in its current form and how to calculate it so that it meets its intended purpose and reflects market reality.

Testing, testing

In addition, and learning from the European experience of Solvency II, testing is needed before the ICS is agreed and finalised for implementation. The stakes are simply too high not to test, given the crucial role insurance plays in society and in providing long-term investment. Testing must answer some crucial questions and must involve not just supervisors, but also policymakers, which in the EU means the European Commission, Parliament and EU member states.

Policymakers will need to understand, among other things: how the ICS would work during a crisis; whether the ICS could have a potentially negative impact on the availability and cost of products or on the industry capacity to invest long-term; and whether the ICS will lead to major spikes in capital requirements — and, if yes, whether this is the intention. This is why the early involvement by policymakers in the ICS project led by supervisors is key, and this is starting to happen in a number of jurisdictions.

Why internal models should be in the ICS

Internal models have clear benefits, including:

- identifying and capturing all potential risk classes by risk type or region;
- avoiding an arbitrary allocation of risks to certain classes; and,
- allowing for the alignment of the internal management view with the regulatory view.

There is, in fact, no practical alternative to internal models for companies with complex businesses/risks.

- With no internal models, the standard method would have to be far more complex than the risk profiles of many of the groups to which it is applied. This should clearly be avoided.
- Solvency II has 28 risk categories and policymakers agreed that these were not enough to capture all the risks of all entities. In comparison, ICS 1.0 has only 15, so it is even less likely to capture all the risks (see figure on p19).

Xavier Larnaudie-Eiffel
Chair, personal insurance committee, Insurance Europe
Deputy CEO, CNP Assurances, France

PENSIONS

PEPP talk

Xavier Larnaudie-Eiffel proposes ways to make the EC's ambitious proposal for pan-European personal pension products (PEPPs) attractive to both consumers and providers

When you think of your own planning for retirement, what is it you want most from your pension? Most people would say that they want to be confident that their savings are safe and that they want their pension product to be affordable, provide adequate returns, be flexible enough to accommodate changes in their circumstances and be easy to understand.

Any company developing a new pension product needs to keep these requirements firmly in mind, and this holds equally true for the EU institutions, in light of the European Commission's proposal to create a pan-European personal pension product or PEPP (see box).

The PEPP proposal has laudable and highly ambitious aims. The arguments for boosting individuals' saving for retirement are well rehearsed, as declining birth rates and rising life expectancy put an unbearable strain on national statutory pension systems. Pension systems come under the remit of national governments in the EU, however, and a pan-European system has never been launched before.

The insurance industry welcomes the European Commission's efforts to boost personal retirement saving by creating a portable personal pension product that individuals can take with them when they move between EU member states. It has a number of suggestions for making PEPPs work as intended, bearing in mind the key priorities of keeping individuals' savings safe and making PEPPs an attractive proposition not only for savers but also for providers.

Inspiring consumer trust

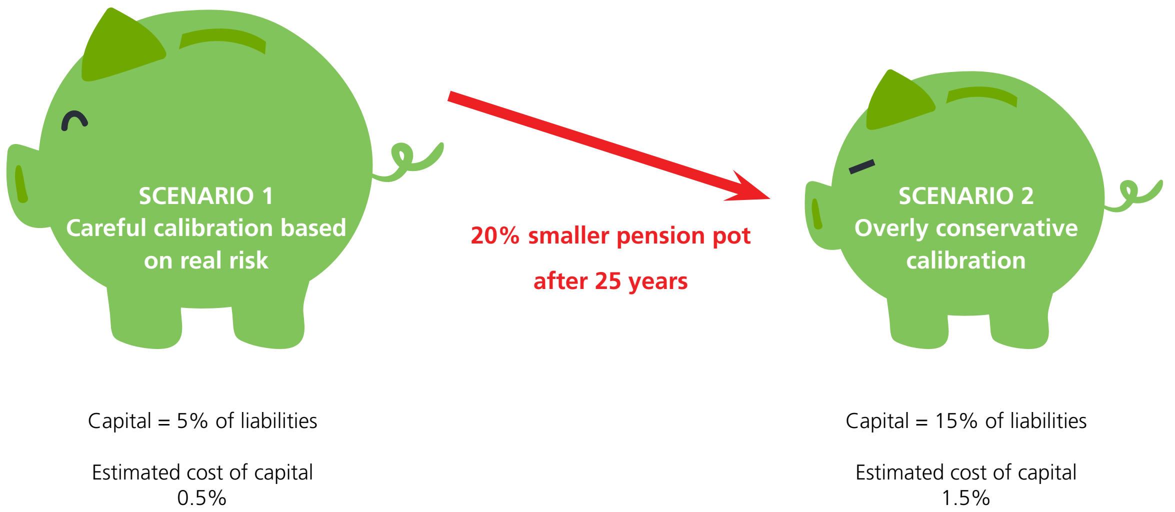
Customers will not — and should not — buy financial products unless they trust them. For customers to trust PEPPs, they must be confident that they are well regulated. This means that they must be subject to solid prudential treatment that reflects the nature of long-term liabilities. For PEPPs offering a guarantee on the capital invested, the prudential regime should be the Solvency II regulatory framework that governs the EU's insurers, since Solvency II was specifically designed to offer a high level of protection to consumers who purchase long-term and pension products.

That said, the capital measurements in Solvency II are currently far more conservative than is justified to cover the risks, which translates into detrimental effects on customers in terms of lower expected returns. This is because excessively high capital requirements can prevent insurers from investing in the right assets, which can provide good investment returns, and can force them to charge higher fees to cover the extra capital costs. A simple example can illustrate how unnecessarily high capital requirements directly impact customers. Insurance

What is a PEPP?

- Personal pensions are currently primarily regulated at national level in the EU.
- After a public consultation, in June 2017 the European Commission launched a proposal for new pan-European personal pensions to complement national personal pension regimes. PEPPs would be portable between EU member states.
- The Commission's stated aim is to offer a simple, innovative, voluntary product that ensures all Europeans have access to a good pension product which they can keep using when they change jobs and even if they move between different European countries.
- The PEPP proposal is also a key component of the EC plan for an EU Capital Markets Union, as it seeks to channel more savings into long-term investment in the EU.
- The Commission's PEPP proposal is currently under discussion in the European Parliament and the Council.

Figure 1: Excessive capital requirements affect pension pots



Europe calculations show that if regulators take an overly simplistic or conservative approach that results in an insurer having to hold capital equal to 15% rather than 5% of funds, this results in an increase of 1% in capital charges, which in turn has a dramatic effect on the customer; a retiree who has saved for 25 years would receive a pension pot that is over 20% smaller (see Figure 1).

The Solvency II framework is the subject of two European Commission reviews, one in 2018 and one in 2020. As part of the reviews, Insurance Europe is advocating a proper investigation of the mismatch between the current regulatory approach and how insurers are really exposed to investment risks (see p14). Refining the Solvency II requirements for long-term liabilities would help insurers to play an active role in contributing to the PEPP project and to increase their investment in equities.

Capital protection as the default option

Under the terms of the EC PEPP proposal, the saver will have five investment options from which to choose, with one default option for those who feel unable to — or do not wish to — investigate the other options.

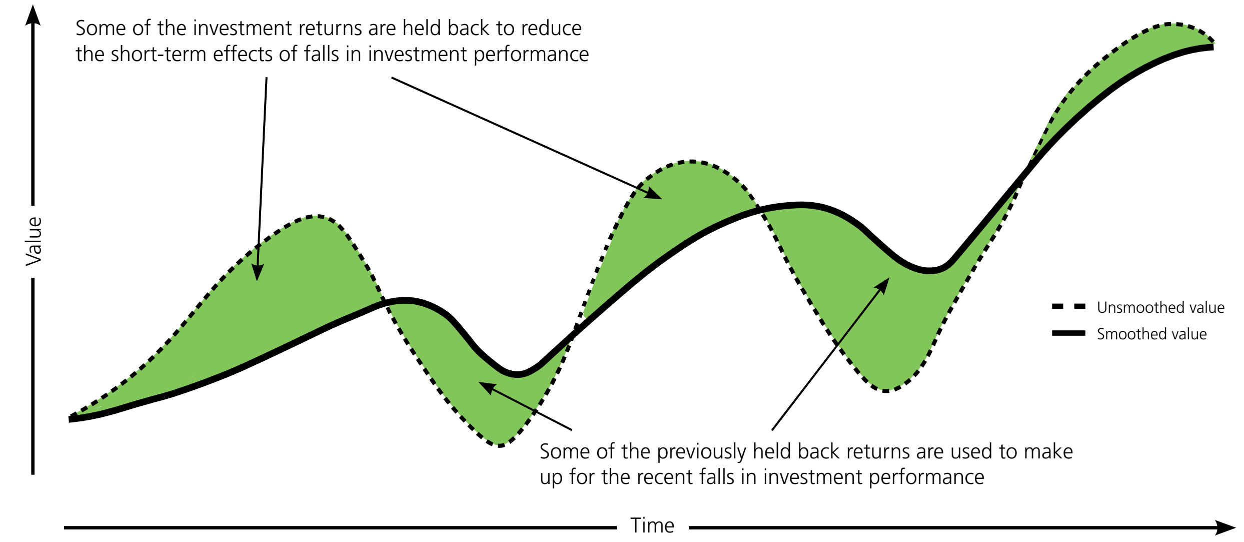
Firstly, Insurance Europe firmly agrees that on the grounds of simplicity — and simply to avoid a contradiction in terms — there should be just one default option. And secondly, if the "safety" requirement is to be correctly fulfilled, that default must come with a capital guarantee. Only guaranteed products can ensure savers recoup the capital they have invested. Products that could potentially create higher returns — but with greater accompanying risks — belong among the alternative options of a PEPP, not as the default.

Safety and performance

To fulfil the requirement of being attractive to customers, PEPP products need to be safe and provide adequate returns.

Against this background, traditional insurance savings products are already playing and can play an even bigger role in pension provision because they are based on the principle of providing a minimum return guarantee and/or using risk-sharing mechanisms such as collective pooling. In addition, they place restrictions on early surrender or include adequate mechanisms to balance the interests of the remaining insurance collective against those of early leavers. This allows insurers to invest long-term in a range of different asset classes and spread the risks across many different investors and across time. In doing so, they can smooth the investment returns and provide all savers with something in line with long-term average market

Figure 2: Return smoothing through collective mutualised investment products



Source: Legal & General

returns (see Figure 2), thus combining the best of both worlds: protection of guarantees and attractive performances made possible by a good asset mix.

True pension products

Both to boost retirement saving and to ensure adequate returns from investment, it is important that PEPPs are true long-term products with pension features in both the accumulation and decumulation phases. In the accumulation phase, allowing too-frequent switching between providers would mean savers losing out on the benefits of long-term returns. As it stands, the proposal similarly fails to give sufficient consideration to the decumulation phase, where the provision of an income for life (for example through annuities) should be given precedence. Other pension features, such as the coverage of biometric risks, should also be given greater consideration than is the case in the Commission's proposal. These are fundamental elements — mandatory in some EU member states — that savers can add on to increase the scope of protection provided. Longevity risk, for example, removes the risk of outliving savings, while morbidity and disability cover protect savers and beneficiaries if death or disability occurs during the accumulation phase.

Costly compartments

The PEPP proposal requires providers to offer a "compartment" in each of the (soon-to-be) 27 EU member states, so that customers can save throughout the EU. This would be beyond the administrative and financial resources of all but a handful of the largest pension providers meaning — in practice — very few providers and higher costs.

Fostering better pension portability — while important and justified — should not take precedence over increasing the number of citizens saving into private pensions. Insurance Europe's solution would therefore be for PEPP providers to select which national compartments they can offer and to give savers the possibility to switch provider if a compartment they do not offer is required.

Better safe than sorry

All these recommendations should help to make the PEPP a true retirement saving product that is safe, long-term and portable and — importantly — has no unintended detrimental effect on the existing European pension landscape. In the next article, my fellow Insurance Europe committee chair Jérôme Roncoroni looks at how to ensure that the PEPP's pre-contractual information requirements are tailored appropriately to the specific nature of a personal pension product without overwhelming customers with unnecessary or duplicated detail.

Jérôme Roncoroni
Chair, conduct of business committee, Insurance Europe
Compliance and public & regulatory affairs director, Covéa, France

INFORMATION REQUIREMENTS

PRIIPs not fit for PEPP

Jérôme Roncoroni explains why using PRIIPs disclosures for PEPPs is a bad idea

When consumers buy a long-term investment product they are making a major financial commitment and it is vital that the information provided enables them to make an informed decision. This is particularly true for pension products, where consumers are making long-term decisions that will affect not only their ability to retire but also their quality of life in old age.

It is vital, therefore, that we get pre-contractual information right. This means not only ensuring that customers receive the information they need to make good decisions, but also that it is presented in a way that enables them to process it. There is a balance to be struck between providing enough detail on what can sometimes be complicated products and making sure consumers do not feel so overwhelmed with information that they cannot identify what is really relevant.

At the European level, significant steps have been taken to try to improve and harmonise the information insurers provide to consumers. The latest of these is the introduction of a standardised key information document (KID) for the proposed pan-European personal pension product (PEPP) (see also p22). The EC has proposed that this will be based on the KID for packaged retail and insurance-based investment products under the recent PRIIPs Regulation, but is that really a sound basis on which to build a KID for a completely new pension product? This is not certain.

Pension-focused information for a pension product

The PEPP will include a lot of variable features and different providers will offer very different products, all under the banner of a PEPP. Any additional services that are built in, or other options, all need to be clearly presented to consumers. The Commission proposal envisages a KID that simply adds information on these new features to the disclosures already required for investment products. This does not help consumers focus on the key features of the product they are about to buy.

The PEPP KID should be recreated so that the information provided to consumers reflects the questions someone typically has when they plan for their retirement:

- Will my investment grow enough to provide me with the income I need?
- How much of my saving is lost through the additional charges I have to pay?
- Is there a possibility I could lose some of my investment?
- What happens if something happens to me before I reach retirement?
- Will I have options in terms of how I receive the money once I retire?

These questions are not well addressed in the Commission proposal, which puts information on key pension features alongside information that is more relevant to a shorter-term savings product, as if both were of equal value.

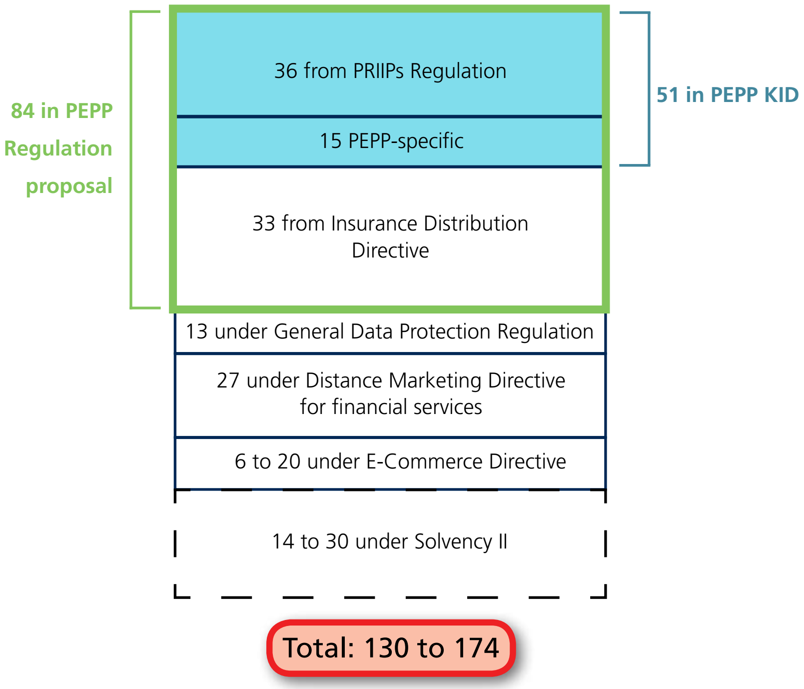
What is the value of presenting pension savers with a "risk indicator" that cannot differentiate between several low-risk products, for example? And how would a pension saver benefit from an indication of the intended retail investor, when the intended investor in a pension is always a person looking to save for retirement? The usefulness of these requirements needs to be reviewed and that is not possible if we simply apply PRIIPs rules to PEPPs.

How much information is too much?

Simply adding more disclosures to a PRIIPs KID would also mean we are overloading consumers with far too much information. And the PEPP Regulation does not exist in a vacuum; other disclosure requirements will also apply.

If a consumer buys a PEPP online from an insurance distributor they will also be presented with disclosures under the Insurance Distribution Directive, the General Data Protection Regulation, the E-Commerce Directive, the Distance Marketing Directive and possibly also the Solvency II Directive. This would amount to at least 130

Figure 1: Number of disclosures for a PEPP bought online from an insurance distributor



different pieces of information, and possibly as many as 174 if all Solvency II and E-Commerce Directive disclosures also apply (see Figure 1). This is clearly too much information for a consumer to process and, in many cases, the information is duplicated, just in different formats.

Don't repeat PRIIPs mistakes

There are other reasons for worrying that PRIIPs does not form a sound foundation for the PEPP requirements. PRIIPs KIDs have only been produced since January 2018 and it is already clear that the Regulation is not delivering the expected benefits to consumers. There have been many instances of them presenting unrealistic projections to consumers.

In particular, performance scenarios that would also form the basis of the PEPP performance projections are regularly presenting consumers with possible returns — under favourable conditions — of thousands of times the initial investment when calculated using the prescribed PRIIPs methodology. This is a level that even the most optimistic saver would never expect to receive. Likewise, costs are sometimes reported that do not come close to reflecting the charges actually paid by the consumer.

"It is unwise to apply a methodology to PEPPs that we know is not working as it should."

The European Commission will begin reviewing the PRIIPs Regulation at the end of 2018, and we hope these shortcomings will be addressed. In the meantime, it is unwise to apply a methodology to PEPPs that we know is not working as it should.

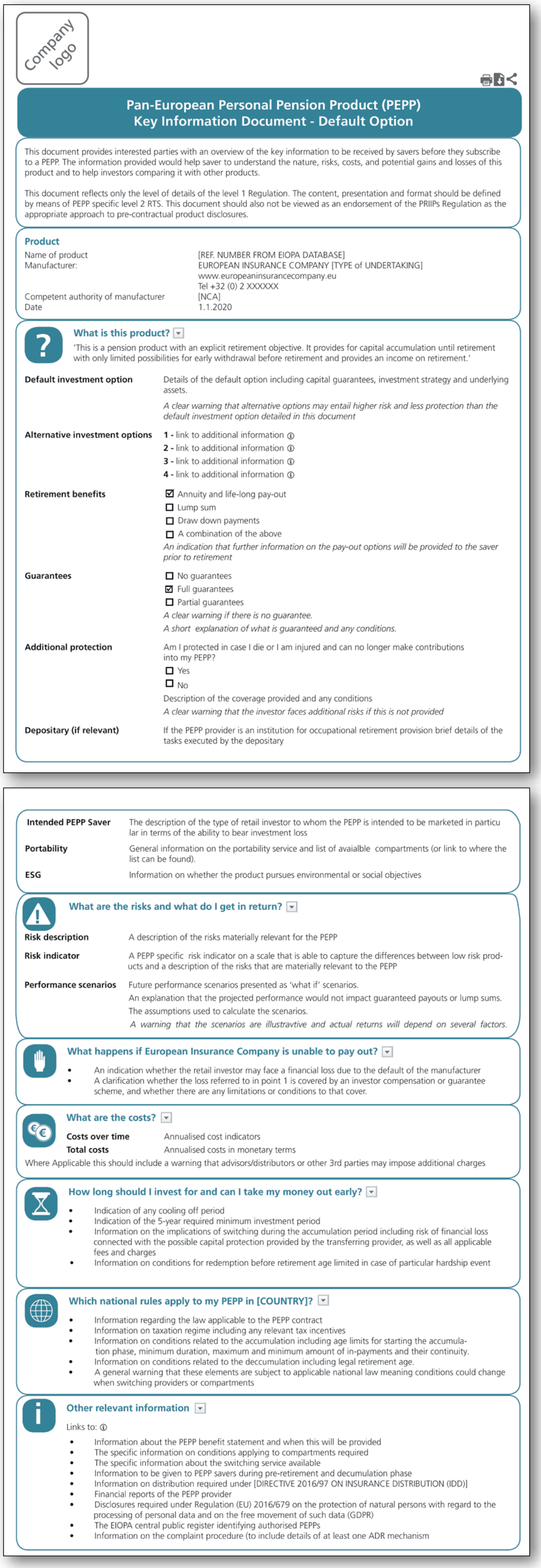
So what needs to change?

The solution is simple. We need to start from scratch and design a key information document for PEPPs that really helps consumers making big financial decisions.

Firstly, we need to focus on the information a consumer needs before they make an investment decision. That means capturing the features of the PEPP that cannot be changed later, answering the simple question "what am I committing to?". Information on pay-out options, switching and national rules in other jurisdictions can be disclosed separately later.

Secondly, we need to focus on the information that allows

Figure 2: Insurance Europe's PEPP KID



Company logo

Pan-European Personal Pension Product (PEPP)
Key Information Document - Default Option

This document provides interested parties with an overview of the key information to be received by savers before they subscribe to a PEPP. The information provided would help saver to understand the nature, risks, costs, and potential gains and losses of this product and to help investors comparing it with other products.

This document reflects only the level of details of the level 1 Regulation. The content, presentation and format should be defined by means of PEPP specific level 2 RTS. This document should also not be viewed as an endorsement of the PRIIPs Regulation as the appropriate approach to pre-contractual product disclosures.

Product

Name of product	[REF. NUMBER FROM EIOPA DATABASE]
Manufacturer:	EUROPEAN INSURANCE COMPANY [TYPE of UNDERTAKING] www.europeaninsurancecompany.eu Tel +32 (0) 2 XXXXXX
Competent authority of manufacturer	[NCA]
Date	1.1.2020

What is this product?

'This is a pension product with an explicit retirement objective. It provides for capital accumulation until retirement with only limited possibilities for early withdrawal before retirement and provides an income on retirement.'

Default investment option — Details of the default option including capital guarantees, investment strategy and underlying assets.
A clear warning that alternative options may entail higher risk and less protection than the default investment option detailed in this document

Alternative investment options
1 - link to additional information ⓘ
2 - link to additional information ⓘ
3 - link to additional information ⓘ
4 - link to additional information ⓘ

Retirement benefits
☑ Annuity and life-long pay-out
☐ Lump sum
☐ Draw down payments
☐ A combination of the above
An indication that further information on the pay-out options will be provided to the saver prior to retirement

Guarantees
☐ No guarantees
☑ Full guarantees
☐ Partial guarantees
A clear warning if there is no guarantee.
A short explanation of what is guaranteed and any conditions.

Additional protection — Am I protected in case I die or I am injured and can no longer make contributions into my PEPP?
☐ Yes
☐ No
Description of the coverage provided and any conditions
A clear warning that the investor faces additional risks if this is not provided

Depositary (if relevant) — If the PEPP provider is an institution for occupational retirement provision brief details of the tasks executed by the depositary

Intended PEPP Saver — The description of the type of retail investor to whom the PEPP is intended to be marketed in particu lar in terms of the ability to bear investment loss

Portability — General information on the portability service and list of avaialble compartments (or link to where the list can be found).

ESG — Information on whether the product pursues environmental or social objectives

What are the risks and what do I get in return?

Risk description — A description of the risks materially relevant for the PEPP

Risk indicator — A PEPP specific risk indicator on a scale that is able to capture the differences between low risk products and a description of the risks that are materially relevant to the PEPP

Performance scenarios — Future performance scenarios presented as 'what if' scenarios.
An explanation that the projected performance would not impact guaranteed payouts or lump sums.
The assumptions used to calculate the scenarios.
A warning that the scenarios are illustravtive and actual returns will depend on several factors.

What happens if European Insurance Company is unable to pay out?

- An indication whether the retail investor may face a financial loss due to the default of the manufacturer
- A clarification whether the loss referred to in point 1 is covered by an investor compensation or guarantee scheme, and whether there are any limitations or conditions to that cover.

What are the costs?

Costs over time — Annualised cost indicators
Total costs — Annualised costs in monetary terms
Where Applicable this should include a warning that advisors/distributors or other 3rd parties may impose additional charges

How long should I invest for and can I take my money out early?

- Indication of any cooling off period
- Indication of the 5-year required minimum investment period
- Information on the implications of switching during the accumulation period including risk of financial loss connected with the possible capital protection provided by the transferring provider, as well as all applicable fees and charges
- Information on conditions for redemption before retirement age limited in case of particular hardship event

Which national rules apply to my PEPP in [COUNTRY]?

- Information regarding the law applicable to the PEPP contract
- Information on taxation regime including any relevant tax incentives
- Information on conditions related to the accumulation including age limits for starting the accumulation phase, minimum duration, maximum and minimum amount of in-payments and their continuity.
- Information on conditions related to the deccumulation including legal retirement age.
- A general warning that these elements are subject to applicable national law meaning conditions could change when switching providers or compartments

Other relevant information

Links to: ⓘ

- Information about the PEPP benefit statement and when this will be provided
- The specific information on conditions applying to compartments required
- The specific information about the switching service available
- Information to be given to PEPP savers during pre-retirement and decumulation phase
- Information on distribution required under [DIRECTIVE 2016/97 ON INSURANCE DISTRIBUTION (IDD)]
- Financial reports of the PEPP provider
- Disclosures required under Regulation (EU) 2016/679 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data (GDPR)
- The EIOPA central public register identifying authorised PEPPs
- Information on the complaint procedure (to include details of at least one ADR mechanism

a consumer to compare products. We need to make sure the differences between the broad range of providers are captured and that costs and services are accurately represented.

And finally, we need to make sure that when we provide a consumer with an indicator or a projection they are based on sound calculations. This is vitally important because consumers are presented with a single figure and have to trust that the calculations behind them, which they do not see, really reflect what they are about to buy.

The experience with PRIIPs proves that this is not easy, especially when we try to address too many products in one go. So, it is critical that we sharpen our focus and concentrate on the specific needs of pension savers.

Insurance Europe's proposal

Insurance Europe has tried to answer these questions in its version of a PEPP KID (see Figure 2). Our proposal focuses on the features of the product — providing much greater detail on the retirement benefits — and uses tick boxes to clearly show consumers whether the product has additional protection features.

The forward-looking performance scenarios address "what if?" questions, rather than attempting to foresee the performance in purely numerical terms, and the cost and risk indicators reflect the longer-term nature of PEPP products. This would, of course, need to be supplemented by technical methodologies developed by EIOPA but designed specifically for the low-risk, long-term characteristics of a pension product.

Our KID is also fit for the digital age. The KID would provide the key information with drop-down menus and links to further details. This means moving away from the PRIIPs requirements on length and A4 format, but we think this reflects the way pension savers are accessing products and product information.

We believe that the Insurance Europe PEPP KID can become a gold standard in pre-contractual information and that the lessons we have learnt from it can inform the review of the PRIIPs Regulation. Trying to approach this the other way around — applying unamended PRIIPs standards to PEPPs — will not work.

Michael Budolfsen
President, Nordic Financial Unions and UNI Europa Finance

REGULATION

Coping with compliance

It is not just companies that struggle with more regulation. A recent study shows that compliance pressures take their toll on staff too, says trade union representative Michael Budolfsen

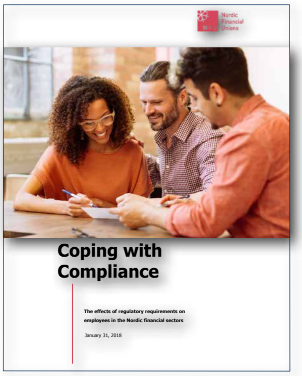
We are now 10 years down the road from the financial crisis, an event that gave rise to the biggest overhaul of financial legislation in the history of Europe. Throughout the reform process, Nordic Financial Unions (NFU) and our sister organisation, UNI Europa Finance, have been strong supporters of a regulatory framework that is strong, effective, proportionate and coherent. Representing the vast majority of finance employees in Europe, we want financial regulation that is fair, transparent and balanced, and which takes into account the interests of all stakeholders: employees, consumers, companies and societies.

The reforms have been many, and they have been far-reaching. Consumer protection rules are one of the areas with the biggest effect on finance employees. Whilst a strong and efficient framework to protect consumers is crucial, our members who work in customer-facing roles have sent worrying signals that the new rules are not working as intended.

Worrying survey results

Based on these experiences, NFU decided to investigate the effects of EU regulatory requirements on employees in the Nordic bank and insurance sectors. In a new survey covering 35 000 finance employees, focus is put on rules on documentation, information to consumers and customer knowledge (know your customer, or KYC) in the key post-crisis regulatory dossiers.

We presented the survey findings in the report "Coping with Compliance", which was published at a seminar in Brussels in January 2018, and the results reinforce the worrying signals from our members.



Pressure from compliance is mounting on finance employees, who are scrambling to complete their documentation, keep up with KYC and information requirements, and at the same time meet with customers and provide them with good advice and information.

Almost half of the respondents in the NFU study experience a conflict of interest between providing good customer service and following rules and procedures. Many also say that documentation is being done at the cost of meeting with and advising customers properly. Over 70% state that the rules on documentation and information increase the stress levels for employees in the insurance sector.

Respondents' views diverge on whether the regulatory requirements have improved the situation for consumers. The majority agree that the quality of advice and customer understanding is improved to some extent, but a significant number also state that the quality and understanding actually decreases.

If this is the case for some, it could be argued that the regulatory requirements do not live up to the legislators' main intention: to improve the situation for consumers by giving them a better understanding of financial products and providing better advice.

Cooperation is the way forward

Going forward, we need cooperation with all the stakeholders involved. Taking stock of how the reformed financial regulation works in practice should involve employees and their representatives, consumers, financial industry associations and other relevant groups entering into dialogue with policymakers at both national and EU level.

> **"It is not in anyone's interest that finance employees are pressured to such an extent that neither compliance nor consumer protection objectives are fulfilled."**

About NFU and UNI Europa Finance

- Nordic Financial Unions (NFU) is the voice of the employees in the Nordic financial sectors, representing the vast majority of Nordic finance employees through seven unions in the five Nordic countries.
- UNI Europa Finance is the organisation for finance employees in Europe, representing 1.5 million workers and 108 trade unions.
- Along with Insurance Europe, UNI Europa sits on the European Insurance Sectoral Social Dialogue Committee (ISSDC). The ISSDC is the only forum at European level in which insurance employer and employee representatives discuss topics of common interest with the support of the EC.

It is not in anyone's interest that finance employees are pressured to such an extent that neither compliance nor consumer protection objectives are fulfilled. But our members also need strong and healthy companies to work for, and financial regulation should support this too.

Getting the right regulatory framework

The financial regulatory framework must therefore support sustainable and long-term oriented financial sectors and stimulate diversity in size, business models and geographical orientation. This is necessary not least to enable financial services to cater to the needs of a wide array of customers and users, who should feel safe as financial consumers and receive the help, support and service that is at the core of the financial sector's mission in society.

We are convinced that we can strengthen our mutual dialogue and learn from each other's experiences. In so doing, we can help to create a stable and resilient financial regulatory framework that both protects consumers and makes it possible for finance employees and their employers to provide quality financial services — both in insurance and banking. That is a good thing for all of us.

William Vidonja
Head of conduct of business, Insurance Europe

REGULATION

Less is more

William Vidonja explains the importance of proportionality and subsidiarity checks for EU legislation

In a political environment in which the European Commission is keen to show that the EU adds value for its citizens, it is quite right to look for ways to benefit individuals and the economy, notably by strengthening the EU single market. The insurance sector fully supports these efforts.

Of course, the EU single market for insurance already functions well and care should be taken that measures to make it work even better do not go against their intended goals. The EU's principles of proportionality and subsidiarity (see box) must always be carefully considered before legislative measures are proposed at EU level. Lessons about applying the principles of proportionality and subsidiarity should be drawn from two recent proposals by the European Commission: a European services e-card and a Single Market Information Tool (SMIT).

Services e-card: disproportionate

Differences in legal systems, tax regimes, languages, rules governing specific business sectors and implementation of the 2006 EU Services Directive all rightly result in professional indemnity insurance practices that vary greatly between countries and business sectors. This ensures that customers get products that suit their needs, as they are adapted to the legal and economic environment in which they are operating.

For customers seeking to offer services in other countries than their own, insurers have developed ways to provide cover, despite the differences between countries. Multinational insurers do this through

EU proportionality and subsidiarity principles

- **Proportionality** EU action must be limited to what is necessary to achieve its treaty objectives.
- **Subsidiarity** Decisions should be taken as closely as possible to the citizen and there should be constant checks to verify that EU action is justified. Specifically, in areas that do not fall exclusively within the EU's remit, action should only be taken if its objectives are better achieved at EU level than if action is taken at national, regional or local level.

their own network of branches and subsidiaries, while insurance brokers have developed networks of partners so that they can operate in a similar way.

In early 2017, the EC's "Services Package" Regulation proposed a European services e-card with the laudable intention of making it easier for service-sector companies to comply with requirements when operating outside their home market. It included a certificate of proof of insurance, possibly in a standardised format, that the home-state insurers would be required to provide on request. It also obliged home-state insurers to provide claims history statements and host-state insurers to take them into account in the calculation of premiums "in a non-discriminatory manner".

The EC proposal aimed to reduce administrative barriers for businesses offering services in another member state. It did not, however, address the regulatory differences (which are not related to insurance provision) and would therefore not have helped those businesses. And the inclusion of insurance in the services e-card was based on the unproven premise that there is a lack of available insurance that hinders cross-border business.

A standardised proof of insurance at EU level would not work for a number of reasons. One is that insurance terms vary in meaning as a consequence of the diversity of legal systems. These differences cannot be reconciled by mere translation, so a harmonised insurance certificate would not help a host-state authority better understand the service provider's insurance coverage in its home market. For example, professional indemnity policies usually refer to protection against negligence claims, but the term "negligence" has very different meanings in different countries. Thus, unless the host state is fully conversant with the home state's liability regime and legal terms, it will not be able to assess a company's existing cover through a certificate of proof of insurance.

In March 2018, the European Parliament's leading Internal Market and Consumer Protection (IMCO) Committee rightly rejected the entire EC proposal, following similar rejections by all four of the Parliament's opinion-giving committees. The services e-card did not, in Insurance Europe's opinion, meet the proportionality criteria, as it would have introduced insurance provisions that were in response to a problem for which there is no evidence. It also disregarded the significant burden on insurance companies — implementing the requirements would have been extremely costly — and the limited appetite for the proposed measures among the service sectors targeted.

SMIT: contrary to subsidiarity and proportionality

A second Commission proposal, a Regulation on a Single Market Information Tool (SMIT), was published in May 2017 as part of its "Compliance Package". It would require undertakings and associations to provide confidential and potentially commercially sensitive data to support EC infringement actions against member states or for EC policy development purposes. Information would be requested by the EC directly from companies, who would be faced with potentially significant and disproportionate penalties for mal- or non-compliance.

European insurers have challenged the EC's proposal, calling for it to be withdrawn on the grounds that it: is disproportionate to the objectives sought in terms of its scope and sanctions; is based on treaty articles that, procedurally speaking, are incompatible; and disregards the division of powers between the EU and member states because the EC would be empowered to require data provision directly from companies, thereby bypassing national authorities.

Insurance Europe recommendations

Much has already been done to develop the smooth functioning of the EU single market, so any future initiatives will have to be well calibrated and respond proportionately to identified problems. In some cases, better application of existing rules and tools is preferable to the introduction of new and additional legislation. More than ever, the principles of proportionality and subsidiarity make sense. This is the message that Insurance Europe sent in its submission to the EC's new Task Force on Subsidiarity, Proportionality and "Doing less more efficiently", which began work at the start of 2018.

Rosa Armesto
Head of public affairs and communications,
Insurance Europe

EU FINANCIAL SUPERVISION

Deliver the goods

The review of the European supervisory authorities (ESAs) is the perfect opportunity to strengthen their focus on acting in the common European good, says Rosa Armesto

The European insurance industry has a long history of providing citizens and businesses with protection and long-term savings. Insurer failures that have affected customers have been extremely rare, even during periods of financial crisis. Nevertheless, in the modern financial system, regulation and supervision play a key role in ensuring that consumer confidence, trust and protection remain strong.

The current system of European financial supervision has many strong points, but there is a need to improve the governance of the European supervisory authorities, as well as to ensure that they have the necessary information to carry out their tasks efficiently and effectively.

The European Commission's review of the regulations that govern the ESAs (see box) is therefore welcome. It is important, though, that any changes are based on clear evidence that they are actually needed. And Insurance Europe believes that the Commission's proposals go beyond what is required and that the insurance supervisor, EIOPA, in fact already has the powers it needs to fulfil its mandate.

The starting point for all elements of this review should be that the ESAs must always consider the common European good when taking action. The ESAs' obligation to act in the best

EU financial supervision in a nutshell

- EU financial supervisory arrangements were reviewed following the financial crisis, leading to the creation of three authorities (ESAs) in 2010. They contribute to the establishment of common regulatory and supervisory standards and practices and to the consistent application of legally binding EU legislation on insurance, banking, and securities and markets. A European Systemic Risk Board (ESRB) monitors financial stability risks.
- Following public consultations, the EC issued proposals in September 2017 that include broad changes to the governance, powers and funding of the ESAs and the functioning of the ESRB, with a view to making EU financial supervision stronger and more integrated.

interests of the EU and its citizens is reflected too narrowly in their founding Regulations. The existing obligation to contribute to the stability and effectiveness of the financial system should be expanded to require the ESAs to act in the best interest of European public good.

For example, they should take into account in their advice and activities sustainability concerns and the potential impact on the price and availability of products, on European growth and long-term investment and on the international competitiveness of the financial services industry. This could help to ensure that the ESAs' activities are always proportional and balanced and that they always consider any possibly negative unintended consequences before taking action. The ESAs should be required to include the steps they have taken to fulfil this obligation in their annual reports.

More focus, not more powers

The Commission rightly concludes that maintaining a stand-alone authority for insurance — and one that is responsible for both prudential and conduct of business supervision — provides the required stability and sectoral expertise. That authority, EIOPA, must then focus its resources on the work that is most important and relevant to the market and must not undertake own-initiative projects that cross into political positions.

> **"The insurance supervisor, EIOPA, already has the powers it needs to fulfil its mandate."**

Insurance Europe remains unconvinced that EIOPA requires any significant changes to its powers in order to fulfil its mandate. Rather it has powers that it currently underuses. That said, Insurance Europe believes that it might be necessary to improve information-sharing between national supervisors and EIOPA in certain areas.

It is extremely important that any changes are designed to take into account the need to maintain the principles of subsidiarity and proportionality that underpin the EU's system of financial supervision (see p32). The role of national supervisors must not be undermined, as they have vital local expertise and accountability, as well as crucial direct contact with the entities they supervise. National supervisors play a key part in the EU supervisory framework and it is important to ensure that the national and European levels work together.

Checks and balances

Meanwhile, EIOPA's governance structure currently does not include adequate checks and balances. The changes proposed by the Commission exacerbate this, rather than addressing it, and Insurance Europe shares the concerns that have been raised in this area by both the European Parliament and Council as they consider the Commission's proposals.

In particular, Insurance Europe would like to see modifications to — and clarifications of — the proposed EIOPA executive board and its interaction with the board of supervisors. For example, the Commission's proposals for additional executive board members will only be effective if those members have a suitably high level of expertise and experience and are appointed independently, and if this is ensured through the involvement of the European Parliament and Council.

Watching the watchdogs

Effective governance and external oversight mechanisms are essential to create a credible supervisory framework. Particularly the European Parliament, but also the Commission, should have a greater role in maintaining EIOPA's accountability. Improvements in the transparency of EIOPA's activities are necessary to make this possible.

"The ESAs must always consider the common European good when taking action."

Maintain funding mix

Last, but not least, there is the important issue of funding. EIOPA and the other ESAs must clearly be efficiently and sufficiently resourced. Insurance Europe believes that the current mix of 40% funding from the EU, with the rest coming indirectly from financial institutions through contributions they make to supervisors nationally, should remain.

It believes that the EC's proposal to change the existing 40% EU budget contribution from a fixed contribution to a maximum, with the rest funded by direct industry fees, could lead to the double-charging of firms and continual increases in the ESAs' budgets. This would be particularly regrettable given how important it is that the EU institutions approve and closely scrutinise the ESAs' budgets and their all-important work plans, which underpin a trusted, well-functioning EU financial services sector.

OPINION

Annamaria Lusardi
Academic director,
Global Financial Literacy Excellence Center, Washington D.C., USA

FINANCIAL EDUCATION

Back to basics

GFLEC's Annamaria Lusardi outlines ways to tackle woefully low global levels of financial literacy

Financial literacy is an essential skill for individuals to thrive economically in today's society. The need to raise personal financial knowledge has captured the attention of academics, practitioners and policymakers, and rightly so. Amid a rapidly changing landscape of digital innovation and cutting-edge technology in the financial sector, new retirement plan designs that place more responsibility on employees and broader access to financial markets, the conversation about financial literacy and financial education has picked up pace.

Measuring the problem

The Global Financial Literacy Excellence Center (GFLEC) works to elevate financial literacy, by which we mean not just financial knowledge but also financial behaviour. To assess financial knowledge, we developed a set of questions — which have become known as the Big Three — on basic financial concepts at the root of financial decision-making (numeracy and interest compounding, inflation and risk diversification) and subsequently an enlarged list of five questions — the Big Five — that generate a more comprehensive understanding of financial knowledge.

More recently, we participated in the design of the S&P Global Financial Literacy Survey, which covers more than 140 countries. The research using our questions and other international surveys consistently shows low levels of financial literacy, not only in emerging economies, but also in countries with well-developed

financial markets. Worldwide, financial illiteracy is not only widespread but is particularly severe among women, ethnic minorities, low-income groups and those with less education. Low levels of financial literacy — even in advanced countries — become more worrying when we note that the composition of vulnerable groups is similar across countries.

"In a survey of 10 western European countries in 2016, Germany scored the highest on risk literacy, and yet only 19% of respondents gave correct answers."

Our measure of financial literacy also produces a better understanding of where people fall short. Individual knowledge is usually weakest in the area of risk diversification, which has a direct implication for individuals' understanding of insurance and behaviour toward risk. In a survey of 10 western European countries in 2016, Germany scored the highest on risk literacy, and yet only 19% of respondents gave correct answers. This is important because knowledge of risk can be linked to a set of financial behaviours and outcomes, including retirement planning and household financial resilience.

The near-crisis levels of financial illiteracy, the adverse impact that it has on financial behaviour and the vulnerabilities of certain groups speak to the need for and importance of financial education. Financial education is a crucial foundation for raising financial literacy and for informing the next generations of customers, workers and citizens. An effective financial education programme efficiently identifies the needs of its audience, accurately targets vulnerable groups, has clear objectives and relies on rigorous evaluation metrics. Our extensive research shows the need for large and scalable initiatives. Schools, workplaces and community platforms provide a unique opportunity to deliver financial education to large segments of the population.

Starting early has benefits

School-based education can be transformational by preparing young people for important financial decisions. Both the 2012 and 2015 versions of OECD's Programme for International Student Assessment (PISA) found that, on average, only 10% of 15-year-olds achieved maximum proficiency on a five-point scale of financial literacy. As of 2015, 22% of young students did not have even basic financial skills.

To promote financial education in schools, GFLEC collaborated with Girl Rising, a global campaign to educate and empower girls, by designing a financial literacy curriculum. We have developed a set of 20 micro-credentials that provide instructors with the information and resources needed to teach personal finance and we are currently involved in an ambitious project to facilitate financial education implementation in US schools by developing a go-to resource centre for all stakeholders in the field.

Adult programmes can be effective

Financial education can also be efficiently provided in workplaces. An effective financial education programme targeted to adults recognises the socio-economic context of employees and offers interventions tailored to their specific needs. GFLEC has created several programmes, such as "Five Steps to Planning Success" (a set of short videos covering the basic concepts of financial decision-making) and "New Ways to Make People Save" (a planning aid to promote retirement savings among women and low-income workers). We have also developed a workplace financial fitness toolkit for large firms with a heterogeneous workforce. These programmes and other recent work have demonstrated the importance of financial education, which has proven to be effective. For example, a case study of US Federal Reserve employees, which we recently conducted, showed that completing a financial-literacy learning module led to significant changes in retirement-planning behaviour and better-performing investment portfolios.

Finally, it is important to provide financial education in the community; where people go to learn, for example. GFLEC is a co-founder of the International Federation of Finance Museums, a global collaboration that promotes financial knowledge through museum exhibits and the exchange of resources.

Financial education is an important tool for empowering individuals to make sound financial decisions. This is reflected in the development of national financial education strategies by as many as 70 countries. Moving forward, we need to step up financial education efforts to accelerate the progress toward a financially literate world.

"A case study of US Federal Reserve employees showed that completing a financial-literacy learning module led to significant changes in retirement-planning behaviour and better-performing investment portfolios."

Insurance Europe's financial education activities

Financial education has a vital role to play in ensuring that European citizens are equipped with the knowledge, confidence and skills necessary to improve their understanding of financial products and concepts. It is a core life skill that needs to be developed and nurtured as early as possible to encourage responsible financial behaviour and to engender in individuals the necessary confidence to take charge of their own financial futures.

Insurance Europe and its member associations engage in a wide range of financial education initiatives — everything from educational games for schoolchildren to online calculators so that individuals can see if they are sufficiently insured or calculate compensation payments. The federation and its members also make recommendations to EU and national policymakers on boosting financial literacy and retirement saving.

Launch of InsureWisely

In January 2018, Insurance Europe launched the "InsureWisely" name and logo, under which it brings together its financial education activities.

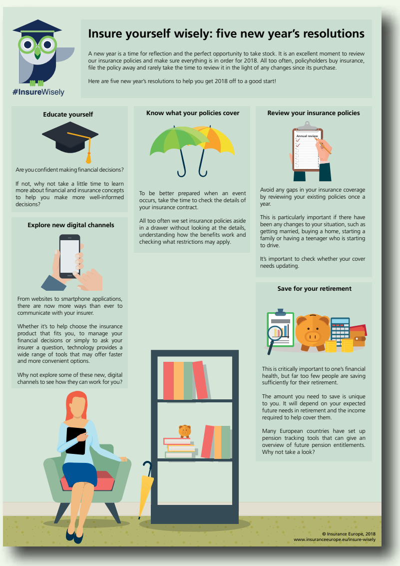
InsureWisely's first action was to publish five financial new year's resolutions, urging individuals to check that their insurance was in order for the year.

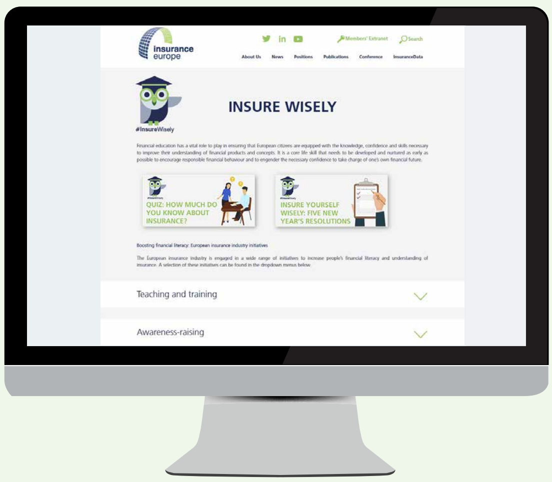
Then in March 2018, to coincide with the annual Global Money Week, InsureWisely ran an online financial education quiz as a light-hearted way for policymakers and the general public to test their level of financial skill.

#InsureWisely

Insurance Europe's 10th International Conference on 24 May 2018 will also feature a panel debate on ways to improve financial education.

A broad cross-section of the insurance industry's many initiatives to increase financial literacy and the understanding of insurance in all parts of society are showcased on the InsureWisely portal, www.insuranceeurope.eu/insure-wisely.





Nicolas Jeanmart
Head of personal insurance, general insurance & macroeconomics, Insurance Europe

CYBER RISKS

A template for change

New EU rules could help to boost cyber resilience. Nicolas Jeanmart explains how.

Society's growing dependence on IT systems and interconnected devices increases its vulnerability to cyber attacks. WannaCry, Equifax and NonPetya are three recent global examples to have hit the headlines. As a result, policymakers around the world are stepping up the requirements they place on businesses to protect themselves from cyber attacks, especially if they undertake essential services or process personal data. In the EU, these take the form of the Network Information Security Directive and the General Data Protection Regulation (GDPR, see also next article).

Both sets of rules will make companies more aware of their cyber-risk exposures and of the importance of implementing appropriate cyber-security measures. And companies that fail to comply with the new provisions could face huge fines — of up to 4% of their annual turnover for infringement of the GDPR, for instance.

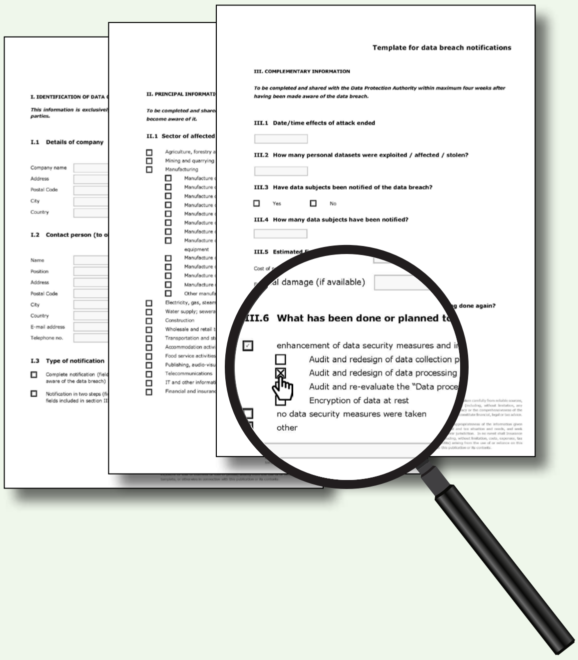
The rules are also expected to have an impact on the cyber insurance market, with more and

Insurance Europe's template

The standard data breach notification template has three sections:

1. Information about the affected company (not to be shared with third parties).
2. Details of the data breach incident that, under the GDPR, have to be sent to the national supervisory authority, where feasible, within 72 hours.
3. A section to be completed following the 72-hour period, when more information is available. This includes additional questions to provide more detailed information about the breach.

The answers to the questions in sections 2 and 3 are either multiple choice or numerical fields. This is so that the authorities can compare datasets across companies and sectors and so that the information in both sections remains anonymous and can be safely shared with the insurance sector.



more companies becoming aware of the risks and wishing to protect themselves against them.

The cyber insurance market in Europe is still at a nascent stage, accounting for just 5% of the global market compared to the US's 90%, according to some estimates. With the impetus from the new legislation, this looks set to change.

Using GDPR data to understand cyber threats

The GDPR comes into force on 25 May 2018 and obliges companies processing personal data to comply with new and more stringent data protection rules. One obligation is for companies to notify (personal) data breaches to their supervisory authority. Companies will have to submit information that includes:

- the nature of the breach
- the categories and approximate number of data subjects and personal data records affected
- the likely consequences
- measures taken to address and mitigate the breach

The obligation to report breaches will produce a wealth of data that, if made available, would greatly help insurers to better understand and underwrite cyber risks, and in turn contribute to increasing society's cyber resilience. In order for this information to be shared securely with the insurance sector, Insurance Europe has developed a template that can be used by companies across all business sectors if they suffer a breach (see box above).

The GDPR may also change the cyber insurance cover currently on offer. Specifically, under the GDPR, new liabilities will arise for the data controller or processor. For example, any person who has suffered material or non-material damage as a result of GDPR infringement will have the right to receive compensation. The GDPR also opens the door to group and public interest litigation under the right to lodge a complaint to the national authorities. This means that a company's potential third-party liabilities could increase significantly and that insurance policies gradually need to be adjusted to cover these new risks.

Insurer initiatives

Meanwhile, insurers throughout Europe have already been taking action to help society prepare for and increase its

"Insurers throughout Europe have already been taking action to help society prepare for and increase its resilience to cyber risks."

resilience to cyber risks. They have been focusing on two areas in particular: small and medium-sized enterprises (SMEs) and offering cyber security services that go beyond mere risk transfer to their customers.

SMEs are particularly vulnerable to cyber risks, as they may not have the knowledge or resources to deal with increasingly frequent and sophisticated cyber attacks. In addition, SMEs are often simply not aware of the need to have adequate cyber-security measures in place, so the European insurance sector is involved in a variety of activities to raise awareness. For instance, some national insurance associations work with governments to support the dissemination of information on cyber threats and to implement strategies that support loss prevention and mitigation. They also produce guidelines and self-auditing tools to help SMEs understand their cyber exposures as well as assess their preparedness and potential insurance needs. For example, the German and Spanish insurance associations have published free guidelines for SMEs on cyber security, which enable companies to audit their own cyber resilience online.

And insurers work closely with cyber-security firms and insureds to offer services beyond mere risk transfer. Many cyber insurance products include risk management advice as well as expert clean-up services should an incident occur. Providing cyber-security services not only benefits consumers by offering additional protection, it also contributes to insurers' developing knowledge of these new risks and enables them to improve the products they offer.

Public and private working together

Challenges remain. Technology is constantly evolving, as are the risks linked to it. That is why it is crucial for the public and private sectors to work closely on ways to increase cyber resilience, without impeding technological innovation.

At European level, learning from what is already being done at national level is a good place to start. Examples range from close cooperation between the insurance sector and chambers of commerce, as is the case in Austria, or cyber security information-sharing between the public and private sectors, as in the UK's "Cyber Security Information Sharing Partnership", operated by its National Cyber Security Centre.

For more examples of insurance sector initiatives, see the event on p71 and visit the cyber insurance section of Insurance Europe's website: www.insuranceeurope.eu/cyber-insurance.

William Vidonja
Head of conduct of business, Insurance Europe

DATA PROTECTION

GDPR is here

William Vidonja looks back at the development of the EU's new personal data protection rules and ahead to how they will be implemented by insurers

The insurance industry relies on the trust placed in it by its customers. And data processing is a fundamental element of its business model (see box). Hence the insurance industry's belief that introducing a harmonised data protection framework in the EU is the right way forward.

The new General Data Protection Regulation (GDPR) harmonises the EU's previously fragmented data protection rules and is an important step in reinforcing the protection of personal data in an increasingly digitalised world. It gives the EU the world's most sophisticated and strictest data protection framework.

EU data protection rules already existed before the GDPR's adoption. However, from the GDPR's application date of 25 May 2018, the data protection landscape changes significantly. The GDPR introduces new data protection principles, enhances data controllers' obligations and greatly strengthens consumer rights.

The most significant principle in the GDPR is the one of accountability. This represents a new regulatory approach for data controllers such as insurers. It not only obliges them to implement appropriate security measures and data protection policies, but also to actively demonstrate

Insurers and data processing

The processing of data, including personal data, lies at the heart of insurers' business:

- They collect and process data to assess and price ("underwrite") the risks against which customers wish to protect themselves so that they can provide properly tailored insurance products.
- Insurers need to process data to perform their contractual obligations, such as evaluating and paying claims.
- They also analyse data to detect and prevent fraud.

that they are compliant with the GDPR provisions. For instance, data controllers now have to conduct "Data Protection Impact Assessments" for risky activities in order to analyse the effect of specific processing operations on the protection of personal data.

At the same time, the GDPR establishes the new obligation for data controllers to notify data breaches to the supervisory authorities, threatening significant fines in cases of non-compliance (see previous article).

From the consumer's perspective, the GDPR grants individuals more control over their own data by strengthening and expanding their rights. For instance, the GDPR provides individuals with wider rights of access to their information and it establishes new rights, such as the right to data portability. This allows individuals to easily transfer their personal data from one service provider to another in a machine-readable format.

A challenging evolution

For the insurance industry, adapting to the GDPR has not been without challenge or cost.

Insurance is already a heavily regulated sector and while preparing for the GDPR, insurers were at the same time having to carrying out extensive operational reform to adapt to the EU's Solvency II requirements, PRIIPs Regulation and Insurance Distribution Directive.

Secondly, a wide range of GDPR requirements had to be clarified via guidelines. These were issued by the Article 29 Working Party, an advisory body made up of representatives of data protection authorities from member states, the European Data Protection Supervisor and the European Commission. The guidelines provide assistance in understanding specific aspects of the Regulation and so, although they are non-binding, they are central to effectively adapting to and complying with the GDPR.

Guideline difficulties

Unfortunately, the process for developing these essential guidelines was far from ideal. The Working Party only issued guidelines on critical issues — such as relying on consent as a legal basis for processing data — shortly before the GDPR application date. And the stakeholder consultations were too short. Initial consultations were only 30 days, with later consultations expanded to a still-insufficient six weeks.

The Working Party will be replaced by the European Data

Protection Board (EDPB), whose enhanced status should contribute to the consistent application of the GDPR across EU member states.

The EDPB has a crucial role to play in ensuring that stakeholders are given the necessary time in consultations on the development of future GDPR guidelines. If it is to fulfil this role successfully, the EDPB has to learn from the difficulties stakeholders encountered in the past.

Specifically, it should follow the EC's Better Regulation agenda and adopt 12-week consultation periods. Additionally, it should ensure that any future guidelines clarify the GDPR provisions without going beyond the Regulation as it was agreed by the legislators.

Supervisory cooperation above all

If the GDPR is to be properly implemented in the insurance sector, good cooperation is required between the EDPB and the industry's supervisor, EIOPA.

The EDPB will have the remit to issue cross-sectoral guidance on the GDPR, while EIOPA is currently analysing and reporting on insurance-related issues that may be affected by the Regulation, such as big data analytics. Use of big data is linked with profiling and automated decision-making. The interpretation of automated decision-making, including profiling, as regulated under the GDPR, therefore has significant implications for how big data will be used by insurers.

"If the GDPR is to be properly implemented in the insurance sector, good cooperation is required between the EDPB and the industry's supervisor, EIOPA."

This means that effective coordination between these two authorities is vital if potential contradictions or counter-productive duplications are to be avoided between EIOPA's current work and the EDPB's future activities, including any guidance on the GDPR. Effective coordination would also ensure that the EDPB takes proper account of the insurance industry's specific features and business models when delivering guidelines.

At this stage, it is impossible to assess the GDPR's impact on the insurance industry and its customers, and it will take some time to evaluate whether the new rules are truly fit for purpose.

OPINION

Jean-Jacques Henchoz
Regional president for Europe, Middle East & Africa,
Swiss Re, Switzerland

DIGITALISATION

Chain reaction

The entire insurance value chain is affected by big data and new technology. Swiss Re's Jean-Jacques Henchoz explains how, and how regulators should respond.

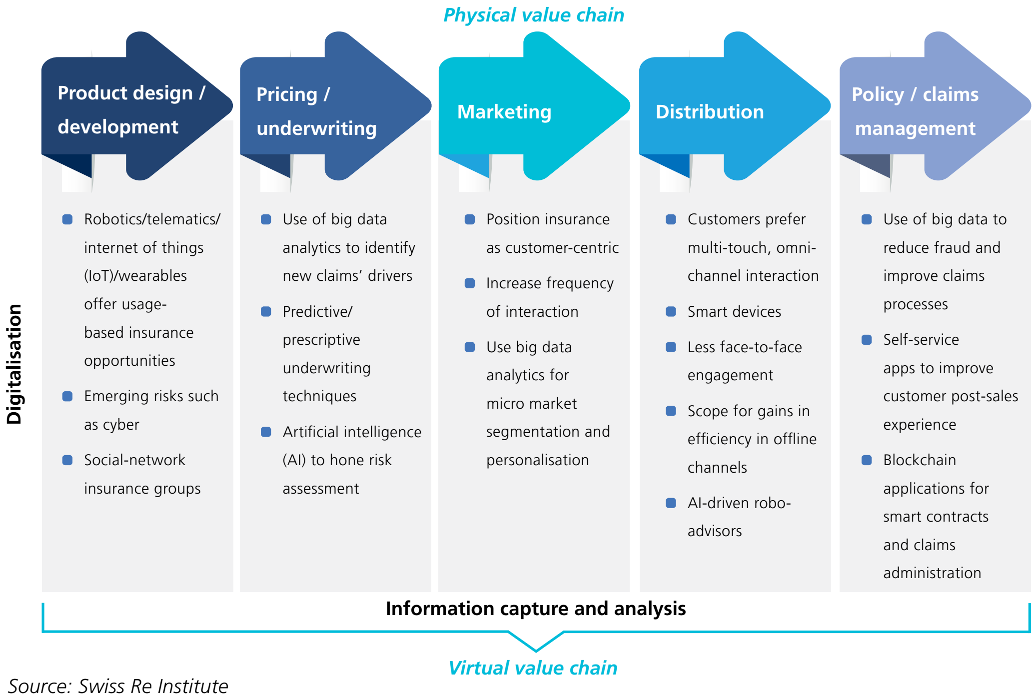
As in other sectors within the financial services industry, the use of big data and digitalisation brings a number of benefits and challenges to (re)insurers. Many companies are embracing new technologies, upgrading their digital capabilities and adopting new and agile structures in order to realise the opportunities that digitalisation represents.

The strategy of some (re)insurers has been to partner with or invest in insurtech firms that can help firms in their own digital transformation. Some (re)insurers are also partnering with large technology firms or creating industry-wide initiatives to test new technologies. For example, in October 2016, a group of (re)insurers including Swiss Re launched the B3i initiative to explore the potential use of distributed ledger technology in smart contract clearing and to develop common industry standards.

Adopting new technologies will bring a significant change to the (re)insurance industry and it will be more important than ever for regulators and insurers to engage in an open dialogue to ensure that technological development reduces the large protection gap[1] that currently exists in Europe and globally. Digitalisation will redefine the relationship between reinsurers, insurers and consumers, and insurance regulators need to ensure policyholder

1 Swiss Re sigma reports: http://institute.swissre.com/research/overview/sigma/

Effect of digitalisation on the insurance value chain



Source: Swiss Re Institute

protection and financial stability while giving the industry the scope to adjust and innovate in response to the tech revolution taking place.

New relations between reinsurer, insurer and consumer

Technology and the availability of new data sources are impacting (re)insurance across the entire value chain (as demonstrated in the chart above) in three main ways:

- **By changing the type of risks that are insured and the role of (re)insurance in the value chain.** Technology is bringing about shifts in the risk landscape and the mechanisms available to firms and individuals to monitor and manage their exposures. While some risks may significantly decrease in the coming years (eg accident risk due to the increased use of sensors and smart homes), the use of new technologies will create new risks (eg cyber risk). The changing risk landscape means that the role of (re)insurers is shifting from predominately focusing on loss indemnification to providing broader advisory services on how to prevent, mitigate and manage risks.
- **By altering the way risks are insured.** Due to the use of big data, (re)insurers can now provide more expanded, tailor-made and usage-based covers. Traditional auto and home insurance policies typically do not cover new risks like ride-sharing and home-sharing. Many insurers are responding by adding riders to existing policies to cover these risks. Others are focusing specifically on addressing the short-term nature of the risks. For example, in early 2017, Swiss Re, UK insurer Collingwood and pay-as-you-go car insurance start-up Cuvva teamed up to offer a new type of insurance policy for car owners in the UK. Using the Cuvva mobile app, which tracks driving behaviour, consumers pay a flat monthly fee to cover the basic protection and top up their cover by the hour when they drive.
- **By affecting the relationship between a (re)insurer and consumer.** By collecting and processing big data, insurers can share more insights with customers, which leads to a more frequent and meaningful interaction. The use of technology has significant potential to increase consumer trust in the industry by making it easier to understand how certain behaviour can impact insurance premiums and what actions could be taken to mitigate the risks and hence lower the premiums. However, restrictions on (re)insurers' ability to use data can create information asymmetries and an unwitting cross-subsidisation of risk in areas other than those in which society demands it, which could lead to this trust being undermined.

“The changing risk landscape means that the role of (re)insurers is shifting from predominately focusing on loss indemnification to providing broader advisory services on how to prevent, mitigate and manage risks.”

Regulation that balances innovation and protection

With new technologies come new risks, and the (re)insurance industry will be more relevant than ever as a financial shock absorber for unforeseen losses for individuals and institutions alike. As outlined already, (re)insurers are adjusting their products and services to address new risks created by technologies in the most efficient way and to narrow the huge protection gaps worldwide. At the same time, regulators and supervisors will have a huge influence over whether the industry is able to develop new products and services that are relevant to customers' evolving needs in the face of technological change, while still ensuring adequate policyholder protection.

Regulators should continuously assess the adequacy of their frameworks and the consequences for policyholders and the market. The pace of technological change means that the development of regulations and regulatory architecture that best match the interests of policyholders is particularly challenging. By being technology-neutral and principle-based, regulators will be able to maintain a regulatory system that is applicable and relevant, even in this fast-changing environment. Doing so will provide companies with clear guidance on the possibilities and boundaries when creating new products and responding to new risks.

Furthermore, the availability of “big data” has tremendous potential to improve the affordability of and access to (re)insurance. Careful consideration of the regulatory balance between data access and privacy will be vital for the provision of effective new products by carriers. The risks of adverse selection and moral hazard have existed since the creation of the insurance industry but these become particularly acute in an era of big data. The implications of information asymmetry will therefore be central to the creation of effective and appropriate regulation in the tech era.

Sound international standards are a prerequisite to successfully harnessing technology. The use of technology in (re)insurance can only reach its full potential if regulation is implemented in a consistent and compatible way across geographies and across industries. Within our industry, an international agreement on a consistent blockchain digital contract vault, for example, would significantly facilitate the cross-border adoption of the technology in a way that is also most easily monitored by regulators and supervisors locally. The somewhat fragmented status quo could pose challenges to the adoption and realisation of the benefits of blockchain for consumers and lead to unequal regulatory treatment of businesses between jurisdictions.

Equal regulation should apply to all players throughout the (re)insurance value chain. Regulatory authorities should apply the same rules to the same risks in order to ensure a level playing field in the market. For example, in markets where safe spaces are created to test innovative ideas and business models, incumbents should be given equal access to participate in such regulatory “sandboxes”.

Revolution ahead

The emergence and adoption of big data tools and platforms represents a revolution in the way the insurance industry has approached risk-based calculations so far. The industry's focus is shifting towards adopting tailor-made, fee-based models and providing broader advisory services on how to prevent, mitigate and manage risks. The use of new technology offers (re)insurers the possibility to develop more personalised solutions and to have more frequent and meaningful interactions with customers, which could make insurance services more accessible and help reduce the massive protection gap.

Regulators can support this process by setting common standards for the consistent application of new technologies (eg blockchain), assessing the adequacy of their regulatory frameworks and offering the same opportunities for start-ups and incumbents to test innovative business ideas.

“By being technology-neutral and principle-based, regulators will be able to maintain a regulatory system that is applicable and relevant, even in this fast-changing environment.”

Nicolas Jeanmart
Head of personal insurance, general insurance & macroeconomics, Insurance Europe

MOTOR

Insurers at a crossroads

As technology transforms transport, Nicolas Jeanmart reviews the implications for Europe's insurers

Motor insurance is the most widely purchased non-life product in Europe. As a protector of millions of European motorists — insurers paid out €104bn in claims in 2016 — it is often the focus of policymakers' attention. This is especially true currently, given the dramatic technology-driven changes affecting all things automotive. The European policy decisions being made — or indeed the lack of them — therefore have the potential to affect the motor insurance business more than ever before.

Action needed on access to data

The vehicles being driven by European motorists are undergoing significant changes, with an increase in connectivity leading to a significant increase in the data they generate and exchange with third parties.

Insurance is, at its core, a data-driven business, so dealing with this data is nothing fundamentally new for insurers. Indeed, the increasing volumes of data generated by vehicles provide them with a tremendous opportunity to overhaul their products, offer new, innovative services and improve the experience of their customers. These positive changes can only take place, however, if consumers are in a position to freely decide with whom they share their data.

Currently, some vehicle manufacturers are developing systems

#Data4Drivers

Data4Drivers

Insurance Europe and its members support the #Data4Drivers campaign, an online petition that calls on EU policymakers to take a regulatory initiative to ensure that drivers control who can access their vehicle data and for what purpose.

Individuals and organisations that sign the petition are also encouraged to raise their concerns with their national politicians and MEPs, as well as the European Commission. And a social media campaign is running, which includes the possibility to upload images of signed pledge cards.

www.data4drivers.eu

that effectively make them the sole gatekeepers of this vehicle data. This deprives consumers of the benefits of increased competition in the market for data-based services related to their vehicle. These services include not just insurance but also repairs, maintenance and the many location-based services enabled by increased connectivity (traffic management information, directing drivers to the nearest garage or hotel, etc.).

Allowing vehicle manufacturers to play this role not only reduces the choice of service providers available to consumers but also compromises the quality of the services on offer. Indeed, the model developed by some vehicle manufacturers means service providers only have access to a selected amount of data outside the vehicle, after it has already gone through at least two servers. This means less data, of a lower quality and after a longer delay than if consumers are in a position to allow the service providers of their choice access to it directly inside the vehicle, with a resulting impact on the quality on offer to consumers.

Furthermore, this situation is at odds with the direction taken by European policymakers on data protection, which gives individuals a bigger say in the data relating to them (see p44).

"What is ultimately at stake when discussing the type of technology used to access vehicle-generated data is consumer choice."

Consumer control

What is ultimately at stake when discussing the type of technology used to access vehicle-generated data is consumer choice. Real consumer control over vehicle data means that, for each service, individuals are able to choose freely from a variety of providers, rather than being bound by agreements pre-negotiated by vehicle manufacturers with third parties.

Insurance Europe has consistently relayed this message in the many initiatives by the European Commission and European Parliament relating to the future of mobility and/or data.

However, the Commission is yet to take decisive legislative action that would ensure the right technological solution is installed in vehicles to allow consumers real control of their data. This is why Insurance Europe backs the #Data4Drivers campaign (see box above).

> **"The European Commission is yet to take decisive legislative action to allow consumers real control of their vehicle data."**

Insurers ready for autonomous vehicles

The other major technological evolution is, of course, the increased automation of vehicles, and the driverless cars that are now becoming a reality. In relation to insurance, this raises questions of liability. Who is liable when a fully automated vehicle is involved in an accident? What if the accident was the result of a fault in the system? How much room is there left for human error in a distant (and still very much hypothetical) future in which all traffic is fully automated?

Insurance Europe has engaged actively with European Commission and Parliament policymakers on this, most importantly as part of GEAR 2030, a high-level group set up by the Commission to gather the whole automotive value-chain to look into the future of the European automotive sector and make recommendations.

MID must be preserved

Questions abounded on the adequacy of the existing regulatory framework — comprising the Motor Insurance Directive (MID) and the Product Liability Directive — to accommodate autonomous vehicles on European roads. Insurance Europe was pleased to find support for its view that this regulatory framework is fit for purpose.

It can be tempting to infer from technological changes that they automatically require a change of law, but that is not the case here. The MID should remain key in ensuring that the victim of a road traffic accident involving an autonomous vehicle receives compensation, regardless of the cause of the accident (software problem or human error).

Autonomous vehicles also raise the issue of access to data, albeit from a different perspective to that discussed above. In its final report, GEAR 2030 acknowledges the need to ensure parties with a legitimate interest have access to data after an accident or incident in order to establish the facts and apportion liability. This is, after all, integral to the work of an insurer.

Autonomous vehicles are not the only reason that the MID finds itself the focus of policymakers' attention. The Directive is often the subject of questions in the European Parliament and there has been a proliferation of cases brought before the European Court of Justice in the wake of a controversial ruling in 2014 (the *Vnuk* judgement), which tested the limits of the MID's scope. The discussions culminated in 2017 with a public consultation by the Commission on the MID.

Protection has to be ensured

Whether under the current Commission's mandate or the next, a revision of the MID is expected. For insurers, it is vital that any change made to the Directive does not result — either directly or indirectly — in a lowering of the current high level of protection afforded to victims of road accidents.

One recurring issue raised by policymakers when discussing the MID is the pricing of motor insurance, with the variations in the price of motor insurance across Europe sometimes misinterpreted as a shortcoming in the EU's single market.

This is not the case. Rather, the variations are due to a range of factors that affect the pricing of insurance policies, including the volume and type of claims made in a particular country, as well as country-specific features that affect risk, such as the cost of medical treatment for people injured in accidents or legal costs.

An open and competitive motor third-party liability (MTPL) insurance market is key to the MID achieving its goals and this means allowing MTPL insurers to exercise their commercial judgement freely. They should remain unimpeded by restraints such as the standardisation of claims history statements, which is a proposal sometimes put forward by the Commission.

It is this same need for an open and competitive MTPL insurance market that requires rules to be in place at European level to ensure access to in-vehicle data that is independent of the vehicle manufacturer.

> **"The Motor Insurance Directive should remain key in ensuring that the victim of a road traffic accident involving an autonomous vehicle receives compensation."**

Luigi Lubelli
Chairman, European Insurance CFO Forum
Group chief financial officer, Generali

FINANCIAL REPORTING

Counting down

20 years in the making, a new standard for financial reporting is requiring significant, sweeping and costly changes to insurers' processes, says the CFO Forum's Luigi Lubelli

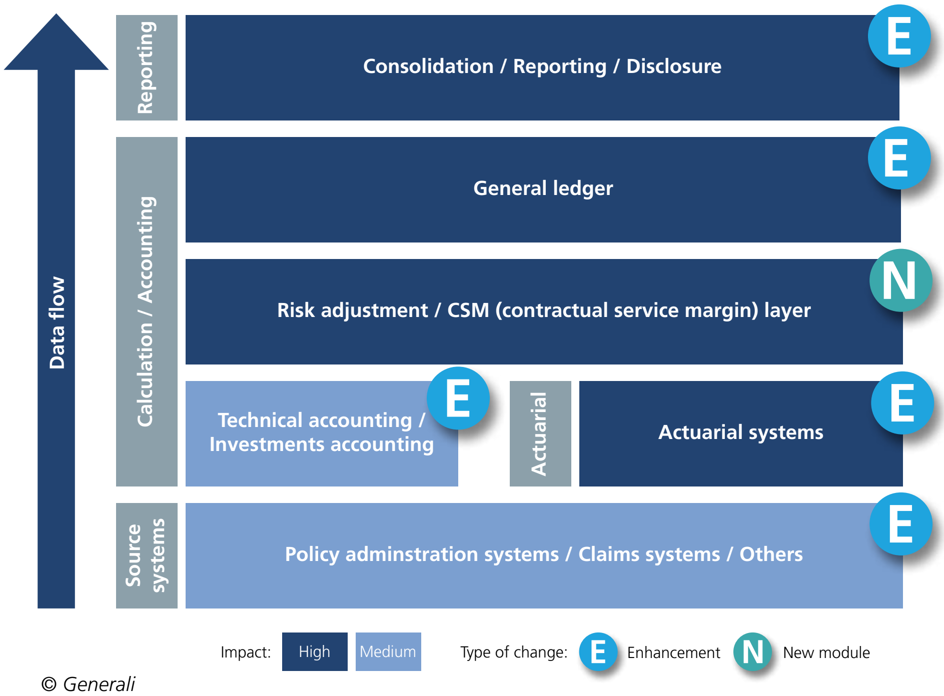
International Financial Reporting Standard (IFRS) 17 on insurance contracts undoubtedly represents the most significant change to insurance accounting requirements ever. It was issued by the International Accounting Standards Board (IASB) in May 2017 after a 20-year international debate around insurance contract measurement, during which IFRS 4 was introduced in 2004, allowing the continuation of different grandfathered reporting bases used historically by insurers. IFRS 17 will apply to reporting periods from the beginning of 2021.

IFRS 17 requires a complete overhaul of insurers' financial statements. To implement IFRS 17, a major programme of change will extend beyond insurers' finance and actuarial functions, with a major impact expected on data, processes and IT systems. Moreover, its business and financial impacts need to be communicated to and understood by a wide range of internal and external stakeholders. Given the scale of this change, investors and other stakeholders will want to understand the likely impacts as early as possible.

The measurement approach results in a fundamental change to current practices in a number of critical areas that will:

- change patterns of profit emergence;
- speed up the recognition of losses on contracts that are expected to be onerous; and,

Impact of IFRS 17 on systems architecture



- Large number of systems impacted.
- As of today, no IT end-to-end solution exists and offering is still not mature. Lack of skilled resources for implementation.
- Granularity and accuracy needs are more demanding than Solvency II. Investments in actuarial platforms likely to be very substantial.
- Opportunity to standardise and centralise closing processes.
- Major update of the ledgers/ reporting/disclosure tools to include new analysis of movement and presentation of IFRS 17 liability components.

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- add complexity to valuation processes, data requirements, assumption setting and analysing, and the communication of results.

Is IFRS 17 fit for purpose?

From the perspective of the wider community of report preparers, investors and other users, there is general agreement on the benefits of introducing a consistent basis of accounting for insurance contracts. Beyond this, however, the new standard must prove that the benefits it promises in terms of providing information that is relevant, reliable, comparable, predictable and — more generally — in the interests of the public good outweigh its implementation costs, which will be substantial. Is it expected to meet these expectations at present? While you are reading this article, two strategic processes are in progress.

First, there is the IASB Transition Resource Group (TRG), which aims to support implementation in key areas of the standard that could potentially result in diversity in practice. Looking at the outcome of the Group's first meeting in February 2018, it will undoubtedly play a fundamental role in addressing preparers' and auditors' interpretations of the high-level principles of IFRS 17, as well as operational complexities and practical considerations arising from the implementation phase — at least that is what the industry expects. A number of technical and operational issues remain in the area of measurement granularity, performance reporting and presentation. These have been flagged by the industry for improvement.

Secondly, the European Financial Reporting Advisory Group (EFRAG) is coordinating a testing case study, which will be a key element in its advice to the European Commission on whether the European Union should endorse the standard. A bottom-up assessment of the technical requirements is a necessary step in the transition process to a brand-new finance era for insurers, as the transition to Solvency II showed some years ago. But is the current testing window sufficiently broad to highlight all the real issues? Of course, the link between the EFRAG case study, the TRG mission and the EU endorsement process is crucial and all the parties should demonstrate flexibility in managing emerging issues during the transition period in order to achieve the IFRS 17 goals. Nonetheless, a number of qualified parties are raising questions about the time available for testing and the overall time allowed for implementation.

How and where will insurers be affected?

Companies are currently in the midst of their implementation plans and can see from these that there will be a huge impact from the standard on data, processes and IT systems and that they will differ from the changes that were recently required to implement the EU's new Solvency II rules.

Actuarial data and assumptions currently in use for Solvency II and MCEV (market-consistent embedded value) reporting will have to be enriched and grouped with the new granularity requirements of IFRS 17, as well as stored and reconciled with actual accounting data in order to avoid artificial volatility in the earning profiles.

The new calculations required, combined with unchanged or shortened deadlines for publishing results, are likely to require extensive reengineering and significant acceleration of actuarial and accounting processes and the related design of specific controls and the audit framework. In parallel, the planning and performance management process needs to be adjusted to the new IFRS regime to limit the risk of a continued need for complementary non-GAAP measures, which would cast some doubt over the business case for IFRS 17.

Due to the new level of complexity, the entire finance and actuarial systems architecture — including source systems, actuarial and risk models, an IFRS 17-specific calculation engine, reporting layers and accounting ledgers — requires changes or new implementations at company and/or group level (see diagram). Reviewing the current technology landscape is a costly and time-consuming process but must be done carefully to ensure benefits for the longer term.

And what are the benefits?

Considering the foreseeable impact, what could be the cost for the industry? Its magnitude is widely considered to be similar to the outlay for Solvency II implementation. However, the right question is possibly a different one: will IFRS 17 deliver a global benefit that justifies this kind of investment?

Opinions may vary today, but they will become firmer once the outcome of the TRG activities and EFRAG testing are known. Now more than ever, each party involved — preparers, auditors, the IASB and the European institutions —– must proactively play their role in the transition to IFRS 17.

This is important because IFRS 17, together with IFRS 9 for financial instruments, represents a strategic opportunity to create a global and sound standard for fair reporting for the insurance industry, which plays such a vital role both as a supporter of a wide range of social needs and as a long-term investor in the real economy and capital markets.

OPINION

Bernard Delas
Vice-chairman, ACPR (banking and insurance supervisory authority), France

EU FREE PROVISION OF SERVICES

Fixing FOS

French supervisor Bernard Delas proposes ways to avoid misuse of the freedom to provide cross-border insurance in the EU

For several decades, EU member states and institutions have been striving for the integration of financial and insurance services in order to make the dream of the single European market come true. The freedom to provide services (FOS) and the freedom of establishment (FOE) are two essential cornerstones of this integration. Unfortunately, while the single European market has been completed for the coverage of large risks and products designed for corporates, this is far from being the case for retail business. Here, the EU market remains frustratingly fragmented.

Less than 5% of the insurance products sold on the French market come from cross-border activities. Furthermore, in this diversified landscape of multiple national realities, recent cases in the French construction insurance market show up some of the abuses to which FOS mechanisms have led. These cases highlight the fact that FOS can easily be diverted from its initial aim to foster competition and that it has opened the door to practices that jeopardise the very notion of this free competition.

Building problems

In France, the construction sector is subject to specific rules that provide a high level of consumer protection. Indeed, both the project owner and the construction professional are obliged to take out an insurance policy covering potential damage to the building over a period of 10 years starting from the delivery of the works.

> **“We do not need to give up the FOS provision to put an end to the wrongdoings of some international players who discredit the single market.”**

This guarantee, specific to French law, is subject to fierce competitive pressure between specialised French insurers, which pushes up the claims ratio to over 100%. Due to the very long duration of the guarantee, insurance undertakings must hold a huge amount of technical provisions for a period of time exceeding 10 years. This is due to the potential delay between the initial cause of the damage and the observation of its visible or measurable consequences. In this context — and taking advantage of the particularities of this line of business — some insurance undertakings have rapidly gained market share by using quick underwriting processes based on poor risk selection and an underpriced product offering. And the key element for the success of their business model is the use of the FOS provision.

These undertakings set up new insurance companies in member states in which the specifics of the French construction market and their implications for prudential requirements are largely unknown. As a result, those new ventures develop a business model that obviously has almost nothing to do with a prudent insurance operation but could rather be compared to something resembling a Ponzi scheme, as the future claims of ongoing insurance policies are most likely to be paid out using not-yet-paid premiums of not-yet-written policies.

In view of this, it is clear that the FOS provision is reaching its limits and the example of the French insurance construction market is a perfect illustration. Inappropriate use of FOS might lead to harmful business practices that need to be denounced because they are a threat to the stability of some market segments, such as French construction insurance or products obeying a specific national rule, as is the case in many European countries. Greedy newcomers lacking both expertise and financial soundness take advantage of a single-market rule that is almost impossible to apply evenly throughout such a diversified European landscape. The quick growth of their activities might therefore end up harming consumers, who are obliged to take somewhat hopeless legal action abroad against insurers, leaving national public authorities alone to face the anger and the unpaid claims.

This situation is, of course, unacceptable and calls for strong and swift action. How can we justify the tremendous efforts made to build up a sophisticated single market legislative framework if one of the most visible consequences of cross-border activities is the development of business misconduct and scandals, winding-up procedures and unpaid insurance claims?

Taking action

Fortunately, we do not need to give up the FOS provision to put an end to the wrongdoings of some international players who discredit the single market as a whole and undermine consumer trust and confidence in European policies. Different initiatives have already been taken and they should be amplified and lead to immediate action and decisions:

- A much closer cooperation and coordination between national supervisory authorities across the EU has to be put in place, especially for unusual lines of business.
- The distinction between home country and host country supervisors should be adapted in order to give more power to the host supervisors, who know more than anyone else the specifics of their markets. Additionally, these supervisors are in the front line to deal with consumers caught out by the failure of a mismanaged insurance company or, in some cases, by a pure scam.
- EIOPA is naturally the perfect place to set up such cooperation processes and ensure they are both complied with and efficient. Those processes should encompass both the ongoing business and the winding-up procedures involving FOS operations.
- Insurance undertakings should be prohibited from using the FOS provision to underwrite classes of business they do not cover in their home country, as this is the origin of most deplorable deviations and abuses.
- All lines of business potentially affected should be identified and granted special attention. As far as the French market is concerned, products besides construction insurance that are subject to the misuse of the FOS provision include medical liability, unit-linked life insurance and statutory risks policies bought by local authorities for their employees.

It is clear that achieving the necessary reform of how the FOS provision is implemented must be high on the agenda of European decision-makers. Indeed, it is an essential milestone on the lengthening road towards making the dream of an efficient European single market for insurance a reality.

Olav Jones
Deputy director general, Insurance Europe

TAXATION

Beat the clock

EU (re)insurers are in a race against time to adjust to the US Base Erosion and Anti-abuse Tax (BEAT), says Olav Jones in a round-up of tax issues

Sometimes tax developments in a non-EU jurisdiction can have a significant impact on the European insurance industry. This was certainly the case with the tax reform bill that the US administration started working on in the second half of 2017 and that it pushed with unprecedented speed through the House of Representatives and Senate at the end of the year.

Among its many provisions, the Act introduces a Base Erosion and Anti-abuse Tax (BEAT) applicable to payments made by US-based companies to foreign affiliates. Since there is no exemption for financial services, the BEAT will apply to reinsurance premiums, suddenly rendering unviable the way most global (re)insurance providers operate in the US (as intra-group reinsurance is extremely common).

When levied on gross reinsurance premiums paid to affiliates based in the EU (and elsewhere), the BEAT — set at 5% for 2018, then 10%, rising to 12.5% from 2025 — will result in a dramatically higher US tax burden for EU reinsurers that are active in the US. This is primarily because the tax will apply to gross premiums, disregarding any inflows corresponding to the reinsurance payments. The BEAT will result in double taxation, given that the profit from reinsurance premiums will also be taxed in the EU.

Insurance Europe alerted EU policymakers early in the US legislative

> “The BEAT will result in a dramatically higher US tax burden for EU reinsurers that are active in the US.”

process to the detrimental effects of the BEAT and to the fact that it discriminates against foreign financial service providers, clearly goes against the spirit of the 2017 EU–US bilateral agreement on prudential measures for (re)insurance (see p60) and may well contravene WTO rules. Despite strong representations from the EC, governments and EU (re)insurers that such a protectionist measure would be ill-advised, the BEAT made its way into the Tax Cuts and Jobs Act.

Under significant time pressure, given that the tax applies from 2018, EU (re)insurers must now find ways to adapt to this new reality in the US, including making changes that go to the core of the international (re)insurance business model. Insurance Europe, meanwhile, continues to engage with the Commission in support of an appropriate European response.

ECJ on CSGs

Back in the EU, in September 2017 the European Court of Justice (CJEU) issued three rulings on articles in the 2006 VAT Directive relating to cost-sharing groups (CSGs). Two of the rulings explicitly state that CSGs in the financial sector cannot benefit from a VAT exemption. According to the CJEU, the VAT Directive only allows VAT exemption for CSGs whose members conduct activities in the public interest, such as education and healthcare. Before, it had been generally accepted that financial services also fell under the scope of the exemption.

CSGs are an essential tool used by insurers to mitigate the cost of irrecoverable VAT. As the financial sector carries out activities that are exempt from VAT, it cannot deduct the VAT paid on its inputs. CSGs offer a solution to this problem, as they allow the creation of an entity from which to receive exempt input supplies. CSGs are therefore widely used in the insurance sector for their simplicity and flexibility. This is why the CJEU rulings constitute a seismic shift that — in EU member states that interpreted the CSG exemption broadly — will force the entire financial sector to reorganise.

> “Insurance Europe has repeatedly called for a review of the EU VAT Directive’s financial services provisions to better align them with the realities of modern financial services.”

Over recent years, Insurance Europe has repeatedly called for a review of the VAT Directive’s financial services provisions to better align them with the realities of modern financial services. The recent rulings only reinforce the need for such a review.

So far, differences of opinion among member states have scuppered EC efforts to address these issues and, sadly, it is likely that this will continue to be the case. Nevertheless, Insurance Europe will continue to argue strongly in favour of a review of the VAT Directive to explicitly allow CSGs, whatever the type of activities conducted by members of the group, and to address other VAT-related issues faced by the industry.

EC on cross-border

In December 2017, Insurance Europe responded to a Commission proposal on new obligations for intermediaries to report cross-border tax planning arrangements. It noted that, in jurisdictions where intermediaries are legally entitled to professional privilege, they benefit from a waiver on filing information. This could lead to it falling primarily to taxpayers and therefore companies to report cross-border arrangements, which could result in an additional administrative burden that should not be underestimated.

OECD on BEPS

At global level, the OECD base erosion and profit shifting (BEPS) project aims to ensure that profits are taxed where economic activity and value creation occur and the insurance industry has always supported these aims. Insurance Europe responded in September 2017 to the OECD’s consultation on the attribution of profits to permanent establishments and restated its concern that, for some insurance business models, permanent establishments would be recognised for tax but not for regulatory purposes, with nil or minimal additional profit being attributed to them. This would represent a disproportionate compliance burden for insurers, as well as for tax authorities, so Insurance Europe asked that the final OECD guidance include an explicit recommendation that jurisdictions should have administratively convenient ways of collecting the appropriate amount of tax.

RAB OPINION

Ulrich Wallin
Chair, Insurance Europe Reinsurance Advisory Board (RAB)
Chairman of the Executive Board (CEO),
Hannover Rück SE, Germany

INTERNATIONAL TRADE

Protection without protectionism

Removing market-access restrictions is essential if reinsurance is to fulfil its role of risk-sharing around the globe, says Ulrich Wallin

Whether people have sufficient insurance cover varies significantly between income groups and between countries. This large protection gap is a societal problem to which the insurance industry can help find solutions.

Reinsurers are pursuing innovative paths by building cooperation with global organisations, entering into cross-border partnerships and working with insurtech start-ups in order to reduce the insurance protection gap and develop innovative practices so that vulnerable consumers and countries can be properly insured.

Using the capital efficiencies of global risk-sharing via reinsurance allows insurance companies to insure against severe and excessive losses with extended capacity at better prices. Open markets are an important factor in increasing insurance capacity in markets with low insurance coverage.

Therefore, if underserved individuals in different countries around the globe are to be reached effectively, it is vital that cross-border reinsurance can be provided without undue restrictions. And it is not just reinsurance capacity, but also the experience and knowledge of the global reinsurance industry that enable local insurance companies to assume more risk. Despite this, the reinsurance industry continues to be faced with various protectionist trade barriers in several countries.

Although protectionism is still one of the key challenges facing reinsurers, it has been very encouraging to see policymakers in some jurisdictions roll back trade barriers over the last year. These positive developments underscore the value of our efforts to demonstrate the benefits of open reinsurance markets.

EU-US Agreement as a leading example

One recent highlight has been the signing by the EU and the US of the bilateral agreement on prudential measures for (re)insurance in September 2017 and its entry into force in April 2018.

For European reinsurers, the elimination of statutory requirements to post collateral when providing services to local ceding companies in the US is a key priority. It has therefore been positive to see the US authorities engaging with stakeholders about the most forward-looking and efficient ways of changing the underlying regulations (the US Credit for Reinsurance Model Law and Regulation). At the same time, the German supervisor (BaFin) — one of the authorities involved in the successful implementation of the agreement in the EU — issued public statements honouring the commitments of the bilateral agreement, subject to its ratification.

Due to the complex cross-conditionality of the agreement, it is crucial that the authorities in both the US and the EU adhere to the agreed implementation schedule. Once entirely implemented, the agreement will represent a great success for proponents of open markets and globalisation.

More good news from the Americas

Brazil, one of the most important markets for European reinsurers in Latin America, introduced two reforms liberalising the insurance sector in December 2017. These regulatory resolutions foresee the removal of two significant barriers that European reinsurers operating in Brazil had previously faced: mandatory placements with local reinsurers and restrictions on intra-group cessions. They followed the decision by neighbouring Argentina earlier in the year to further fast-track reforms aimed at reducing certain restrictions to market access for reinsurers — a step taken in response to global industry engagement.

These long-awaited reforms give us reason to hope that market liberalisation policies are contagious and certainly to believe that the benefits of readily available reinsurance coverage through open markets speak for themselves.

Mixed picture in India

For some time now, European reinsurers have invested significant resources in further developing their presence in the growing Asian markets that face a large protection gap. Many of us have established branches in India, starting operations in 2017 — moves made possible after India finalised welcome reforms to open the market.

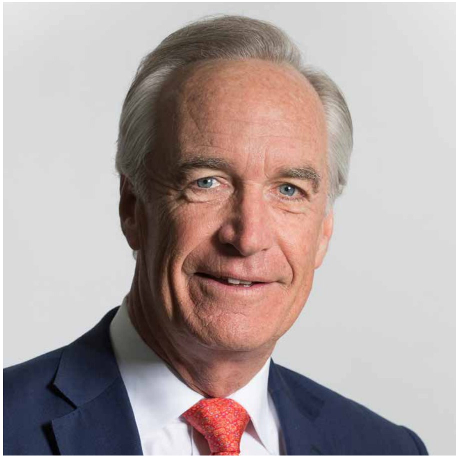
Yet, shortly after the market-liberalising reforms, the Insurance Regulatory and Development Authority of India (IRDAI) established a regime under which Indian insurers are mandated to cede business to reinsurers according to a prescribed order of preference which gives precedence to the Indian state reinsurer over foreign reinsurers' branches and cross-border reinsurers. Given that the branches of foreign reinsurers are required to meet the same regulatory requirements and are supervised by the same authority (IRDAI) as Indian reinsurers, this step was difficult to understand and demonstrated that a completely open market was not (yet) on the agenda in India.

The 2018 review of the IRDAI's reinsurance regulations could be a good opportunity to further open up India's reinsurance market. While the first draft regulations show some improvements, the final regulations are still to be announced, thus keeping the industry in a state of transition. Further steps need to be taken in order to arrive at a level playing field between foreign reinsurers and their branches in India and local reinsurers.

This assessment resonates very strongly with the vision shared by Prime Minister Modi at the recent World Economic Forum Annual Meeting in January 2018, when he named protectionism as one of the most significant dangers to the world today. European reinsurers remain committed to the Indian market, with the goal of effectively supporting the population with the insurance cover that it needs.

Continue along this path

The leading reinsurers in the Reinsurance Advisory Board have long recognised the need to work together with our partners and policymakers in order to overcome trade obstacles and find innovative ways to ultimately close the multi-billion-dollar deficit in global insurance coverage. This will facilitate greater access to insurance where it is most needed. With our continued joint engagement, we remain convinced that the need for and benefits of free reinsurance markets will be recognised in more jurisdictions.



Governor Dirk Kempthorne
President, Global Federation of Insurance Associations (GFIA)
President & CEO, American Council of Life Insurers (ACLI)

INSURERS AND THE G20

G20 force

Collaboration between the Global Federation of Insurance Associations and the G20 goes from strength to strength, reports Dirk Kempthorne

One of the most rewarding activities for those of us who have the honour to serve on the GFIA Executive Committee is to liaise with the successive presidencies of the G20 — the global forum for financial and political collaboration that comprises 19 countries and the European Union. Over the years since GFIA's 2012 foundation, we have had the pleasure of engaging with G20 representatives from Mexico, Russia, Australia, Turkey, China, Germany and, now, Argentina.

GFIA has a successful history of engagement at the highest level in international fora and has earned a reputation for offering valuable insights and expertise. Our proactive engagement with the G20 has always been welcomed and encouraged, and our December 2017 meetings with the incoming Argentinian presidency were no exception.

The GFIA delegation was delighted to meet the Minister of Public Finances, Luis Caputo; the President of the Central Bank, Federico Sturzenegger; Superintendent of Insurance Juan Pazo; and Daniel Funes de Rioja, the Argentinian Representative to the G20 and B20.

The Argentinian representatives were very welcoming of the insurance industry's engagement, particularly in relation to the G20's infrastructure objectives. It was reassuring to encounter not only interest in the insurance sector, but also a clear understanding of insurers' ability to support economic growth through both risk protection and investment in long-term assets.

People first

Each G20 presidency has its unique impact on the global regulatory landscape. Argentina has chosen a people-centred agenda that focuses on development, fairness and sustainability, under the title "Building consensus for fair and sustainable development". The presidency is concentrating on three issues: the future of work, infrastructure for development and a sustainable food future.

The G20 has identified a global infrastructure gap from now to the year 2035 of an estimated $5.5trn (€4.5trn), despite institutional investors around the world having $80trn in assets under management. It believes "investment in infrastructure is far less than what is needed to sustain vigorous growth and make it truly inclusive" and is planning to develop infrastructure as an asset class by "improving project preparation, addressing data gaps on their financial performance, improving the instruments designed to fund infrastructure projects and seeking greater homogeneity among them".

Building bridges …

This is a significant opportunity for the global insurance industry. Our industry has $4.6trn of premiums to invest annually and more than $26trn of assets under management. Since most of our liabilities are long-term, we need long-term assets to match. We are well-placed to support long-term investment such as infrastructure.

Minister Caputo was keen to discuss how private investment can be enhanced via public resources, for example through public-private partnership projects and the use of credit enhancement. Insurance Superintendent Juan Pazo was particularly interested in a 2017 survey that GFIA conducted among its members. That study showed the growing interest of the insurance sector in infrastructure investment. It also identified a widespread scarcity of suitable investment projects and revealed concerns that, in some cases, well-intentioned public support actually crowds out private investors.

In two workstreams that report to the G20 — developing a global insurance capital standard (ICS) and the Financial Stability Board's work assessing the impact of past G20 reforms — GFIA asked the G20 to ensure a suitable prudential framework across jurisdictions to avoid unintended or unnecessary barriers that could disincentivise investment in long-term assets and hinder growth. Before introducing regulation for insurers, GFIA calls on policymakers to carry out assessments of their impact

About GFIA

The Global Federation of Insurance Associations was established in October 2012. It has 40 member associations representing the interests of insurers and reinsurers that account for well over $4trn of annual insurance premiums worldwide, or nearly 90% of the global total. GFIA's secretariat is headquartered at Insurance Europe in Brussels.

on insurers' ability to offer products that represent value for consumers and to invest long-term.

… and beyond

GFIA's wide-ranging discussions with the G20 go far beyond infrastructure, of course. As well as the Argentinian presidency's three primary goals, it is also seeking to build on the legacy of past presidencies in many other areas.

Those of particular interest to the insurance industry include improving financial regulation, working towards a strong and sustainable financial system, improving the fairness of the global tax system and cooperating on trade and investment. For example, GFIA strongly supports the commitment to strengthen cooperation in trade, with the aim of developing an inclusive system that contributes to shared and sustainable growth. It believes that lowering barriers to trade and resisting protectionism are crucial drivers of economic growth.

One of the other issues that GFIA raises regularly with the G20 is tackling the pension gap. World leaders regularly tell me that longevity is one of their major challenges for the future. In an ageing global society, it is vital to ensure that there is a diversified pension landscape. Likewise, incentivising private savings is crucial. The G20 should encourage national policymakers to ensure that insurers can continue to play their pivotal role in providing long-term savings products. A healthy insurance market is part of any robust pensions system. Indeed, our industry's great mission is to provide products that allow people to age with dignity, including in retirement, and to pass on a legacy to their families.

To B20 or not to B

The G20's B20 business engagement group now includes a pleasing number of GFIA members and insurance industry representatives on its taskforces. My own association, the American Council of Life Insurers, hosted the B20 in Washington, D.C. in April 2018 on the margins of the International Monetary Fund/World Bank Spring Meetings. I was glad to see so many members of GFIA participate in the B20 for the first time. And GFIA will have a further opportunity to engage with the G20 later in 2018, as the Argentinian authorities are considering an event focusing on insurers' role in the G20 agenda.

GFIA looks forward to continuing to work with the Argentinian and future G20 presidencies on the many ways the insurance industry can contribute to economic development and growth through its protection against risk and its investment in long-term assets.

Insurance Europe

Member associations

Austria	Verband der Versicherungsunternehmen Österreichs (VVO) President: Othmar Ederer www.vvo.at tel: +43 171 15 62 00
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Czech Republic	Česká asociace pojišťoven (ČAP) President: Martin Diviš www.cap.cz tel: +420 222 35 01 50
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		Association of British Insurers (ABI) Chairman: Andy Briggs www.abi.org.uk tel: +44 20 7600 3333
		International Underwriting Association of London (IUA) Chairman: Malcolm Newman www.iua.co.uk tel: +44 20 7617 4444
		Lloyd's Chairman: Bruce Carnegie-Brown www.lloyds.com tel: +44 20 7327 1000

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Serbia	Udruženje Osiguravača Srbije Secretary general: Duško Jovanović www.uos.rs tel: +381 112 92 79 00

Partner

Russia	All Russian Insurance Association (ARIA) President: Igor Yurgens www.ins-union.ru tel: +7 495 232 12 24

Events

9th International Conference "Digitalisation today and tomorrow"
Zurich, Switzerland, June 2017

Outlining the latest technical innovations: Dickie Whitaker of Oasis Loss Modelling Framework; Geeke Feiter of NN Group, Netherlands; Insurance Europe vice-president Torbjôrn Magnusson; Leigh Ann Pusey of the American Insurance Association; and moderator Karel Van Hulle.

Insurance Europe president Sergio Balbinot opens the full-day conference by setting out the issues facing insurers in a more digital world.

Swiss Re Group CEO Christian Mumenthaler addresses the regulatory challenges in a digital age.

Established versus new: a head-to-head debate between Gary Shaughnessy, CEO EMEA of Zurich Insurance Group (right), and Guy Farley, co-founder of Bought By Many (centre), with moderator Karel Van Hulle acting as referee.

Ted Nickel, president of the US National Association of Insurance Commissioners (NAIC).

Boosting EU cyber resilience: awareness and information Brussels, October 2017

Keynote speaker Luukas Kristjan setting out the Estonian EU Presidency's priorities in the fight against cyber threats.

MEP Cora van Nieuwenhuizen discusses providing insurers with access to the data generated by data-breach reporting under new EU regulations.

Insurers' contribution to sustainable finance, Brussels, November 2017

Debating how to tackle barriers to greater sustainable investment: (L to R) Manuela Zweimueller, EIOPA; Carina Silberg, Alecta, Sweden; moderator Olav Jones, Insurance Europe; Sven Giegold MEP; and Michael Leinwand, Zurich Group Germany.

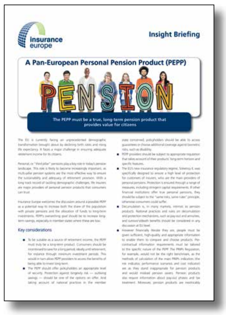
Left: EC Vice-President Jyrki Katainen sets out the Commission's efforts to foster sustainable finance in his keynote address.

Publications

These Insurance Europe publications, and more, are available at www.insuranceeurope.eu

Annual Report 2016–2017
(May 2017)

Articles on current insurance topics and details of Insurance Europe's structure and organisation.



Insight Briefing
The PEPP must be a true, long-term pension product
(June 2017)

The industry's views on a pan-European personal pension product (PEPP) ahead of the proposal by the European Commission.

Insight Briefing
Big data analytics: An insurance (r)evolution
(July 2017)

How big data analytics enables insurers to cover new risks, to offer products better tailored to consumers' needs and to provide better loss prevention advice.

Insurers' role in increasing cyber resilience
(October 2017)

A leaflet describing insurers' role in providing cover, helping clients prevent cyber risks and mitigating the impact when they materialise.

Insight Briefing
Protectionism creates dangerous risk concentrations
(October 2017)

Why open (re)insurance markets make losses more easily absorbed.

Insight Briefing
Compulsory insurance: when it works and when it doesn't
(November 2017)

Why EU compulsory insurance schemes will only work in very specific circumstances.

Insure yourself wisely: five new year's resolutions
(January 2018)

Suggestions for getting 2018 off to a good financial start.

Key messages
PEPP
(January 2018)

The industry's recommendations to policymakers for making the pan-European personal pension product (PEPP) a success.

European Insurance in Figures: 2016 data
(February 2018)

Detailed 2016 statistics showing European insurers' life and non-life premiums, benefits paid and portfolios, as well as market structure information.

Key messages
Brexit
(February/March 2018)

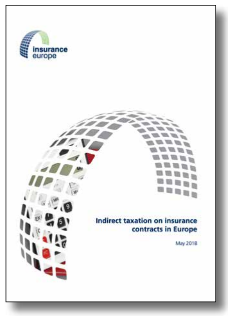
Three sets of messages on the consequences for existing contracts, the consequences for data flows and the need for transitional arrangements.

Insight Briefing
2018 Solvency II review
(March 2018)

What should and should not be changed in the 2018 review of Solvency II.

Factsheets
Market access and trade barriers
(March 2018)

Individual factsheets on the issues faced by European (re)insurers in Argentina, Brazil, India, Indonesia and Turkey.



Indirect taxation on insurance contracts in Europe
(May 2018)

A full survey of rules, tariffs and regulations. It provides an overview of taxes applicable to insurance premiums, as well as declaration and payment procedures.

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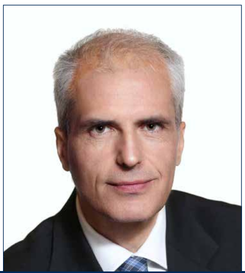

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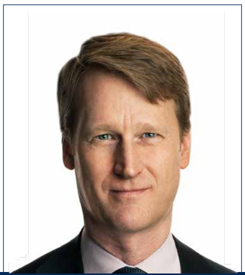

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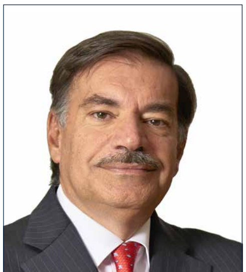

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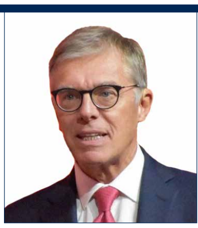

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