Annual Report 2018–2019

insurance
europe

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Insurance Europe is the European insurance and reinsurance federation. Through its 34 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of more than €1 200bn, directly employ over 950 000 people and invest over €10 200bn in the economy.

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Glossary

CRO Forum	forum of large European insurers' chief risk officers
EC	European Commission
EIOPA	European Insurance & Occupational Pensions Authority
ESAs	European supervisory authorities
GDP	gross domestic product
IAIS	International Association of Insurance Supervisors
OECD	Organisation for Economic Co-operation & Development
SMEs	small and medium-sized enterprises
UN	United Nations

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Foreword

Andreas Brandstetter
President

Michaela Koller
Director general

The election of a new European Parliament every five years and the associated arrival of a new European Commission always provide an opportunity both to reflect on the past and set out hopes for the future.

The outgoing Juncker Commission came in promising "An agenda for jobs, growth, fairness and democratic change". After the previous Barroso Commission, which responded to Europe's worst financial and economic crisis since World War II with a slew of rushed legislation, we in the insurance industry hoped to see a considered review of existing legislation. There were, after all, initially-sound legislative proposals that, to a certain extent, had become over-engineered or had even snowballed into a mass of rules and requirements with unintended consequences for insurers and their customers.

We had the opportunity to contribute to many of the Commission's workstreams and to bring in the perspective and experiences of the insurance industry so that, ultimately, aspects relevant for our industry were considered. Nevertheless, frankly speaking, not all our hopes were realised, as in each of the five years of the Juncker Commission we still saw a staggering number of legislative proposals. And while we welcomed the EC's "Better Regulation" initiative and its Task Force on Subsidiarity, Proportionality and "Doing less more efficiently", we have yet to truly see these bear fruit.

This presents a real opportunity for the new European Parliament and Commission — working together with the Council — to really make an impact.

This coming year will be a crucial one for the EU's insurance regulatory regime, with work on the first major review of Solvency II since its introduction at the start of 2016. As firm supporters of the world's most sophisticated risk-based insurance regime, we very much hope that policymakers will take this opportunity to make the improvements needed to the design and calibration of the framework. We will be engaging closely to offer our expertise and our members' experiences throughout the process.

Another opportunity is presented by the review of the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation, whose rules are simply not working. The information provided to consumers, as we explain later in this Report, is at best unclear and at worst misleading.

Addressing deficiencies in the EU regulatory process is also something for which Insurance Europe has been calling for some time. We see three areas for improvement: adequate implementation timelines that give companies time to prepare for new legislation; the prioritisation of quality over speed when developing regulation;

and regulation that is sufficiently detailed, is adequately scrutinised by legislators and is not left to the interpretation of supervisors.

We look forward to contributing to debates on these and other issues and to introducing our industry to new incumbents in the EU institutions. After all, despite the regulatory rollercoaster, insurance continues to drive the economy and touch every aspect of modern life. Insurers provide the cover for a huge range of risks that enables individuals to go about their lives and companies to operate and innovate. Our Annual Report illustrates this clearly — setting out the many and varied workstreams of our federation over the past year.

In these uncertain times, economic, environmental and technological vulnerabilities only seem to be increasing. Yet insurers can provide expertise and cover in all these areas and more — enabling and even driving social and economic development. By mutualising risks, insurers reduce the effects of adverse events. And by managing savings and investments over the long-term, we contribute to economic growth and counter-cyclical financial market stability.

On the risk side, for example, cyber attacks are growing in frequency and scale, but Insurance Europe and its members are achieving success in raising cyber-risk awareness and resilience, particularly among SMEs, and the take-up of cyber insurance in Europe is growing steadily. And, to give a second example, floods, tropical cyclones, wildfires and earthquakes took 2018's natural catastrophe losses to an estimated $160bn (€142bn), but roughly half the losses were insured, so pay-outs by the insurance industry helped individuals and economies recover from the disasters.

Of course, significant underinsurance still exists in many areas of life and many geographical regions. Greater insurance penetration could make the functioning of economies more efficient and dynamic, raising overall societal well-being. Closing this insurance protection gap must be a priority for policymakers.

For the insurance industry to play its essential societal role, insurers need an environment — economic, political and regulatory — in which they can operate optimally. This is where Insurance Europe comes in; working to ensure that European insurers are subject to proportionate and appropriate regulation in all the areas set out in this Report.

Insurance Europe and its members very much look forward to engaging with new and existing members of the Commission and the Parliament — providing them with the information they need to create a regulatory environment in which Europe's insurance industry can operate efficiently and competitively, contribute to the economy and provide our customers with the most advanced and appropriate products possible.

Gérald Harlin
Chair, economics & finance committee, Insurance Europe
Deputy CEO & group CFO, Axa Group, France

SOLVENCY II

Big ambitions

After the missed opportunity of the 2018 review of the EU's regulatory framework for insurers, the 2020 review needs to be ambitious

The EU's Solvency II insurance regulation, which has been applied since January 2016, is the most comprehensive and sophisticated regulatory framework developed on such a large scale in the entire global insurance industry. It places risk management at the centre of the management of insurance companies and promotes advanced risk management practices.

Solvency II continues to be strongly supported by European insurers. However, as for any sophisticated framework, some of the assumptions, methodologies and calibrations decided on a few years ago need to be reviewed to ensure that insurers can continue to provide the full range of products that customers need and value, along with their vital, long-term funding of the European economy.

There are many positive aspects to Solvency II that create clear improvements to the regulation of EU insurers and give rise to benefits for their customers. Solvency II notably allows for advanced and tailored economic management of the business and the balance sheet through a risk-based approach that includes using refined tools such as internal models.

Nevertheless, experience has also confirmed the insurance industry's fears that the regulatory framework results in a number of negative consequences in key areas such as insurers' ability to offer attractive

Survey: the impacts of Solvency II

Insurance Europe conducted a survey in the first half of 2018 of 87 insurers from 17 European markets, which together are responsible for around a third of the European industry's total investments.

As shown in Chart 1 overleaf, a number of elements have improved due to Solvency II. One should not underestimate the value of these improvements and, if anything, there should be a commitment to enhance their value in the review.

However, Solvency II has produced unintended consequences. Foremost among these is that insurers have shifted away from guarantees and long-term business. This effect has been reported by supervisors and insurers alike. Indeed, EIOPA's 2017 report on the long-term guarantee measures in Solvency II noted that supervisors have witnessed a shift due to the cost of Solvency II requirements and the introduction of the risk margin that is particularly high for certain products.

The results of Insurance Europe's industry survey support those findings, with 70% of companies with long-term business reporting that they have made changes to their business. While low interest rates were cited as one of the reasons for this, over two thirds of companies identified Solvency II as one of the causes.

In addition, Solvency II has had a negative impact on insurers' investment behaviour and today leads to sub-optimal asset allocations (see Chart 2). Nearly 50% of the companies surveyed reported that Solvency II was acting as a barrier to investing in assets related to the real economy. This figure rose to nearly 60% for companies using the standard formula.

long-term products and to invest in diversified long-term assets. Indeed, the market-based nature of the framework and some of its uneconomic assumptions make insurance business appear artificially short-dated and more volatile than it really is.

When finalising Solvency II back in 2013, policymakers recognised the importance of the long-term guarantee measures for the insurance business as a whole, since they are aimed at addressing the issues of artificial volatility and pro-cyclicality risks. They also acknowledged that it was difficult to get the design and calibration of such an ambitious and comprehensive framework right first time. Therefore, requirements to review the framework were built into the directive to make sure it works as intended and to make changes where needed: these were the just finalised 2018 review and the recently launched 2020 review.

2018: a missed opportunity

The 2018 review is today viewed by the industry as a missed opportunity to support the growth priorities of Europe. While certain improvements have been made to the framework in terms of simplifications and some fixes of technical inconsistencies, these have been limited and will ultimately have a minimal impact in terms of removing unnecessary barriers to fostering Europe's growth priorities.

For example, the postponement of the risk margin[1] to the 2020 review is a prime example of a missed opportunity to enhance the industry's investment capacity. The industry provided extensive technical evidence that the risk margin could be safely reduced and that the EIOPA recommendation contained some assumptions that could be challenged. EIOPA has, however, decided not to re-evaluate its advice and the Commission did not challenge EIOPA's position. According to EIOPA, depending on market conditions, the risk margin can add a staggering €160bn[2] to the capital the industry needs to hold for its European operations. This negatively impacts all insurance business, but particularly affects longer term products.

On the other hand, the proposal on capital requirements for long-term equity investment is potentially a good step in the right direction, although it remains to be seen if and how it will work in practice.

2020: be bold

From the insurance industry's perspective, the 2020 review should be a comprehensive, but focused, exercise with targeted improvements to the framework that aim to address flaws and reduce unwarranted prudence where relevant. But, due to its sophistication, a careful balance needs to be found when attempting to introduce changes, especially when pursued in a

Chart 1: Companies that have seen improvements due to Solvency II

Element	% of companies
Risk management/governance	96%
Asset/liability management	76%
Regulatory harmonisation	63%
Data quality	89%
Internal models	47%
Other benefits	30%

Chart 2: Companies investing less than optimal amounts in key assets due to Solvency II

Asset class	% of companies
Listed shares	27%
Unlisted shares	23%
Long-term corporate bonds	28%
Private placement/unrated debt	28%
Infrastructure	19%
Property	19%

piecemeal manner. The impact of changes needs to be carefully considered at all levels.

The industry welcomes the EC's recognition of its role in society. This includes protecting citizens, businesses and organisations, providing long-term savings and pensions, and significant investment to support the European economy and its long-term and sustainable growth. Insurers' counter-cyclical business model, both life and non-life, also means they contribute to financial stability during a crisis, rather than amplifying risk, and pursue stable, long-term investment strategies.

It is fundamental that any adjustment that might be proposed preserves the equilibrium of the framework and fits with the economic approach that underpins it, rather than taking an overly prudent stance that could prove harmful in the long run for the entire system.

The 2020 review is a key opportunity for co-legislators to:

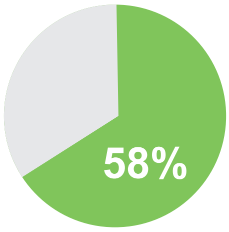
- improve the design and calibration of the framework;
- address areas that do not work as intended or have given rise to unintended consequences for the products insurers offer and their investments; and,
- support and enhance insurers' role in Europe's society and economy and their competitiveness internationally.

"When higher capital is needed because of real risks and volatility, the consequences should be accepted. When excessive capital is due to incorrect measurements and overly cautious regulatory design or calibration, they should not."

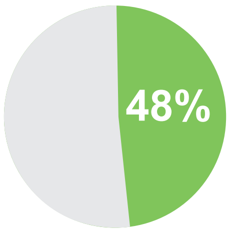
It is vital that the review does not lead to an increase in overall capital requirements. The simplistic idea that more capital is always better should be recognised as false (see box opposite). Too much capital can be as damaging as too little. Let us not forget that the Solvency II framework is already calibrated to a level designed to ensure that every insurer is able to withstand 1-in-200-year events. This level of calibration provides a very strong and significant level of protection for consumers.

While it may be natural for supervisors to be conservative, they should also take responsibility for assessing the unintended consequences of their conservativeness and making these clear to the co-legislators. It is the co-legislators who are ultimately responsible for balancing all regulations against overarching policy priorities that include economic growth, long-term investment, building a sustainable future

Chart 3: Unintended impacts of Solvency II



"Solvency II contributed to a negative impact on guarantee business."



"We invested less than optimally in the real economy due to Solvency II capital requirements."

Overly prudent capital requirements

Volatile and overly prudent capital requirements placed on insurers can have a number of unintended and detrimental effects on insurance customers and the wider economy.

For the consumer, they can potentially lead to higher premiums and lower benefits, fewer attractive and useful products (eg long-term products with guarantees) and lower benefits as a result of sub-optimal investment strategies.

For the economy, insurers' reduced ability to invest in diversified long-term assets has an indirect impact on the creation of jobs and economic growth, while the availability of fewer suitable retirement savings products puts more of the strain of retirement funding back on governments and individual pension savers.

When higher capital is needed because of real risks and volatility, the consequences should be accepted. When excessive capital is due to incorrect measurements and overly cautious regulatory design or calibration, they should not. A great deal of effort has rightly gone into ensuring that companies have sufficient capital. Similar effort should go into ensuring that companies do not have too much capital relative to their actual risks so that they can continue to play their role in the economy.

and improving EU citizens' access to protection and pension/savings products.

The insurance industry's key priorities for the 2020 Solvency II review can be summarised as:

- Improve the measurement of insurers' liabilities, better supporting the link between assets and liabilities to correctly reflect the real economic risks faced by insurers and targeting sources of undue volatility.
- Enhance proportionality and its application in practice.
- Improve reporting by focusing on preserving what is actually needed and has proven useful for supervisors and the public, while removing what has proven to be an excessive burden on companies with no benefit for any stakeholder.
- Preserve the effectiveness of internal models.
- Level the international regulatory playing field.

A well performing insurance sector has much to contribute to society. And an effective risk-based regulatory environment is essential for a healthy industry. Insurance regulation needs to be strong enough to protect policyholders, but should not hinder insurers' ability to provide customers with protection and long-term savings and to support economic activity through the products they provide and the investments they make. Risk-based regulation needs to be carefully designed to measure the actual risks.

As work on the 2020 review of Solvency II gets underway, the insurance industry remains committed to offering technical expertise, experience and evidence to support the discussions.

1 The risk margin is an amount over and above funds needed to pay claims and benefits. Its prudential purpose is to ensure that, should an insurer fail, there are additional funds, above the best estimate of liabilities, to provide further protection to customers.
2 Based on EIOPA data for solo undertakings in the European Economic Area at the end of 2017

OPINION

Denis Kessler
Chairman & CEO, SCOR, France

CLIMATE CHANGE

Hot topic

Tackling the risks associated with climate variability must be a global and shared commitment

Climate variability, the increased frequency of certain extreme events and the growing vulnerability of modern societies to natural hazards have thrown down the gauntlet, challenging us to adapt to climate change. Tackling and addressing the associated risks is a global and shared commitment.

While there is very little reason to believe that climate change could cause systemic risks for the (re)insurance sector — because the associated risks would develop over the long term and would hence allow (re)insurers to adapt and to take mitigating actions — it is necessary for each industry player to integrate climate change issues into strategy-setting, risk-taking, underwriting and investing. (Re)insurers are directly exposed to the risks associated with climate change on both sides of their balance sheets, as risk carriers (on the liability side) and as institutional investors (on the asset side).

On the liability side, a very wide range of property and casualty (P&C) and life risks may be deeply transformed by climate change. In addition to increasingly destructive weather events, climate change-related risks may include water risks, food insecurity, threats to biodiversity, forced migrations, social tensions, political crises and more. Climate change is likely to affect the well-being, health and mortality of populations, and could possibly have an impact on the risk of pandemics.

On the asset side, (re)insurers must face the implications of climate change for their investments, considering both physical and transition risks.

Economic standpoint

A fundamental step when considering the fight against climate change is to examine the normative issue of the compatibility of financial asset prices with the "common good", and to analyse the conditions necessary to ensure that capital allocation on a macroeconomic level maximises collective wellbeing. For instance, if renewable energy projects could be financed at a lower interest rate than those linked to fossil fuels, the energy transition would be the natural outcome of rational investment decisions by economic agents and therefore much easier to accomplish.

This kind of analysis requires a look at the determination of the discount rate used to quantify the economic impact of climate change and value the measures and projects designed to mitigate the associated risks. This discount rate is the crucial parameter used to measure the "sacrifices" made by current generations and to assess the relevance and legitimacy of those sacrifices in light of the estimated wealth of future generations [1]. It is crucial to address latent market short-termism to fight climate change efficiently on the asset side.

> **"It is crucial to address latent market short-termism to fight climate change efficiently on the asset side."**

Absent such an "ethical" valuation — which aligns asset prices with what they should be according to our societal goals — any "common good" problem, such as the fight against climate change, gives rise to moral hazard and free-rider issues. While all economic agents are likely to gain significant benefits in the long term from a reduction in greenhouse gas emissions, few of them want to take action individually and incur their fair share of the costs. Instead, they would rather let their peers shoulder the burden of the environmental transition.

In such a situation, an integrated solution to the issue of climate change requires us to find ways to combat free-riding behaviour. That can be done through well designed economic policies incorporating incentive systems that align the individual interests of the various economic agents with the collective interest[2].

This would help to ensure that businesses include the social cost of the environmental externalities they cause in their production process and would thereby encourage them to implement sustainable development policies and strategies. In this way, negative externalities driving climate change would be "internalised" in the decisions made by all economic agents. Hence it is critically important to articulate the role that the private sector should assume in combating climate change, and the associated technology, regulatory and competition-related issues.

(Re)insurance standpoint

A study published in early 2019 by the CRO Forum highlighted the fact that, due to the risks associated with global warming, maintaining insurability throughout the world may be challenging. The (re)insurance sector has a pivotal role to play in facilitating comprehension, mitigation and protection with regard to the risks arising from climate change for two main reasons: its deep expertise in risk modelling and the structuring of risk transfer solutions, and its fundamental function of pooling risks to optimise diversification benefits.

Protecting the welfare of citizens and communities is an integral part of the (re)insurance industry's corporate mission. In particular, we need to promote insurability and to bridge the "protection gap", because there are still too many people who remain underinsured in both emerging and developed countries. Addressing this global issue requires the combined efforts of governments and the private (re)insurance industry in the form of strong and innovative public-private partnerships.

The industry has been progressively committed to fighting climate change for a very long time. The SCOR group was one of the first to grasp the importance of managing extreme events and the risks associated with climate change by signing the UN Global Compact in 2003. The (re)insurance industry further supported the UN Kyoto Declaration in May 2009, under the aegis of the Geneva Association, the insurance think tank.

Ahead of several international declarations, the Geneva Association clearly stated 10 years ago that climate change poses a major long-term threat to the global economy. It also stressed that the fight against the consequences of climate change needs to be a global commitment requiring the combined efforts of all (re)insurers as their fiduciary responsibility. The Extreme Events and Climate Risk Working Group of the Geneva Association specifically investigates the issues pertaining to climate change.

More recently, in 2016, the Insurance Development Forum was set up by the industry, the United Nations and the World Bank to foster modelling and increase (re)insurance penetration. Furthermore, the (re)insurance industry is closely following and actively supporting scientific research to roll back the frontiers of knowledge and share insights into the main climate change-related risks threatening the world.

ESG on both sides of the balance sheet

The (re)insurance industry is fully committed to being an active contributor to the environmental transition. It is up to each company to define underwriting and investment policies to this end. On the asset side, (re)insurers are increasingly adopting well-defined environmental, social and governance (ESG) investment guidelines, which notably lead them to divest from companies that do not meet minimum ESG standards.

On the liability side, (re)insurers are also increasingly adopting underwriting guidelines that include ESG criteria and accordingly define limits or exclusions for some risks and activities.

It should be emphasised though that, at this stage, (re)insurers cannot adopt a "black or white" approach, which would result in all companies that currently have a weak ESG "rating" suddenly becoming ineligible for insurance cover. Such an approach would obviously be unsuitable. It could harm the protection of their personnel, their clients, the communities in which they operate and their shareholders.

Therefore, the challenge is to optimally manage the energy transition. (Re)insurers should support this transition and help their clients invest in, and achieve, their own sustainable and responsible development. It is important in this respect for (re)insurers to encourage clients who demonstrate improving ESG behaviour and to increase their support for renewable energy-related projects.

In an ever riskier and more uncertain world, the (re)insurance industry has a leading role to play in working towards sustainable and responsible development. It is our collective responsibility to prepare for the industry's future and, more fundamentally, to undertake everything possible to enhance the well-being of future generations.

1 See "Ethical asset valuation and the good society", Christian Gollier, Columbia University Press, 2017

2 See "Economics for the Common Good", Jean Tirole, Princeton University Press, 2019

Olav Jones
Deputy director general, Insurance Europe

SUSTAINABLE FINANCE

From vision to practice

Insurers have a major role to play in the transition to a sustainable economy, but they are not the only ones

Sustainable finance is about taking environmental, social and governance (ESG) considerations into account when investing. As such, it plays a decisive role in the transition to low-carbon, resource-efficient and more sustainable economies that promote inclusive economic growth. The EC's agenda to integrate sustainability considerations into its financial policy framework is new. But sustainability is not new for insurers; it has been a consideration in their investment and risk underwriting strategies for many years.

Indeed, the insurance industry has been a pioneer in sustainable investing. Over recent years and on their own initiative, an increasing number of companies have made commitments to adhere to market principles and standards for sustainable or responsible investing and have set clear goals targeting specific assets for investment or disinvestment, often with stringent timelines.

A variety of strategies are employed, including the use of stewardship and shareholder influence, which are quickly growing in importance. Through these strategies, insurers are contributing not just to environmental but also social objectives. Insurance Europe calculates that European insurers have committed to invest well over €50bn in sustainable investments between 2018 and 2020.

On the underwriting side, in Europe alone, of the €19.5bn total estimated economic losses due to natural catastrophes in 2018,

Key EU initiatives on sustainable finance

- EC: taxonomy for sustainable activities
- EC: disclosure of sustainability risks in investment & advisory processes
- EC: proposals on sustainability in Insurance Distribution Directive
- EC: work on standards & labels for green financial products
- ESAs: work to attenuate short-termism in capital markets
- EIOPA: proposals on sustainability in Solvency II (qualitative)
- EIOPA: work on sustainability in Solvency II (quantitative)

€7.3bn were covered by insurers compensating municipalities, businesses and individuals. Insurers also provide advice on and incentives to adapting to and mitigating the consequences of climate change. In collaboration with policymakers, they work to raise risk awareness and encourage better management of climate-related risks.

Shared responsibility is vital

Transition to a low-carbon and inclusive economy can only occur if all are committed and take their share of responsibility. Yet in recent months policymakers appear to be placing significant emphasis on the financial sector, rather than on sectors that are at the heart of sustainability.

For example, policymakers are seeking to change energy sources by pressuring insurers not to insure or invest in certain energy-producing sectors. This ignores economic and political realities. Ambitious European goals to green the economy are vital, but there must be feasible alternatives available. There is a need for a carefully planned transition — and the insurance industry is ready to support this — but the alternative energy sources, sustainable projects and assets need to be created first.

Sustainability will be a key priority for the Commission that will take office in November 2019. It will need to set out clearly its strategy for how every sector should contribute to the transition to a sustainable economy and how it plans to monitor progress.

Implementation concerns

Over the last year, European co-legislators and the European financial supervisory authorities have been working to ensure that regulatory frameworks incorporate sustainability. Regulations on sustainability were drafted and approved in a very short timeframe and in parallel, creating the risk of inconsistent, infeasible or disproportionate rules.

These initiatives include the EC proposal for disclosure of sustainability risks in investment and advisory processes, EIOPA's work to reflect sustainability in the EU's Solvency II regulatory framework (qualitative requirements) and the explicit integration of sustainability in the Insurance Distribution Directive. Other workstreams relevant for the insurance industry include the EC proposal to establish a classification system, or taxonomy, for sustainable activities and further EIOPA work on embedding sustainability in Solvency II (quantitative requirements).

Together, these initiatives represent a huge step towards an even more sustainable insurance sector, but they can only be successful if their implementation is possible in practice and makes sense, not if speed is prioritised over appropriateness. Despite the need for urgent action, a certain degree of flexibility is necessary to ensure that the proposed requirements can be embedded in insurers' business models in a proportional and efficient manner.

The order and timing of the proposals also needs consideration: European policymakers must prioritise the initiatives and consider the varying sizes and resources of insurers, as well as the economic realities in which they operate, before imposing mandatory requirements. Comprehensive and robust impact assessments should be carried out, including their effects on the stability of financial markets.

Delivering on the EC action plan

To meet its targets under the December 2015 Paris Agreement at the UN Climate Change Conference, which included a 40% cut in greenhouse gas emissions by 2030, the EC has estimated that it must fill an annual sustainable investment gap of about €180bn. The insurance industry can play a fundamental role here, since it is the largest European institutional investor with more than €10 200bn of assets under management and annual gross written premiums of over €1 200bn.

In the last year, EU co-legislators have focused on proposing new rules to enhance risk transparency and bring sustainability into mainstream business processes and functions. While these are clearly needed, ambitious action is also required to first enhance the availability of suitable sustainable assets. Three questions are key for insurers:

- Is it clear what sustainability means and, if not, how can it be made clear?
- Are enough sustainable investments available?
- Are there any regulatory disincentives to investing sustainably?

Creating a taxonomy

A key pillar of the EU's sustainable finance policy agenda is the EU taxonomy to assess the degree of sustainability of investments. Given that all other transparency measures refer back to this concept, its development should be the main priority for the EU co-legislators. The insurance industry has supported the taxonomy proposal from the start. It would welcome its early finalisation but stresses that it must include all three factors — E, S and G — since they all matter to investment decisions, they are interconnected and EU member states have varying interests and needs (some states prioritise infrastructure investment in hospitals, social housing and schools, others investment in renewable energies, etc.).

Fostering investment availability

The key to a smooth economic transition is redirecting financial flows to long-term, sustainable assets that are economically viable and attractive. Today, insurers' willingness to invest sustainably is not matched by the availability of assets. Increasing the supply of assets that meet not only sustainability criteria, but also quality and security requirements, will be fundamental to increasing sustainable investment not just by large, but also by small and medium-sized insurers.

Insurers welcome the European initiatives to attract more institutional investment to long-term assets, which include the European Fund for Strategic Investments (EFSI) and the InvestEU programme with its focus on sustainable infrastructure and social investments, but further action will be needed to ensure that private investment is mobilised and investment targets are reached.

Removing regulatory disincentives

Any regulatory barrier to long-term investing by the insurance industry will also be a barrier to sustainable investment. While not all long-term assets are sustainable, improving the design and calibration of regulations to better reflect the long-term nature of the business will also benefit sustainable investment.

The 2020 review of the Solvency II regulatory framework (see p6) is a key element in the EC's sustainable finance agenda. This was highlighted in the January 2018 report by the EU High-Level Group on Sustainable Finance, set up by the Commission, which recommended investigating how Solvency II could be adapted to facilitate further long-term investment while maintaining its strong risk-based nature.

Solvency II should remain risk-based and should not attempt to artificially support green assets or penalise brown ones via artificially adjusted capital requirements, not least because differentiating between green and brown assets is extremely challenging. The insurance industry supports prudential rules that capture actual risks based on an asset class's risk profile.

Given its fundamental role in the financial system and the economy, the insurance industry is well placed to contribute to the transition to sustainability and is committed to do so. In turn, it is essential that policymakers ensure that any sustainable finance requirements are efficient and effective in achieving their objectives.

Cristina Mihai
Head of prudential regulation & international affairs, Insurance Europe

GLOBAL INSURANCE CAPITAL STANDARD

No competitive disadvantage

The ICS must not result in EU insurers operating at a disadvantage in global markets

2019 represents a milestone for the global insurance capital standard (ICS) project, as the second version, ICS 2.0, is due to be finalised by the IAIS and start a five-year monitoring period. This involves significant work and costs for the European companies involved, which at the same time are having to provide substantial data and input into the major review of the EU's Solvency II framework that is running until 2020 (see p6).

The European insurance industry has two key strategic priorities for the ICS:

- to ensure that the reviewed — and improved — version of Solvency II becomes the European implementation of the ICS, and thus that EU insurers avoid the unacceptable situation of having to run their business under two parallel prudential regimes; and,
- to avoid the ICS leading to further competitive disadvantage for EU insurers globally, especially given that Solvency II is the most conservative regime in the world.

The first of the two priorities will remain for a while, since the ICS is still in development and Solvency II is under review. Broadly speaking, it is key for the European industry that the ICS takes a risk-based approach, is based on an appropriate market-adjusted valuation for the balance sheet and allows the use of both the standard formula and internal models for measuring capital requirements. None of these technical elements have yet been finalised in the ICS.

Testing so far has revealed flaws in the various options tested and confirmed that the IAIS is still some way from finding a framework that captures the risks well enough to both provide consumer protection and avoid unintended consequences. It has also revealed how difficult it is for IAIS members to agree, so final decisions for ICS 2.0 are expected to be taken very late. This leads us to expect that more discussion will be needed during the monitoring phase.

The second priority — avoiding competitive disadvantage — is more complicated, as it relates to the question of just how global the global ICS will be.

How global is global?

Ever since the ICS project began five years ago, the European insurance industry has stressed that the ICS can only be of value as a truly global standard if it receives support from a global community of regulators. The industry has since expressed concerns that political support appears to be lacking in a number of key jurisdictions. On several occasions, the question of just how global the ICS will be has been raised, but without a clear resolution, not least because:

- Supervisors cannot answer the question: the IAIS is a group of supervisors developing standards for the consideration of regulators, so they can only take responsibility for development, not for implementation.
- Regulators cannot answer the question: jurisdictional regulators (with rare and isolated exceptions) have indicated that they cannot confirm whether ICS will be implemented — as it is not yet finalised.

A few months before the finalisation of ICS 2.0 and the launch of the monitoring period, it is not just the technical details that lack agreement and clarity from the IAIS, but also more high-level issues that are key for the European industry. Although most of these issues were agreed by IAIS members when they met in Kuala Lumpur in November 2017, details of how those agreements will be implemented are still lacking.

Going to college

A very clear example relates to the existence and role during the monitoring period of supervisory colleges, which are formed to monitor insurers active in multiple jurisdictions. The Kuala Lumpur agreement foresees that ICS 2.0 will be used for discussion in the colleges. Today, it is clear that all European internationally active insurance groups (IAIGs) have a college, however this is not the case for all non-European ones. ComFrame, the common framework for supervising international groups of which the ICS forms part, which is also due for finalisation in November 2019, does include a requirement for colleges to be set up. So, the question is whether ComFrame is enough to ensure that all IAIGs are treated the same way when it comes to this element of the Kuala Lumpur agreement.

> **"The ICS can only be of value as a truly global standard if it receives support from a global community of regulators."**

A reassurance from the IAIS that all IAIGs will have a college would help ensure comparable application of ICS 2.0-related provisions to all IAIGs in the monitoring period. The existence of colleges for all is key, and it is likewise essential that the ICS-related information that is discussed in the colleges is the same for everyone and that supervisory discretion is avoided, as it could lead to different applications of the provisions.

Comparability question

The most frequently asked, and least frequently answered, question relates to comparability. The Kuala Lumpur Agreement notes that the goal of the ICS is comparable — ie, substantially the same — outcomes. This is important because, although the Kuala Lumpur agreement foresees a reference methodology based on a single market-adjusted valuation, it also allows testing of a different "aggregation" measure during the monitoring period. This aggregation measure would be assessed against the reference to determine whether it leads to substantially the same outcomes.

It appears unlikely that this will be clarified soon, not least because the IAIS is prioritising the technical discussion and the governance of the monitoring period. The European insurance industry has been calling for transparency in the IAIS discussions on this matter and for stakeholder consultation.

Ultimately, it is vital that the ICS, which was intended to increase understanding and convergence, does not have the opposite effect of creating, or increasing existing, competitive disadvantages for specific jurisdictions and/or entities.

OPINION

Alberto Corinti
Member of the board of directors, Italian Institute for the Supervision of Insurance (IVASS)

SYSTEMIC RISK

All systems go

The IAIS aims to have a systemic risk framework for the world's insurers finalised by the end of 2019

In November 2018, the International Association of Insurance Supervisors (IAIS) published, for consultation, a holistic framework for the mitigation of systemic risk in the insurance sector. With this framework, the IAIS proposes to evolve its approach to mitigating systemic risk, which is currently focused only on the potential systemic impact of the failure of individual insurers and is characterised by the application of a predefined set of policy measures to a limited cohort of insurers (global systemically important insurers or G-SIIs), identified annually based on their systemic footprint.

Capturing individual and collective risks

The proposed framework considers both individual and collective sources of systemic threats, ie common exposures and behaviours across the sector that could collectively result in systemic risk propagation. Also, it aims to move away from a binary scope of application of the policy measures, by designing mitigating measures for a wider range of insurers, proportionate to the systemic importance of the relevant sources of risk. In this sense the framework could be considered "holistic".

The underlying assumption is that activities or exposures that could potentially lead to systemic risk at the level of an individual insurer are often substantially the same as those that could determine its amplification at sector-wide level; only the propagation of the risk is different.

Five key elements

Overall, the framework aims to prevent potential systemic risk from building up, to monitor and identify cases in which this nevertheless occurs and, in such cases, to provide tools and processes to mitigate it. Its key elements are:

- An enhanced set of policy measures for macro-prudential purposes — providing the pre-emptive part of the framework — to help prevent certain risk exposures from developing into systemic threats. These measures are often a strengthening of existing policy measures that primarily have a micro-prudential purpose (ie reducing the probability of failure of individual insurers, with the ultimate objective of protecting policyholders), but that may also help decrease the probability of negative externalities to the system.
- A global monitoring process by the IAIS to detect the possible build-up of global systemic risk in the insurance sector at individual insurer level and at sector-wide level, taking into account how its nature can vary over time and capturing, as far as possible, cross-sectoral and general financial market developments.
- Where a potential systemic risk is detected, a set of supervisory powers of intervention that, when needed, should make possible a prompt and appropriate response by national supervisors.
- A process, based on a collective assessment of potential threats and consequent responses, to help ensure an appropriate, transparent and consistent application of the policy measures and interventions at jurisdictional level.
- An assessment by the IAIS of the consistent implementation across jurisdictions of enhanced supervisory policy measures and powers of intervention.

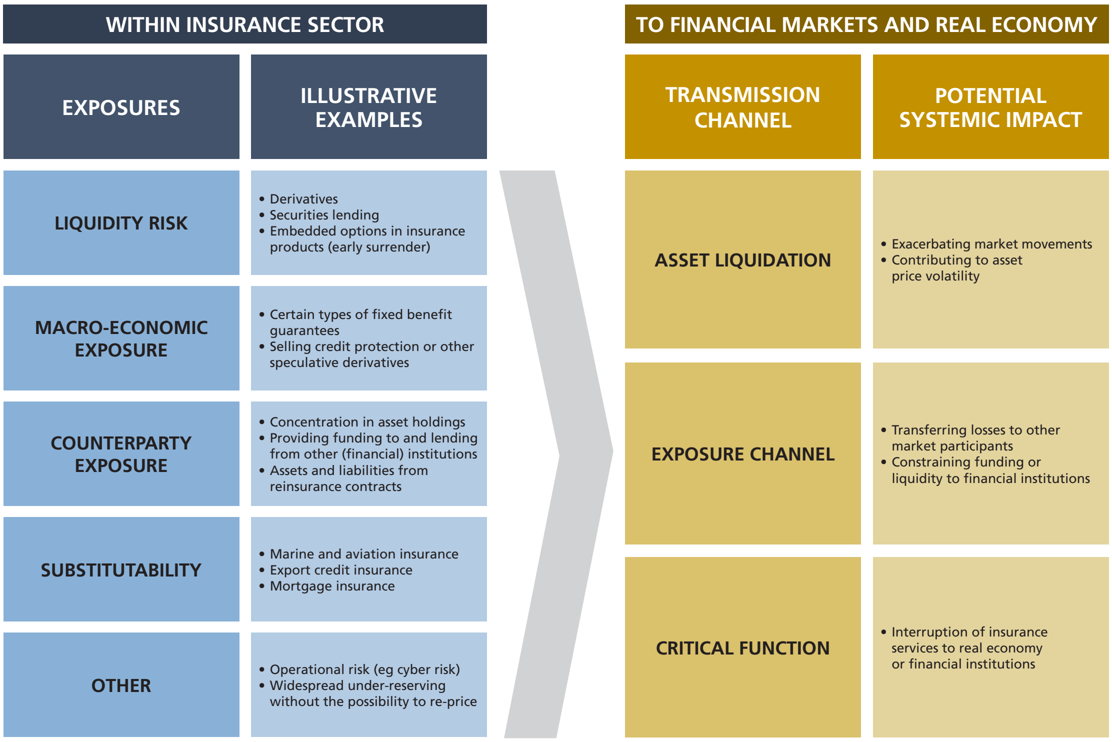
The proposed framework includes proportional application of most of the policy measures that currently only apply to G-SIIs to a broader set of insurers through the Insurance Core Principles (ICPs) and ComFrame. In this context, a standardised form of a higher loss absorbency (HLA) standard is not part of it, but reinforcement of the financial position is proposed to be integrated as a supervisory power of intervention.

Ensuring success

Will this framework achieve its objectives without undesired consequences? The above elements, in my view, also identify its main challenges and the factors that will determine its success. That success will depend on:

- How the measures to mitigate the sources of systemic risk are implemented in national jurisdictions and how national supervisors enforce them; in particular, how they use the discretion left by the framework to identify the

Potential sources of systemic risk and their transmission



Source: Public consultation document: Holistic Framework for Systemic Risk in the Insurance Sector, IAIS, November 2018

scope of the measures and to calibrate the intensity of their application, proportionate to the risk exposure.

- How effectively the global monitoring exercise by the IAIS will be able to promptly detect potential systemic threats, both at individual-insurer and sector-wide level.
- How national supervisors make use of their own macro-prudential monitoring and the collective assessment at the IAIS when applying the policy measures and deciding if and which intervention should be taken.
- How effective and transparent the collective assessment at the IAIS will be in identifying global systemic threats and supporting prompt, consistent and transparent responses by national supervisors.

Finally, for all the factors above, it will be key that the implementation assessment process of the IAIS will be effective in supporting appropriate and consistent implementation globally, not only in relation to the power and ability of national supervisors to enforce the measures, but also to the concrete supervisory practices used.

Finalisation of the framework, which is planned by the end of 2019, would certainly represent a unique occasion to endow the insurance sector with a systemic risk mitigation framework that is consistent with the overall financial sector approach, but also tailored to the specificities of insurance. Its success will depend not only on its design but, more importantly, on how supervisors apply it and their ability to work together at IAIS level to address any global systemic threats.

Regional debates

At a European level, enhancing the macro-prudential framework through the mitigation of systemic risk is one of the key issues currently being debated. EIOPA has published a series of papers on systemic risk and macro-prudential policy in the insurance sector. The European Systemic Risk Board published in November 2018 a report on macro-prudential provisions, measures and instruments for insurance.

Overall, these papers contribute to the ongoing discussions on strengthening the EU regulatory framework by including a macro-prudential perspective. The EC has also included macro-prudential supervision in its call for technical advice to EIOPA on the review of Solvency II. Eventually, any EU regulatory development could be seen as a concrete implementation of the IAIS framework. Similar developments are or should be under way in other jurisdictions. It will be vital that all those workstreams develop in a consistent way and eventually create a coherent, efficient and globally harmonised macro-prudential framework to support global financial stability.

Olav Jones
Deputy director general, Insurance Europe

FINANCIAL REPORTING

Standard deviation

Two key International Financial Reporting Standards need changes to make them work for insurers

The insurance industry strongly supports the goals of the International Financial Reporting Standards (IFRS) defined by the International Accounting Standards Board (IASB), which are to achieve high quality global accounting standards that provide meaningful, consistent and reliable financial reporting.

Financial reporting is particularly important for the insurance industry, which is both a preparer and a user of reports. As preparers, insurers see an impact from IFRS on their products and investments. IFRS can also impact the cost and availability of the capital used to cover the high levels of solvency that help ensure companies remain strong and safe. And insurers are significant users of financial reporting, relying on financial information for their investment activities. Indeed, the European insurance industry is the region’s largest institutional investor, with over €10 200bn of assets under management.

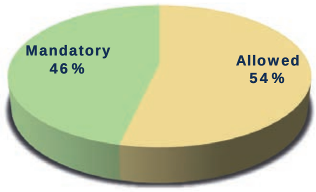
Big in Europe

Since 2005, European regulation has required IFRS for consolidated reporting for all insurers that have shares or bonds listed on regulated exchange markets. However, significantly more insurers are affected by IFRS across Europe because many countries have opted to permit or require all companies, including unlisted insurers of any size, to apply IFRS. In fact, IFRS is mandatory for unlisted companies’ consolidated financial statements in over half the countries in the EU (see chart on p22).

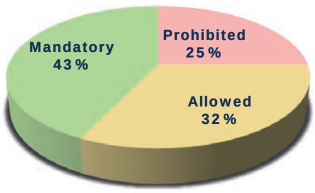
IFRS use in the EU

Listed companies' consolidated reporting

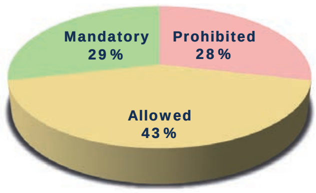
Unlisted companies' consolidated reporting



Listed companies' statutory reporting



Unlisted companies' statutory reporting



Sources:
"Overview of the use of options provided in the IAS Regulation (1606/2002) in the EU", Accounting Regulatory Committee, December 2013
Insurance Europe survey, November 2017

Two key standards affect insurers in particular: IFRS 17, which applies to insurance liabilities, and IFRS 9, which applies to the investment assets that insurers hold to back those liabilities.

IFRS 17: improvements needed

IFRS 17 was published in May 2017 after a 20-year international debate around insurance contract measurement and it has continued to be a major area of concern for insurers in Europe and globally.

Soon after publication, the European Commission asked the European Financial Reporting Advisory Group (EFRAG) for advice on whether Europe should endorse and apply IFRS 17. The extensive testing coordinated by EFRAG as part of its assessment, along with implementation projects by companies, provided significant new information and evidence of industry concerns.

The insurance industry identified the need for more time to implement the standard and 11 areas in which improvements to it were needed in order to address significant issues and their impact on correct measurement, operational complexity and implementation challenges. EFRAG wrote to the IASB raising concerns about six of these areas.

Insurance Europe, together with many other insurance associations from across the world, called for the standard to be reopened and the application date to be delayed by two years to allow time both for the necessary improvements and for the wide range of companies that are affected to implement the standard.

In October 2018, and supported by the wider industry, the CFO Forum, which includes the chief financial officers of 23 major European insurers, proposed solutions for all the industry's 11 areas of concern.

Insurers' therefore welcomed the IASB's decision to consider reopening the standard and to explore potential areas for improvement, including the issues raised by the industry. The IASB also decided to consider a one-year delay to the date the standard is due to become effective.

European insurers recognise the considerable work done by the IASB to date in its assessment of the issues. The CFO Forum presented its assessment of those proposed amendments to EFRAG in March 2019. This analysis indicates that, while the IASB has proposed some helpful changes, many issues remain unaddressed.

Insurance Europe has been engaging with the Commission, EFRAG, the IASB and the European Parliament, while also working closely with the CFO Forum and coordinating with other associations worldwide to provide a clear industry message to the IASB. It will continue to do so looking ahead to the IASB exposure draft expected in June 2019.

IFRS 9: problems with equity treatment

Capital gains form on average about 60% of the total yield from equity investments, so it is important that they are included in insurers' profit and loss (P&L) statements. It is also important that there is a mechanism to avoid short-term volatility in price movements providing misleading performance signals to users. This short-term volatility impacts unrealised gains and losses but does not affect the actual financial outcome for an insurer.

IFRS 9 provides, through the use of FVOCI (fair value through other comprehensive income), the mechanism to avoid price volatility distorting the P&L account by keeping the short-term volatility within the OCI part of the accounts. However, under IFRS 9, if FVOCI is used, insurers will not be allowed to recognise any of the actual realised gains from equity investments in the P&L. Allowing realised capital gains to be recognised in the P&L as they move out of OCI is called "recycling" and without it IFRS profits do not reflect the true financial performance.

Insurance Europe therefore lobbied during the development of IFRS 9 for recycling to be allowed and has since highlighted it as an issue that should be addressed, arguing:

- There is a need to allow recycling for equities measured at FVOCI as it is the only way to ensure the P&L account correctly reflects the financial performance of long-term investors.
- Insurers recognise that impairment rules would be needed as part of this and are in favour of an impairment model similar to International Accounting Standard 39.
- The recycling rules should also apply to equity-like investments such as UCITS (undertakings for collective investment in transferable securities).

The Commission has asked EFRAG for advice on solving this. In its endorsement of IFRS 9, EFRAG noted that IFRS 9 might not reflect the business model of long-term investors because of the prohibition of recycling, which led to the EC's first request for advice. As part of its Action Plan on sustainable finance and to foster long-term investment, the EC then asked EFRAG in June 2018 to also investigate "alternative" methods of accounting for long-term equity investments by the second quarter of 2019.

Insurance Europe welcomes the EC's recognition that this issue can affect insurers' willingness and ability to invest in equities and it will continue to seek a solution to the issue.

Ensuring that accounting standards work as intended for insurers is crucial, given the importance of financial reporting to them and the key role they play in providing society with protection and investment products, funding economic growth and contributing to financial stability.

The challenge of developing IFRS for insurers

International Financial Reporting Standards prescribe principles for companies to apply in their public financial reporting. It is a challenge to develop ones that work as intended for insurers because of the specific nature of the insurance business model.

Insurers manage risks by pooling across customers and over time, but also through a range of risk management activities and techniques including policy limits, asset-liability management, hedging, reinsurance and holding a great deal of solvency capital. To correctly capture these core elements of insurance, accounting rules — and indeed regulations in general — need to:

- take account of the pooling of costs and risks and therefore apply at portfolio rather than at contract level;
- cope with business where the costs, income and risks apply over many years rather than within a reporting period;
- recognise the economic impact of the links between assets and liabilities and how asset performance can, in some cases, change the liabilities; and,
- recognise the impact of risk-taking, risk mitigation and risk management.

It is not easy to develop accounting standards that correctly capture all these elements as well as insurers' very wide range of product types, features and investment strategies. Solutions that could work for one company or market will sometimes not work for others.

William Vidonja
Head of conduct of business, Insurance Europe

REGULATION

Making rules that work

Beware EU insurance regulation and regulatory processes that ultimately fail to benefit citizens, warns William Vidonja

Consumer protection is rightly taken very seriously by EU legislators. And the insurance industry itself firmly supports high-quality EU insurance regulation that protects consumers effectively and enables it to serve them fairly. Insurance is an industry that is based on trust, so a firm underpinning of appropriate regulation is essential for a well-functioning industry to remain reliable and trustworthy.

Unfortunately, financial services regulation in the EU has not always achieved that ultimate aim of benefiting consumers. And the regulatory processes themselves do not always lend themselves to good outcomes.

Lamfalussy has limitations

There seems to be increasing evidence that the EU's four-level "Lamfalussy" process for creating financial services regulation, which was first introduced in 2001 and subsequently reformed after the financial crisis, is playing a role in this. Under it, basic laws and framework principles are proposed by the European Commission and adopted by the European Parliament and Council in the usual way, but the details are left to be worked out at "Level 2" by the Commission with input from supervisors, as well as via "Level 3" measures developed — at times separately — by both the Commission and the supervisors.

Instead of creating legislation that is fit for purpose and of high quality,

Don't forget insurance employees

Legislative requirements can have unforeseen consequences for the insurance workforce. Mandatory "know your customer" questions, for example, can lead to threats, insults and even violence against the employees that have to ask them.

The EU's Insurance Sectoral Social Dialogue Committee (ISSDC), which brings together employer and employee representatives, issued a declaration in February 2019 on the effects of regulatory requirements and compliance on the wellbeing of employees.

The declaration (available on the Insurance Europe website) identifies a substantial rise in employees' workloads and stress levels due to a significant increase in regulatory requirements and the related compliance procedures, with the burden being felt particularly by those working at smaller entities.

The ISSDC therefore called on EU regulators to:

- involve the insurance social partners in the legislative process, including implementation and reviews;
- allow sufficient time to implement regulations and train staff; and,
- address the combined effect of new and existing legislation.

the Lamfalussy process has resulted in a "trial and error" approach that has in fact led to legislation that frequently fails to meet its intended objectives and therefore regularly has to be revised, complemented and reinterpreted.

In recent years, insurer have been confronted with a significant increase in the quantity of regulation, a decrease in its quality and all too regular reviews and amendments to legislation, sometimes even before markets have had time to adjust to the new rules and before there is sufficient evidence of a need for change.

While it is insurers that face the immediate negative effects of this triple hit, the ultimate losers are consumers in terms of the cost, variety and quality of products and the standard of customer service available to them as a result of the insurance industry being hindered from working optimally.

For example, the PRIIPs Key Information Document (KID), which was supposed to help consumers take informed decisions, is in reality too difficult for consumers to understand, not clear enough to enable comparison and, at times, even misleading (see p30). To address the flaws in the KID, the adoption of the PRIIPs Regulation and its delegated regulations was followed by Commission guidelines, several successive batches of Q&As by the European supervisory authorities and a supervisory statement. And now the delegated regulations are subject to a mini-review ahead of a formal PRIIPs review that could result in further changes to both the PRIIPs Regulation and delegated regulations, therefore most likely necessitating new Level 3 measures.

These successive changes to the PRIIPs KID not only result in unreasonable and unnecessarily high compliance costs for the industry, but they could also confuse consumers further and reduce their trust in the information they receive and ultimately in the insurance industry.

Quantity versus quality

The Commission's 2019 Work Plan alone contained 15 new initiatives, 10 reviews of existing legislation and a staggering 45 outstanding priority proposals, many of them in areas that affect the insurance industry. Meanwhile — and possibly because of the sheer number of initiatives — the quality of recent EU legislation has diminished and here we would highlight three particular areas of concern.

Firstly we have seen an increasing number of cases where legal uncertainty has been created. During the legislative process, policymakers tend to prioritise quick political achievements over the quality of the new rules, assuming that the rules can be improved during future reviews or that the Level 2 or 3 measures can address the Level 1 shortcomings.

Need for a holistic view

As a result, we have been confronted with inconsistencies, overlaps and duplications between different pieces of legislation because the cumulative impact of individual rules is not considered and the coherence of the entire regulatory framework is not taken into account.

For example, 2016's Solvency II Directive and 2018's PRIIPs Regulation, Insurance Distribution Directive and General Data Protection Regulation were each developed in isolation, leading to a 250% increase, from 33 to 115, in the number of individual disclosures that a broker is required to make to a customer when selling an insurance-based investment product. The number for an online sale is an unfeasible 161 disclosures. The negative impact on consumers is clear.

We have also been faced with outdated rules; the PRIIPs Regulation, for example, requires pre-contractual information to be provided to consumers on paper by default — highly inappropriate in our digital age (see the article on digitalisation on p35). More efforts are required on the side of legislators to allow the insurance industry to use modern digital tools that can improve the experience of customers and that customers now expect to be available.

Compliance concerns

Deficiencies in the EU law-making process are also creating compliance headaches for insurers. Companies are often left with insufficient time to implement required changes to their processes and train staff (see box on p25), or they face substantially increased implementation costs because of frequent changes in legislation.

To take just one recent example, companies would have been left with just two months — once all the Level 2 measures had been developed and adopted — to implement all the changes they needed to make to comply with the Insurance Distribution Directive and its Level 2 delegated regulations. Only following repeated and strongly argued requests by the insurance industry was a seven-month delay to the implementation date eventually secured.

> **"We have been confronted with inconsistencies, overlaps and duplications between different pieces of legislation because the cumulative impact of individual rules is not considered."**

> **"More efforts are required on the side of legislators to allow the insurance industry to use modern digital tools that can improve the experience of customers."**

Increased compliance costs and risks have a negative effect on insurers' competitiveness and hence on the services they provide and the prices they charge to customers.

Insurers have the experience and knowledge to support policymakers in developing quality EU regulation that is effective and truly benefits consumers. EU policymakers should take advantage of this expertise when drafting legislative proposals.

Time for a fresh start

With Parliamentary elections in May 2019 and a new Commission taking office towards the end of the year, there is a clear opportunity for Europe's new legislators to take a fresh approach to financial services legislation; one in which regulation delivers on its intended objective of better protecting consumers; one in which insurers can serve their customers fairly; and one in which compliance costs and risks are kept to a minimum.

To achieve those aims, it is vital that EU policymakers always:

- focus on quality rather than quantity;
- develop rules that are fit for purpose and not copied blindly from other sectors;
- consider the cumulative impact and coherence of the regulatory framework;
- undertake thorough consumer testing;
- create digital-friendly and future-proof regulation;
- ensure sufficient time for implementation; and,
- hold timely and meaningful consultations with all interested parties.

Getting regulation to work, rather than getting it done, must be the priority for the new institutions.

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

PENSIONS

PEPPing up provision

Agreement on a pan-European pension product, or PEPP, is an important milestone, but its effects on levels of saving remain to be seen

National pension regimes are under strain the world over, as populations age and public finances are squeezed. The situation in the EU is no different and, although pension provision comes under the remit of national governments, EU policymakers have been looking at ways to stimulate pension saving. After nearly two years of negotiations, in early 2019 they found common ground on the design of a pan-European personal pension product (PEPP) that is intended to complement national regimes and be portable between EU states, thus reaping the benefits of European scale.

Overall, the agreement reached between the EU institutions has brought greater clarity to the original text of the European Commission and has addressed some issues of major importance to the insurance industry, Europe's largest personal pension provider. In particular, the insurance industry welcomes the removal of the requirement that each PEPP offers a "sub-account" in each member state, as this would have been beyond the resources of all but the very largest pension providers.

The clarification of the rules on switching providers, with the introduction of a fixed minimum holding period, will provide savers with greater flexibility while still allowing PEPP providers to manage investments over the long-term. The insurance industry also supports the clarification that guarantees are due at the start of the decumulation phase (ie, when assets are withdrawn) — rather than

Insurance Europe contributes to EC planning

In July 2018, the European Commission established a high-level expert group to create a roadmap for the pension policies of the next Commission's five-year term, which will start in November 2019. Insurance Europe is part of the group, providing the perspective and experiences of the insurance industry. The group also includes other pension providers, academics, regulators and other interested parties.

The group is due to deliver a report by the end of 2019 — identifying the main challenges to the provision, adequacy and sustainability of supplementary pensions, as well as making concrete policy recommendations to address them.

at the point at which a saver switches provider — and that they should not cover inflation, costs and fees.

Given the variety of providers eligible to offer PEPPs — and the different rules that apply to them depending on their type — Insurance Europe welcomes the fact that the information disclosures and distribution rules focus generally on the level of guarantees and the risks entailed by a particular type of PEPP. Last but not least, the introduction of stand-alone, pre-contractual information requirements tailored to the specific characteristics of a PEPP will hopefully result in a meaningful PEPP key information document, or KID, that will enable savers to select the PEPP best suited to their needs.

Impact uncertain

Despite these welcome improvements to the Commission's original PEPP proposal, it is still too early to predict how popular PEPPs will prove to be or to estimate what their impact could be on levels of pension saving across Europe. This is primarily because a number of crucial questions have not been addressed in the Regulation and remain to be dealt with in the secondary, "Level 2" measures or through guidance by supervisors.

For instance, the EU institutions have agreed to have PEPPs "registered" nationally. The PEPP Regulation sets out the roles to be played by the responsible authorities in the home and host states, the conditions that have to be fulfilled to apply for registration, the steps in the process and the timing. However, it does not establish the criteria to be considered by the national authorities when assessing PEPP applications, which are vital both to ensure that the PEPP label is a sign of quality across Europe and to avoid inconsistencies between categories of providers and of products. Only time will tell whether the national approaches will converge.

The agreed PEPP registration process introduces another unknown, as it challenges established supervisory practices. Under the current EU supervisory framework in place since the 1980s, national authorities supervise providers, not products (with exceptions in the securities sector). So a PEPP authorisation process is uncharted territory for the insurance and banking sectors and it is unclear what this product-based supervision will mean in practice.

Taxing questions

The issue of taxation remains the "elephant in the room". The PEPP proposal was published with a non-binding recommendation inviting member states, which are exclusively responsible for tax matters, to grant PEPPs exactly the same tax

treatment as national personal pension products, even when the PEPP does not match all the national criteria required to benefit from tax relief. What is unclear at this stage is how granting the same tax treatment regardless of the design of a particular PEPP product will work in practice and, indeed, why member states would do so if very strict conditions have to be met in their jurisdiction.

Furthermore, EIOPA must develop a long list of technical standards within 12 months of the Regulation's entry into force. The fact that important elements of the PEPP framework will be determined at a later stage by EIOPA makes it difficult to assess how PEPPs will look in the end. Also, leaving these elements to Level 2 raises questions, particularly for more political issues, such as the one of ensuring a fair level playing field between providers.

For instance, it is not clear if the 1% cap on costs will cover all types of costs, or whether it will exclude those related to the provision of specific features such as guarantees, biometric risk coverage and personalised advice. Establishing an unrealistic cap on costs would reduce the diversity of PEPPs on offer and have a detrimental impact on insurers' ability to distribute PEPPs with guarantees, biometric risk coverage and annuities, thus depriving savers of these additional protective features.

Likewise, under the PEPP Regulation, both capital guarantees and conservative investment strategies (including life-cycling) backed by risk mitigation techniques are eligible investment options. However, these techniques fall under different prudential rules, if any, and tend to serve different purposes.

EIOPA has been asked to define the risk mitigation techniques to be used by providers to render certain types of investment strategies eligible for the PEPP. This will be crucial, as it will largely define providers' ability to design attractive investment strategies and, most importantly, build on the strengths of their business models. It is crucial that EIOPA's work avoids distortions based on the sectoral regulatory framework applicable to different providers and at the same time ensures that the capital savers invest is equally protected to foster their trust.

The PEPP is a highly ambitious European project and a key component of the EC's plan for a Capital Markets Union, as it seeks to channel more savings into long-term investment. With the PEPP, the EC has tried to give a European dimension to products that are intrinsically national. While it is to be praised for its proactive approach, and while the objectives of closing the pension savings gap and promoting long-term investments are welcome, much effort will still be needed on all sides in the coming months to make the PEPP a success.

Jérôme Roncoroni
Chair, conduct of business committee, Insurance Europe
Internal audit director, Covéa, France

PRIIPS REGULATION

No quick fix

The 2019 review of the EU's PRIIPs Regulation can fix its problems — but it must not be rushed

The EU's Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation came into force in January 2018. Since then, insurers have produced key information documents, or KIDs, for all their insurance-based investment products. These are intended to provide consumers with clear and accurate information before they purchase a product.

The PRIIPs Regulation was an ambitious project. The aim of providing harmonised and comparable information for all investment products across all EU jurisdictions was commendable, but pulling it off was always going to be challenging.

Eighteen months on, it is clear that the PRIIPs rules are not working. The information provided to consumers is not clear, it often does not capture key features of a product, and at times it is simply misleading.

There is still time to fix this. The 2019 review of the PRIIPs Regulation provides an opportunity to put the major flaws right, but only if it is done properly and if lessons are learned from the mistakes made during the original drafting of the Regulation.

What went wrong?

While policymakers had the best of intentions with the PRIIPs Regulation, they lacked the commitment to technical detail to make it a reality. Ultimately, this meant key decisions were not taken during legislative discussions, but were pushed to the European supervisory authorities (ESAs) to sort out.

The ESAs were left to manufacture methodologies that would fit the broad scope of products to be covered in the PRIIPs Regulation. Products ranging from funds to guaranteed life products to exchange traded derivatives had to be shoehorned into a single formula to calculate values representing key features of these diverse products.

To make matters worse, the scope of the Regulation was so broad that some products that policymakers had not even considered ended up in its scope. This meant that the scope was too broad to ensure meaningful KIDs for all possible PRIIPs.

Added to this, the process of drafting these new detailed rules became fraught with political pressure to finalise it rapidly. Changes to key sections ended up being rushed at the last minute — notably the finalising of the methodology for presenting the performance of products — and left very little time for insurers and their national supervisors to deal with smooth implementation.

What doesn't work?

Not everything about the PRIIPs Regulation has not worked. Information on costs expressed in terms of the reduction in yield included in the KID, while not perfect, is a significant improvement on any cost disclosures included in other EU legalisation. The information provided seems to be well understood by consumers and gives accurate information on this key aspect of any product.

Other areas, however, need improvement. The presentation of performance in the KID is widely accepted as being inaccurate. By taking the five previous years' performance and projecting this into the future, some KIDs show projected returns of over 1000%. Even at the less extreme end, we need to ask ourselves whether providing a "moderate" projection that suggests returns of over 30% is reasonable when we know consumers cannot expect to see these levels of return.

Insurers also face additional problems, as they are required

"If the PRIIPs review is carried out correctly, we can get a lot closer to achieving the laudable aims of the original Regulation."

to provide performance scenarios for products that are not designed to have investment performance at all. A client buying a lifelong annuity or cover for their funeral expenses is not making an investment, but is purchasing an insurance product. There is no sense in providing them with projected returns.

Policymakers also need to look at whether KIDs are providing the right type of information, and to do this they need to acknowledge that this may vary between products. To ensure comparability, every KID could indicate whether additional insurance features are included, but detailed information on the cover would only be needed for those products that actually provide cover.

We already have a great model for presenting information on insurance coverage: the insurance product information document (or IPID) used for non-life products under the Insurance Distribution Directive.

Policymakers need to look carefully at what can be learned from the simplicity and user-friendly nature of this document. And they need to honestly assess the scope of PRIIPs. When a product is designed to offer insurance cover and only has an insignificant investment element, they should frankly question whether the rest of the PRIIPs KID is really useful at all.

"Where consumer testing does not provide a clear answer, policymakers need to be brave enough to go back to the drawing board and start again."

What needs to happen now?

If the PRIIPs review is carried out correctly, we can get a lot closer to achieving the laudable aims of the original Regulation and provide consumers with useful and comparable information on the products available to them.

Firstly, we need to accept that the problems cannot be fixed quickly. The initial Regulation and accompanying implementing legislation took years to draft and still fell short. Fundamental problems are not going to be solved with quick fixes or interim measures. It is better to take the time needed to get this right once and for all.

Secondly, we need to take care not to overload the KID with further information that could confuse consumers. For example, although it is unlikely that a single methodology or standard presentation of performance will work for all insurance-based investment products, it is important not to end up with two measures of performance in the same KID.

Thirdly, getting it right will mean extensive consumer testing that captures all products in the Regulation's scope. Not only must this include all the various sorts of products in its scope, it must also recognise national differences; what works for a guaranteed product in Spain may not work for a similar-sounding product in France. Where consumer testing does not provide a clear answer, policymakers need to be brave enough to go back to the drawing board and start again, not accept the least bad option.

And finally, the market and consumers need to be given time to adjust to the new KID once it is finalised. Constant tinkering with the detail of the KID will not aid consumer understanding and will make comparability between old and newer products impossible. Repeated changes will confuse consumers and will devalue the KID's reputation as a reliable document.

Fixing PRIIPs will not be easy. It is vital that the efforts to do so do not repeat the mistakes of the past and finally develop rules that provide consumers with the information they need.

Janina Clark
Editorial manager, Insurance Europe

FINANCIAL EDUCATION

Wise words

Insurance Europe's financial education activities — under its "InsureWisely" branding — have continued to spread their wings

The need for individuals to be financially literate is increasing. Strained social welfare systems mean people are more responsible for their personal finances than ever before, while developments in technology and in financial products and services are revolutionising all financial sectors.

Yet research consistently shows low levels of financial literacy worldwide. The S&P Global Financial Literacy Survey, which assessed 150 000 people in over 140 countries back in 2014 on four fundamental concepts — knowledge of interest rates, interest compounding, inflation and risk diversification — found that financial literacy was shockingly low: just one in three people worldwide understood three of the four basic concepts.

And good financial literacy is essential not only for individuals but also for the economies in which they live. If people do not understand finance and financial products, they are excluded from financial markets and the overall health of economies is affected.

Welcome work by the OECD

The OECD is drafting a Recommendation on financial literacy and education, aiming to create a single, comprehensive, global standard to assist governments, public authorities and other stakeholders in designing, implementing and evaluating financial education strategies. Building on previous OECD work, it was developed by the OECD International Network on Financial Education.

The Recommendation includes specific suggestions on insurance issues, proposing that financial education programmes and campaigns promote a culture of responsibility for personal protection and prevention, covering risks, issues of insurance cover and innovative or complex insurance products.

Insurance Europe responded to the public consultation on the Recommendation in March 2019, welcoming the substantial work done by the OECD on financial literacy and education and the explicit identification in the Recommendation of insurance as a component of financial education strategies.

In its response, Insurance Europe suggested that one of the best ways of changing individuals' behaviour is by starting early and integrating financial literacy into school curricula, but it also suggested that the workplace can likewise be an effective setting for providing information. It called on European and international policymakers to play a greater role in supporting national strategies, in particular urging the EC to come forward with a Recommendation of its own.

Research also suggests that people's knowledge is often weakest in the area of risk diversification, which has direct implications for their understanding of insurance and behaviour towards risk.

Insurance Europe and its member associations have a long history of engaging in a wide range of financial education initiatives and in January 2018 Insurance Europe launched its "InsureWisely" brand, under which it now brings together its activities.

Over the last year, it has published three infographic factsheets — on motor insurance, travel insurance and home insurance — with tips to help people understand their risks and choose the right cover for their needs.

The motor insurance infographic was published together with a separate one-pager of advice on what drivers should do if they have a road accident while driving abroad. The home insurance infographic was released to coincide with the annual Global Money Week in March 2019.

All the factsheets are available in the InsureWisely section of Insurance Europe's website, which also showcases the many and varied initiatives of Insurance Europe's member associations to boost financial literacy and the understanding of insurance.

Insurance Europe's 11th International Conference on 23 May 2019 will feature a panel debate on financial education for the 21st century. The panel will exchange best practice and look ahead to the financial literacy needs of the future.

Frédéric de Courtois
Vice-president, Insurance Europe
General manager, Generali Group, Italy

DIGITALISATION

Tomorrow's world

If insurers and their customers are to get the best from increased digitalisation, legislation must be future-proof

The insurance industry is constantly innovating to better meet the evolving needs and demands of consumers. Technological developments are significantly changing consumers' expectations of insurance, while the digital environment enables both established companies and start-ups to bring innovations to market much faster and to better meet these emerging needs.

The EU regulatory and supervisory framework for insurance should be conducive to innovation and allow consumers and businesses to benefit from the opportunities that digitalisation can offer. This is currently not the case.

There are still regulatory barriers to providing insurance to consumers online. For example, paper requirements were recently introduced as the default method of information disclosure under the Insurance Distribution Directive (IDD) and the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation (see p30). EU legal texts should be digital-friendly, technologically neutral and sufficiently future-proof; insistence on paper information provision does not reflect the growing digital trend. Such requirements only hold back innovation and the provision of online services, which consumers today expect to be easy to use and available.

Big data: big benefits

In today's digital world, enormous, unstructured sets of data can be collected from widely diverse sources. Mining this "big data" has the potential to bring benefits to consumers in terms of the insurance products available and their price, the way products are distributed and sold, customer service and claims-handling.

Insurers are currently exploring the many possible opportunities for using big data to optimise their business and the outcomes for consumers. These include: better analysis of whether products work as intended and reach the right consumers; easier detection of fraud with resulting benefits for honest customers; better risk-management advice to consumers; more tailored products; and cover for previously uninsurable risks.

A comprehensive framework of EU rules — including the Insurance Distribution Directive and the General Data Protection Regulation (see p41) — ensures that big data is used responsibly in insurance. Data has always been vital to insurance; big data is set to be just as, if not more, important.

An additional requirement under the IDD that may present a barrier to innovation concerns the provisions on product oversight and governance (POG) and the specific requirement to carry out appropriate product-testing. In an environment of innovation, speed is key and product-testing is carried out in real time. It is therefore important to ensure that any requirement to carry out product-testing is reasonable and conducive to supporting innovation, and does not unnecessarily lengthen the time needed to bring innovative products and solutions to market. This should be the case regardless of whether the product is developed by an established insurer or an insurtech start-up.

Insurance Europe has also been stressing the importance of ensuring proper and consistent application of the principle of proportionality to insurance legislation to enable both established market participants and insurtech start-ups to provide innovative products and solutions, and avoid giving a competitive advantage to one type of market participant over another when the activity and risk are the same.

> **"EU legal texts should be digital-friendly, technologically neutral and future-proof."**

Data challenges and opportunities

It is not only insurance-specific legislation that can present obstacles to innovation. Access to adequate data is of paramount importance to insurers and is at the heart of their business, allowing them to assess risks and informing their underwriting decisions, as well as to develop new and innovative products and services. This raises a number of important considerations that policymakers need to bear in mind.

For instance, due to the increased use of digital means, as well as EU legislation addressing companies' obligations relating to cybersecurity, the demand for insurance cover for associated risks is increasing in the EU. Insurance has a key role to play in helping to increase society's cyber resilience (see p38). Beyond compensating losses caused by cybersecurity incidents, insurers can help citizens and companies implement prevention measures to avoid cyber incidents as far as possible and to mitigate the effects of successful attacks as quickly as possible.

However, cyber insurance is still in its relative infancy. One of the reasons for this is that it is a difficult market to underwrite, characterised by a lack of data and by historical loss data that is of limited value because cyber risks are constantly evolving. Sharing information about attempted or actual cyber incidents with the insurance industry is therefore vital. Insurers and policymakers need to work together to channel useful data so that cyber risks can be better understood and managed.

Insurers could, for example, be granted access to the (anonymised) data gathered as a result of cyber-incident reporting requirements, such as the notification obligations under the EU's General Data Protection Regulation and its NIS Directive on the security of network and information systems.

To support the discussions on this issue at European level, Insurance Europe has developed an EU template for data breach notifications and recommended that EU provisions be put in place to maximise the use of the data gathered under the different reporting requirements. These provisions should allow insurers to access this data in an anonymised format, which would help improve coverage and protection against cyber risks for companies of all sizes.

Ensuring an appropriate framework for data access and (re-)use in the digital economy is also key, particularly given the important role data plays in driving innovation. The ability to fully utilise large data sets is core to insurance in the development of customer-centric, innovative, tailor-made products, deepening understanding of risks to the benefit of the customer and society, increasing product innovation and encouraging competition.

Safeguarding data ownership

However, insurers do not generally produce or control the connected devices and vehicles that generate this data. If the manufacturers of such devices have the ability to restrict access to raw data (either by the customer or by potential competitors), it could lead to a monopoly on access to big data. Whether the data is being created and/or used by established insurers, insurtech start-ups, technology companies or other third parties, such as connected car or smart device manufacturers, it is important to safeguard data ownership.

Data should be treated as being owned by the customer and not by the manufacturer. EU legislation must always ensure that it is customers who decides whom they allow to use their data and for which purpose and duration, with the responsibility on industry and manufacturers to facilitate this through open standards. Insurance Europe has therefore recommended adopting provisions at EU level to ensure that consumers decide who can access their vehicle data and for what purpose, by putting all stakeholders on an equal footing in their access to in-vehicle data (see box on p45).

Addressing regulatory barriers

In light of the ongoing work of EIOPA's Insurtech Task Force and the European Commission's Expert Group on Regulatory Obstacles to Financial Innovation, Insurance Europe has been heavily engaged in identifiying potential regulatory barriers to financial innovation and putting forward appropriate recommendations to address these issues. It published a paper highlighting examples of regulatory obstacles to digital innovation in the insurance industry, which it shared with EIOPA and the EC Expert Group. It has also participated in EIOPA insurtech roundtables and provided further input to EIOPA via its InsurTech Insight Survey in August 2018.

It is now for EIOPA and the Commission to take measures to ensure that the EU's regulatory and supervisory frameworks are fit for the digital world and do not stand in the way of innovation.

Promoting best workplace practice

Digitalisation will continue to have profound effects in the workplace, with insurance companies no exception. Insurance Europe is an active member of the EU's Insurance Sectoral Social Dialogue Committee (ISSDC), which brings together employer and employee representatives and which, earlier this year, signed a follow-up to its 2016 declaration on the social effects of digitalisation.

The February 2019 declaration (available on the Insurance Europe website) stresses that employees require good training — in the widest sense — to be ready for the ever-changing digital age, with particular attention paid to employees whose function is likely to change dramatically or disappear.

It also stresses that employees should be made aware that it is in their best interests to participate in training to maintain and enhance their employability in the digital age. And given the trend towards employees' greater autonomy in determining when and how long they work, the declaration calls for boundaries to be set to protect their work-life balance.

OPINION

Greg Medcraft
Director, Directorate for Financial and Enterprise Affairs, OECD

CYBER RISKS

Breaking down the barriers

The OECD sees progress in tackling the challenges to growing the cyber insurance market

The growing use of and reliance on digital technologies are creating significant opportunities for innovation, convenience and efficiency, but they also come with specific cybersecurity and privacy protection risks. These risks are among the top concerns of those doing business around the world, and managing them is clearly a high priority. As in other business lines, cyber insurance can play an important role by providing policyholders with financial protection against risks that cannot be fully prevented and by putting a price on cyber risk and sharing expertise about how best to reduce it.

In recognition of the critical contribution that insurance can make to managing cyber risk, the OECD has undertaken significant analysis of the emerging cyber insurance market and the challenges to its development, with the support of its Insurance and Private Pensions Committee and High-Level Advisory Board on the financial management of catastrophic risks.

In November 2017, we published our findings in a comprehensive report on "Enhancing the role of insurance in cyber risk management". In February 2018, we brought together leading experts from the industry and governments around the world to reach a common understanding of the impediments to the market's development, and to identify the priority areas for action so that insurance is better leveraged to manage cyber risk.

Multiple challenges to cyber insurance growth

The emerging cyber insurance market faces a number of challenges. Relative to other lines of commercial insurance, there is a low level of take-up of cyber insurance, with limited amounts of coverage being made available — particularly outside the US market. There are significant complexities in quantifying the cost of cyber exposure in the context of a constantly evolving threat and risk environment — limiting both the demand for insurance coverage and insurance companies' willingness to provide coverage.

There is huge potential for risk accumulation due to the ubiquity of certain software applications and cloud and IT service providers, as well as the scaleability of attack methods, which are unconstrained by sectoral or geographical boundaries. And there is a high level of confusion about the coverage on offer for cyber risks, in stand-alone cyber policies as well as in traditional property, liability and specialty lines of insurance.

> **"There is some evidence that the gap between penetration rates for cyber insurance in the US and elsewhere has been all but eliminated."**

While these concerns remain, in the OECD's view there has been significant progress on many of these issues in the last 12 to 18 months. To give four examples:

- There is some evidence that the gap between penetration rates for cyber insurance in the US and elsewhere has been all but eliminated (though estimates do vary significantly). For example, a survey by insurer Hiscox in 2017 found that penetration rates[1] in Germany and the UK were 50–60% of the rates in the US. The same survey in 2018 found equivalent rates of take-up in the US and UK, and rates in Germany that were only marginally lower (less than 10% difference). The penetration rate in Spain was actually higher than in the US[2].
- Probabilistic catastrophe models — which have played a huge role in helping insurers manage natural catastrophe risk and unlocking new sources of capital — have been developed and released in the last few months, both by well-known and well-established global insurance companies and by numerous start-ups focused on cyber-risk modelling.
- Insurance regulators and supervisors, not to mention the insurers that they oversee, are placing much greater emphasis on identifying and addressing silent cyber risk in property, liability and other traditional lines. An increasing number of jurisdictions are stress testing cyber-

Common types of cyber incidents		Potential losses
PRIVACY BREACH	eg Unauthorised disclosure of third-party personally identifiable information	Incident response costs Breach of privacy compensation Defence costs Fines and penalties Reputational damage Data and software loss Business interruption
DENIAL OF SERVICES	eg Distributed denial of service attack on a server leading to the unavailability of a company website	Business interruption Incident response costs Reputational damage Directors' and officers' liability Data and software loss
CYBER FRAUD	eg Illegitimate financial transfer made as a result of social engineering	Financial theft and/or fraud Incident response costs Directors' and officers' liability
CYBER EXTORTION	eg Ransomware that impedes access to data or a network until a ransom is paid	Cyber ransom and extortion Business interruption Incident response costs Reputational damage Directors' and officers' liability Data and software loss

> **"Insurers have invested significantly in simplifying and harmonising cyber-policy wordings, and policyholders are becoming increasingly comfortable with the level of clarity provided."**

risk exposures (across business lines) and/or encouraging insurers to provide greater clarity about when cyber risk is and is not covered.

- Insurers have invested significantly in simplifying and harmonising cyber-policy wordings, and policyholders are becoming increasingly comfortable with the level of clarity provided. A US survey in the second half of 2018 found that 30% of policyholders indicated that there was sufficient clarity about what was covered (and not covered) in cyber insurance policies — up from 13% in the same period in 2017[3].

There is still work to be done, however. Cyber risk is a relatively new concern for everyone, not just insurance companies, and the industry will need to continue to adapt to a continuously evolving legislative, regulatory and policy environment.

At the OECD, we intend to focus on a couple of issues where we think that international collaboration and coordination are particularly important: the role of insurance in responding to politically-motivated cyber attacks, such as cyber terrorism and attacks by state-backed actors; and supporting greater clarity about the insurability of different forms of fines and penalties and ransom payments in different jurisdictions around the world.

Increasing digitalisation will ensure that this risk remains at the top of the agenda for the foreseeable future. The OECD looks forward to continued collaboration with Insurance Europe and its members, as we believe these challenges will only be overcome if all stakeholders — policymakers, (re)insurers, intermediaries and companies — work together in identifying potential solutions.

1 Gross written premiums as a percentage of GDP
2 The Hiscox Cyber Readiness Reports 2017 and 2018, Hiscox, London, https://www.hiscox.com/documents/brokers/cyber-readiness-report.pdf; https://www.hiscox.com/sites/default/files/content/2018-Hiscox-Cyber-Readiness-Report.pdf
3 Cyber Insurance Market Watch Survey: Executive Summary, Council of Insurance Agents & Brokers, USA, December 2017 and February 2019, https://www.ciab.com/download/11984/; https://www.ciab.com/download/16876/

William Vidonja
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DATA PROTECTION

Happy birthday?

As the EU's General Data Protection Regulation turns one, it is time both to take stock and to look ahead

A year has passed since companies had to implement and comply with one of the EU's most demanding and complex pieces of legislation. The General Data Protection Regulation or GDPR (see box overleaf) has been a challenge for companies throughout the EU, and insurers have been no exception.

Insurers support sound data protection regulation and understand the importance of data protection, since data processing lies at the very heart of their business. They process data to analyse the risks that individuals wish to cover and this allows them to tailor their products accordingly. Data processing also plays an essential part in evaluating and paying policyholders' claims and benefits, as well as in detecting and preventing fraud.

The GDPR introduces new requirements for insurers, provides enhanced rights for consumers, strengthens data authorities' powers and establishes high upper limits for fines in cases of non-compliance. To promote awareness of the new rights and obligations, Insurance Europe published an infographic (on p43) setting out insurers' obligations under the GDPR ahead of its application deadline, followed by another (also on p43) presenting an overview of insurance consumers' rights.

GDPR in a nutshell

The new European data protection regulatory framework — the General Data Protection Regulation (GDPR) — became fully applicable in May 2018.

Its aim is to reinforce the protection of European citizens' personal data in an increasingly digitalised world. And the GDPR effectively introduced what is recognised as one of the strictest — if not the strictest — data protection regime in the world.

The GDPR also introduced a new independent body, the European Data Protection Board. This and the new European Data Protection Supervisor have become the European data protection watchdogs.

A year after the implementation of the GDPR, however, many important questions remain unanswered.

The GDPR replaced the Article 29 Working Party, an advisory body of representatives of member states' data protection authorities, with the European Data Protection Board (EDPB). The EDPB's main role is to promote cooperation between national data protection authorities and to contribute to the consistent application of data protection rules throughout the EU. To achieve its aims, the EDPB has a mandate to issue binding decisions should there be conflicting views between national data protection authorities and to continue the Working Party's development of guidelines to provide further clarity on the application of key aspects of the GDPR.

Guidelines still not finalised

The EDPB guidelines, although not binding, provide assistance in understanding key aspects of the Regulation and are therefore an essential instrument for complying effectively with the GDPR. A number of GDPR concepts and requirements had to be clarified via guidelines. Some of those, such as the ones on consent, transparency or automated processing and profiling, were adopted by the Working Party just a few weeks before the GDPR application date.

To make things more complicated, several guidelines relevant for the insurance sector were not issued by the GDPR implementation deadline. For example, the EDPB did not publish its draft guidelines on certification and identifying certification criteria and the guidelines on the territorial scope of the GDPR for stakeholders' consultation until after the deadline.

Some guidelines have still not been finalised a year on, including the long-awaited guidelines on codes of conduct and monitoring bodies. Codes of conduct help to clarify the application of the GDPR principles to a given sector. They could facilitate insurers' compliance with the GDPR by providing useful guidance on processing data that takes into account the particularities of the insurance business model and sector. They could also provide clearer guidance and guarantees to consumers on how their data is processed.

Importantly, the draft of these guidelines on codes of conduct and monitoring bodies proposed to make it mandatory to designate a monitoring body as a precondition to obtaining the approval of codes of conduct. If adopted as they are, the guidelines would result in an unexpected and burdensome challenge for insurers. Unexpected because such a requirement would contradict the GDPR text itself, which clearly states that the establishment of a monitoring body is optional. And burdensome because the cost of maintaining these bodies is infeasible. The risk is high that industries, including the insurance industry, will refrain from creating codes of conduct if the final guidelines retain mandatory monitoring bodies.

Worse, more than 10 guidelines that are key to providing assistance in the correct application of the GDPR are still to be developed by the EDPB.

All these delays create unnecessary legal uncertainty for the industry, when ideally all the guidelines should have been made available long before the GDPR's application to allow smooth compliance and avoid rushed implementation.

GDPR vs innovation?

The European Commission is currently undertaking a stocktaking exercise to evaluate the state of play in the application of the GDPR. The outcome will feed into a review of the GDPR by the Commission which is due by May 2020. This exercise will no doubt reveal a number of areas of tension between the prescriptiveness of the GDPR and the EDPB guidelines on the one hand and innovation on the other.

For example, one could ask to what extent the use of blockchain technology in insurance might be jeopardised due to potential incompatibilities with the GDPR. From an insurance perspective, blockchain technologies have the potential to reduce costs and increase transparency and trust. However, the underlying principles of blockchain technology raise certain questions about compatibility with the GDPR: how to reconcile the GDPR's rights to erasure (commonly, "right to be forgotten") and to rectification with the fact that blockchain technology is designed to be an immutable and permanent record of all transactions?

Moreover, with technological developments, the use of automated processes throughout the insurance value chain

> **"Ideally all the guidelines should have been made available long before the GDPR's application to allow smooth compliance and avoid rushed implementation."**

> **"The underlying principles of blockchain technology raise certain questions about compatibility with the GDPR."**

to serve consumers better and more quickly is becoming more and more relevant. However, the EDPB's guidelines on automated decision-making and profiling create such legal uncertainty that they may discourage insurers from introducing new automated processing and profiling techniques.

Indeed, the guidelines allow insurers to use solely automated processes to perform or enter into a contract only where they demonstrate that such a process is necessary, which would not be deemed the case if other effective and less intrusive means to achieve the same goal exist. In other words, the guidelines may prevent the development of innovative products based on solely automated techniques, such as real-time insurance through mobile phone applications, and this would be to the detriment of consumers.

It will be crucial to ensure that the application of EU privacy and data protection rules does not create unnecessary barriers to the deployment of blockchain technology solutions and other digital innovations that could benefit insurance consumers. The EC's stocktaking exercise provides a perfect opportunity to draw lessons and improve.

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Group chief reinsurance officer, Generali, Italy

MOTOR

Directing traffic

Insurance Europe sees mainly good, but some bad, in the revisions being proposed to the EU Motor Insurance Directive

Motor is undoubtedly the insurance product people are most familiar with in Europe. It would be hard to imagine that anyone does not know that the car they are driving needs to be insured.

In many ways, too, this reality has its roots in the European project. Indeed, the first Motor Insurance Directive (MID) was adopted back in 1972, both to ensure the protection of victims of road traffic accidents and to facilitate the free movement of motor vehicles throughout Europe. This foundation was built on in the decades that followed to create a strong European framework to achieve those two objectives. It has a number of key provisions, which include:

- Compulsory motor third-party liability (MTPL) insurance valid throughout the EU on the basis of a single premium and with an obligatory minimum amount of cover.
- The prohibition of systematic checks on the insurance of vehicles normally based in the EU at internal borders.
- The creation of guarantee funds to ensure the compensation of victims of road traffic accidents where the vehicle responsible is uninsured or unidentified.

The MID is seen as a success story for the EU, and motor insurance's familiarity to European citizens has made it a very popular topic with European policymakers. While the MID is most definitely worthy of the spotlight, it also means there have been attempts

Driven by data

Many cars on the road today generate large amounts of data that can be sent to third parties, giving rise to the term "connected" cars. This increase in data generated by connected cars provides insurers with a real opportunity to overhaul their products, offer new and innovative services and improve their customers' experience.

Vehicle manufacturers have developed their own solutions involving remote servers from which service providers can access the data generated by vehicles.

In July 2018, Insurance Europe joined a project initiated by ACEA and CLEPA (the European associations respectively representing vehicle manufacturers and automotive suppliers) to test the adequacy of the technological solutions put forward by vehicle manufacturers for third-party access to in-vehicle data in real-life scenarios. The testing began in April 2019 and the results will be reported to the EC, which is monitoring the project. Insurance Europe is keen to comprehensively evaluate the technological solutions proposed by the vehicle manufacturers.

"The scope of the compulsory MTPL insurance requirement has been a particularly contentious point in the discussions around the Motor Insurance Directive."

to tamper with aspects of it that did not necessarily need to be amended.

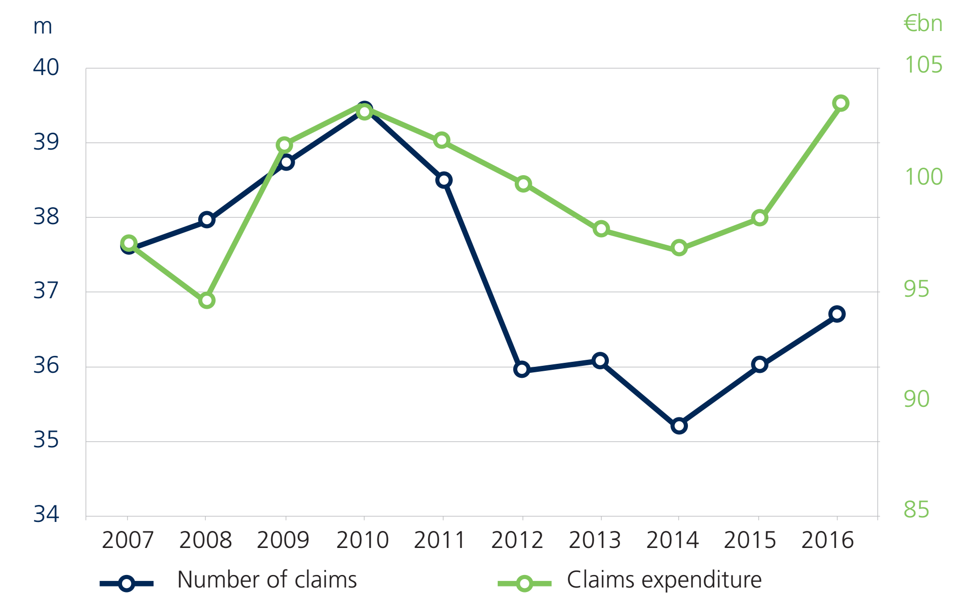
The European Commission initiated a review of the Directive in 2016 through various consultations to which Insurance Europe contributed. This evaluation concluded that the MID remains overwhelmingly fit for purpose, with some areas nonetheless requiring changes. This led to a proposal, published in 2018, which Insurance Europe welcomed while expressing strong reservations about some of its provisions. At the time of writing, the proposal is still going through the legislative process, with the European Parliament having adopted its position and the Council deciding on its approach.

Compulsory challenges

The scope of the compulsory MTPL insurance requirement under the MID has been a particularly contentious point in the discussions around the MID ever since the *Vnuk* ruling in 2014. This case was referred to the Court of Justice of the European Union by the Slovenian Supreme Court and concerned a farmworker who fell off a ladder in a farmyard when it was hit by a trailer attached to a tractor. The referral focused on the meaning of the term "use of vehicles" under Article 3(1) of the MID. The Court concluded that "use of vehicles" should be understood to cover any use of a vehicle that is consistent with "the normal function" of that vehicle.

This ruling effectively greatly extended the scope of compulsory MTPL insurance under the MID, at least in a number of member states, to accidents in which motor insurance was until then not understood to be relevant: on construction or industrial sites, related to agricultural work or even in motorsport competitions. In many member states, other types of liability insurance or compensation mechanisms are used to cover such risks. While there was a need for clarification following the confusion created by the *Vnuk* ruling, the EC arguably made the situation worse by proposing to extend the scope of compulsory MTPL insurance even further.

The MID is a piece of EU law that sets out minimum harmonisation, ie a threshold that national legislation must meet. Insurance Europe pointed out that the Directive had



allowed for variations from one member state to another and that MTPL insurers had built their business models around its scope in each market. The EC's maximalist interpretation of the *Vnuk* ruling therefore threatened the balance found in the MTPL markets. Insurance Europe urged the EC to stick to the original objective of the MID — the protection of road traffic accident victims — arguing that protection of victims of agricultural, construction-site or motorsport accidents should not mandatorily come from the motor insurance risk pool. This view was shared by the European Parliament in the report it adopted in February 2019.

The aftermath of the *Vnuk* ruling is not the only reason the scope of the MID's compulsory MTPL insurance obligation is being hotly debated. The last few years have seen a proliferation of new, small electric vehicles on the street of European cities, such as electric scooters, mopeds and electric bicycles (e-bikes). The EC's proposal does not mention

"European insurers already offer insurance solutions for small electric vehicles and there was no need to bring them within the scope of the MID."

these because — the EC explained — they should already be deemed covered under the MID. This interpretation is particularly problematic as it effectively asks motorists to cover the cost of accidents through their MTPL policies or a guarantee fund's intervention even if they only involve devices more akin to bicycles. European insurers, in fact, already offer insurance for these vehicles and there was no more need to bring them within the scope of the MID than to do so for bicycles. Thankfully, on this point too, the European Parliament redirected the EC's proposal in the right direction.

Statements should not be standardised

One aspect of the proposed revision where the Commission and Parliament are more in tune is the standardisation of claims history statements. Under the MID, policyholders have the right to request a statement from their insurer covering the last five years of MTPL claims. The Commission's proposal went a lot further by proposing to standardise the content of these statements. While the European Parliament lessened the blow by removing the impractical obligation to include the value of claims, the proposed standardisation remains.

One interesting aspect of this approach is that it assumes that claims history statements are at the heart of the business, while this is only one of the many factors that influence the

Falling claims, rising costs

Insurance Europe's latest statistics on the motor insurance markets of Europe show a trend of claims reducing but the cost of those claims increasing. This is due, at least in part, to improved driver-assistance technology and more road safety initiatives, offset by more expensive vehicles and vehicle parts.

In the decade to 2016, the frequency of compulsory motor third-party liability (MTPL) claims fell a full percentage point to 5.1% and the frequency of optional damage cover claims fell 1.3 percentage points to 11.7%. Meanwhile, the average cost of an MTPL claim rose 6.8% in the same decade and that of a damage claim 15.1%.

For more European motor insurance data, see the 2019 update to a 2015 report on the Insurance Europe website.

"There have been calls for undefined changes to reflect the increased automation and connectivity of vehicles, but this reveals a misunderstanding of the MID's nature."

underwriting process. Technological developments mean that claims histories have to be integrated with additional information such as driving behaviour, to take just one of the most relevant examples. The increased digitalisation of processes from sales to claims means that the idea of a (paper) statement is already obsolete in a number of markets and is increasingly so in the others, with insurers often able to access the relevant national databases directly.

It is regrettable that this aspect of the proposal makes the MID less future-proof than it already is, since one of the main messages Insurance Europe has — successfully, so far — relayed is that the MID is fit for the future. There have been calls for undefined changes to reflect the increased automation and connectivity of vehicles, but this reveals a misunderstanding of the MID's nature. The Directive is not a piece of legislation that looks at how liability for an accident is apportioned. It ensures that, where a motor vehicle is involved in an accident, the victims receive compensation. There is no need to change any aspect of the MID to ensure this is still the case with automated and connected vehicles or in a world where car-sharing becomes the norm; the car being shared will still require insurance. Fortunately, this is a point both the Commission and Parliament acknowledged.

While Insurance Europe has concerns about both the EC proposal and the amendments suggested by the Parliament, notably in relation to claims history statements, it also sees many positive aspects to the proposal, not least the fact that all European victims of accidents involving an insolvent MTPL insurer will now benefit from the same protection afforded by motor guarantee funds to those involved in an accident in which the vehicle was uninsured or unidentified.

What is clear is that even when the Directive is finally adopted — either later in 2019 or, more realistically, in 2020 — work on it will not end. The proposal currently leaves the door open to delegated regulation by the Commission on significant topics such as claims history statements and guarantee funds. Insurance Europe will therefore carry on liaising with the EU institutions to ensure the high level of protection that European road users enjoy remains.

OPINION

Alison Martin
Group chief risk officer, Zurich Insurance Group, Switzerland

FLOODS

Take five

There are five areas in which the EU's Floods Directive could become more effective

Floods affect more people globally than any other type of natural hazard and cause some of the largest economic, social and humanitarian losses. And, as climate change increases the incidence of extreme weather events, some researchers indicate that, for the EU, average annual flood losses could rise more than fivefold from €4.2bn in the period 2000–2012 to €23.5bn by 2050.

With the UN's Intergovernmental Panel on Climate Change (IPCC) Special Report on Global Warming in October 2018 giving us 12 years to limit the most substantial impacts of climate change, the current "fitness check" of the EU's Floods Directive (see box) is both timely and relevant.

The EU Floods Directive is to be commended for increasing the importance of flood risk management and the general understanding of the topic. The interactions between public authorities, the insurance industry, citizens and businesses are complex, and an integrated approach to flood risk management requires shared ownership of risk.

Nevertheless, there are five areas in which changes to the current framework could make the Directive more effective:

1. Improving the approach to *ex ante* prevention

Preventing flood losses and building societal resilience to

About the EU Floods Directive

- The aim of the EU's 2007 Floods Directive was to be a catalyst for managing the risks of significant water floods by introducing Flood Risk Management Plans to reduce damage and adverse consequences for health, the environment, cultural heritage and economic activity.
- The European Commission began a "fitness check" of its Water Framework Directive and the Floods Directive in late 2017, which is due to be completed in the third quarter of 2019. The check is looking at the relevance, efficiency, coherence and added value of the two directives, including an assessment of the potential for simplifying the regulation and reducing the regulatory burden.

flooding are important elements in integrated flood risk management. Studies conclusively show that prevention and resilience-building are — beyond avoiding human misery and suffering — also highly cost-effective. On average, every euro invested in flood-risk reduction saves five euros in avoided future losses[1]. With certain flood prevention programmes, the benefit-to-cost ratio can be much higher, as demonstrated by one evaluation following flooding by storm Xaver in the UK in 2013, where it was estimated that flood defences prevented up to £32bn (€37bn) of financial losses[2].

One recommendation for the Directive would therefore be for more integrated approaches to "grey" and "green" infrastructure measures by including non-physical approaches to resilience-building and nature-based prevention solutions. Today, the emphasis too often remains on "grey", or man-made, prevention infrastructure and large-scale flood prevention programmes or schemes.

"Average annual flood losses in the EU could rise more than fivefold from €4.2bn in the period 2000–12 to €23.5bn by 2050."

We must also introduce more direct and indirect long-term incentives to prioritise resilience-building. At the moment these are lacking, coupled with a tendency to compensate for incurred losses.

Examples of disincentives are found in approaches to land-use and zoning management (making land available that creates new, future risk in flood zones) and building codes (the absence of requirements for both resilient construction and resilient repair). Additionally, development and growth decisions still lack integrated risk management and protection components.

2. Incentivising insurance take-up

Ex-post government aid can create disincentives to individuals to take up private insurance. Importantly, an over-reliance on *ex-post* government assistance can also hinder awareness of flood risk and thus premiums do not properly reflect the extent of the risk.

Countries should therefore prioritise actions to promote the use of insurance. For insurance to function properly, we need to spur voluntary uptake of flood insurance by citizens, businesses and communities. This requires information to be made available about the costs and benefits of insurance

A stranded car near Hamburg fish market after storms caused flooding and damage in northern and eastern Germany in October 2017.

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uptake and about the consequences when risks are uninsured.

3. Standardising language

One example of the need for standardised language relates to the frequency and severity of flooding and the design standards of corresponding protection structures.

At present, the definitions used by the European Commission speak about "frequent flooding" and "extreme flooding". This leaves room for interpretation by those responsible for producing hazard maps and deciding on relevant protection. Similarly, language must more clearly outline the probability of flooding based on the expected lifetime of the structure that needs to be protected.

4. Providing forward-looking scenario planning

As a society, we continue to use historical data, statistical analysis and current conditions to design infrastructure that will still be in use 50 years into the future. This approach has become inadequate, as the risks of floods are increasing as a result of both natural and man-made actions. Instead, a scenario using regional worst-case historical information coupled with a strong emphasis on forward-looking climate and development scenarios could be more appropriate.

"Transparent, easy and free access to basic hazard and risk-informed data is an important stepping stone towards risk reduction."

5. Promoting the availability and transparency of data

Transparent, easy and free access to basic hazard and risk-informed data is an important stepping stone towards risk reduction and increased risk awareness that is currently not used to its full potential. Some insurers are working with national and state governments to produce free, open-access, natural hazard radars, combining public hazard information with risk-reduction advice.

The current evaluation of the EU Floods Directive, which is due to be finished in 2019, is an ideal time to address all five of these areas. With floods increasing in frequency, severity and impact, doing so is a vital and urgent task.

1 "Making communities more flood resilient: the role of cost-benefit analysis and other decision-support tools in disaster risk reduction", Zurich Flood Resilience Alliance, September 2014
2 "After the storm: how the UK's flood defences performed during the surge following Xaver", Zurich, September 2014

Michaela Koller
Director general, Insurance Europe

EU FREE PROVISION OF SERVICES

Free but not easy

Insurers' freedom to provide services across borders in the EU must always come with the appropriate responsibilities

At the very heart of the European project are what are often referred to as the four freedoms: the freedom of movement for goods, people, services and capital. By its very nature as a European federation, Insurance Europe is dedicated to promoting the smooth running of business across borders throughout Europe, and these four freedoms are essential to this objective.

The freedom to provide services (FOS) across the EU has been a tremendous opportunity for European insurers, along with the freedom of establishment (FOE). Insurers have made great use of FOS over the years, contributing to a highly integrated single market. However, this success has not been without its problems. While the overwhelming majority of market players use FOS as it was intended, a few have made a problematic use of this freedom, which risks undermining it and, ultimately, threatening the integrity of the single market.

In general, these few rogue players have been found to be under-reserving and providing misleading information in marketing material about their compliance with solvency requirements. Some also operate through opaque legal constructs and with complex intermediary arrangements, making it difficult to identify people with key functions. In a number of cases, these companies are set up in one (home) market but operate exclusively or almost exclusively in other (host) markets on the basis of FOS.

Even though FOS was not meant for permanent and near-exclusive operations in other markets, this is not a problem *per se* and insurers should not be penalised merely because they operate through such a business model. The problem that needs to be addressed is that this way of working has allowed a few players to maintain inadequate solvency positions and circumvent certain supervisory requirements in the market in which the bulk of their activity is carried out.

Better supervisory communication required

The key to solving this issue lies in a high level of cooperation and communication between the national supervisors of the home and host markets, as well as at European level. This is especially important at the authorisation stage and once an insolvency has been declared.

Day-to-day supervision is also crucial, and the home supervisor must have the capacity to exercise this duty and actively cooperate with the host supervisor. In line with the EU passporting principles, of course, the host supervisor relies on the home authority's supervision.

While there is a problem with only a very small proportion of companies, the victims are not only their customers but also the overwhelming majority of European insurers that abide by the rules and contribute to a healthy and competitive cross-border market, as consumer trust is undermined. A mere handful of companies are creating a reputational risk for the entire insurance sector and calling into question the freedoms of the European project.

Powers and tools to solve the problem

Insurers welcome the efforts of EIOPA and national supervisors to address this issue, notably by making optimal use of the powers and tools at their disposal. Back in January 2017, EIOPA detailed a range of useful mechanisms to foster cooperation between authorities in the day-to-day supervision of FOS activities, covering the exchange of information at all stages of the supervisory process at which cooperation and communication between authorities is crucial: authorisation, beginning of FOS activities, transfer of portfolios, withdrawal of authorisations, reorganisation measures and winding-up proceedings. More recently, in December 2018, EIOPA issued an opinion on non-life cross-border insurance business of a

"The key to solving this issue lies in a high level of cooperation and communication between the national supervisors of the home and host markets, as well as at European level."

long-term nature and its supervision. However, the tools in it lack the binding nature that the gravity of the problem requires.

EIOPA's existing powers and tools can go some way to resolving the issue. These include its breach of union law powers and the power to settle disagreements between national supervisors in cross-border situations. However, EIOPA still lacks the binding power needed to fully address any problems. It therefore clearly needs specific additional powers to ensure the sound supervision of FOS insurers' activities.

Unsurprisingly, this issue came up in the discussions of the EC proposal of September 2017 for the revision of the regulations governing the European financial supervisory authorities (see article opposite). Insurance Europe expressed support for specific new powers, clearly limited to addressing this issue, to enable EIOPA to play a coordinating role in disputes between national authorities on FOS/FOE issues.

The new regulation was agreed in April 2019, giving EIOPA the requested new powers, including the ability to: recommend that the relevant national authority initiates an investigation; set up collaboration platforms on its own initiative; and make decisions when no agreement can be reached among national authorities. In addition, the amended regulation provides new duties for the national authorities, such as notifying EIOPA and the host national authorities of FOS-related issues and providing them with information.

The increase in EIOPA's powers and new duties for national authorities will go some way towards resolving a problem that goes to the heart of the European project. This should help to preserve the good functioning of the European financial system and insurers' freedom to provide services across Europe.

Insurance Europe will continue working to ensure insurers benefit from the opportunities of FOS business by seeking to have the outstanding supervisory and regulatory gaps addressed and to have all insurers held to the same standards.

Jeroen Benning
Head of public affairs & communications,
Insurance Europe

EU FINANCIAL SUPERVISION

A fine balance

Insurance Europe largely welcomes the outcome of the EU's review of financial supervision

Looking back at where the revision of the European system of financial supervision was a year ago, it is fair to say that the contrast between the European Commission's original proposal of September 2017 and the final text agreed by the European Parliament, Council and Commission in April 2019 is stark. Having started with opposing positions, the co-legislators ultimately decided not to support the sweeping overhaul proposed by the Commission and supported by EIOPA.

The legislative process was a reality check for the authors of the proposal: the Parliament and the Council were ultimately unwilling to transfer the main powers in insurance supervision from national authorities to EIOPA.

Important differentiation between sectors

From the insurance industry's perspective, it has been particularly important to stress the difference between the financial sectors in terms of supervision, as banks are already under the single supervisory mechanism (SSM) and credit rating agencies and central counterparties will understandably come under direct supervision by the European Securities and Markets Authority.

Insurers welcome the fact that the co-legislators

"The Parliament and the Council were ultimately unwilling to transfer the main powers in insurance supervision from national authorities to EIOPA."

pushed back on more direct EU supervision for insurance undertakings. The strength of the insurance industry is closely linked to the effectiveness of its supervisors, which helps to foster trust among consumers. In the case of the European insurance industry in particular, this confidence is based on the balance between supervision at both EU and national levels.

Good compromises

Insurance Europe believed that a complete overhaul of the existing supervisory architecture was not necessary at this time, but it is pleased with a number of key compromises found in the final agreement.

Insurance Europe has consistently argued that EIOPA's governance structure does not include adequate checks and balances, so the new structure proposed is a step in the right direction. EIOPA's board of supervisors will remain the primary decision-making body, which will help ensure that national authorities retain a central role. It is, after all, they that have the close supervisory contact with insurers and have built up a detailed knowledge of companies.

EIOPA, meanwhile, is naturally well placed to play a role in addressing certain cross-border issues (see p51), including the application of EU law. Disputes between home and host supervisors over the oversight of insurers have arisen in the past. Enabling EIOPA to act helps to address such disputes, as well as providing a clear framework for exchanging information. Insurance Europe therefore supports the new powers that allow EIOPA to set up independent panels of national authorities to address such issues.

Model agreement

The relationship between national authorities and insurers is important in the oversight of specific aspects of insurance business. In view of this, we believed that EIOPA did not need significant changes to its powers in relation to the internal models that companies use to measure their risk exposures (see RAB article opposite). Internal models are governed by the Solvency II framework, so there should be no doubts raised about their suitability once they are approved by an insurer's supervisor, and the review has rightly left the primary role in model approval in the hands of national authorities. However, EIOPA can now formally play a role in offering technical support to national supervisors should they request it.

Concerning the proposals related to anti-money laundering, we have consistently argued that the specific characteristics of the insurance industry should be taken into account by supervisors. While the European Banking Authority has been granted greater powers in this area in relation to all financial institutions, not just banks, it is positive that EIOPA will sit on the anti-money laundering committee.

Insurance Europe has also consistently highlighted the need for a clear link between EIOPA's tasks and its resources. However, there was insufficient evidence that the funding rules needed to change, so the retention of the status quo is welcome. Gathering fees directly from insurers, as the review initially proposed, created the risk of overlap in the fees paid at national and EU level and the possibility of double charging.

EIOPA's mandate allows it to meet its supervisory objectives of financial stability and supervisory convergence sufficiently. Both the Parliament and Council sought to introduce new measures to ensure EIOPA's actions have a clear basis in legislation. EIOPA has a host of tools available for the execution of its supervisory activity including issuing guidelines, recommendations and questions and answers. These should always have a legal basis rather than being issued on the authority's own initiative.

The European supervisory authorities should always act in the common European good. They must behave transparently and be overseen effectively by legislators to ensure that the supervisory system remains credible.

"Both the Council and Parliament should play a role in maintaining EIOPA's accountability, and the changes introduced by both represent a step in the right direction."

RAB OPINION

Christian Mumenthaler
Chair, Insurance Europe Reinsurance Advisory Board (RAB)
Group CEO, Swiss Re, Switzerland

INTERNAL MODELS

Getting the inside track

Reinsurers have a long history of developing the sophisticated models they need to understand and measure their complex risk exposures

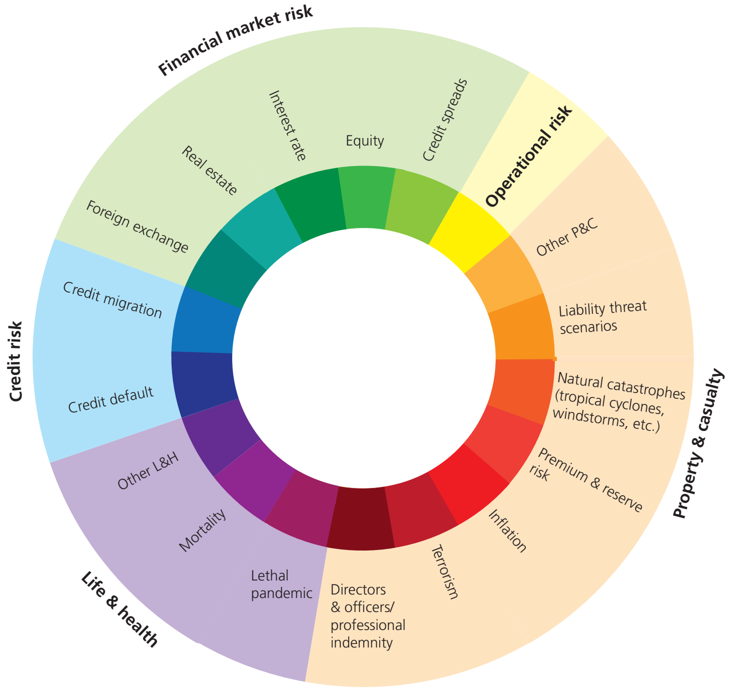
Reinsurers — the insurers of insurers — offer cover across the globe for a myriad of risks; everything from lethal pandemics to natural catastrophes. This inevitably results in non-standard risk profiles in terms of concentration and interdependencies. Reinsurers have been modelling and assessing their risks for business purposes by using internal models for decades.

Reinsurers have different operational, underwriting and counterparty default risk profiles to direct insurers. Whereas insurers have potentially millions of customers, reinsurers have only a few thousand institutional clients. The reinsurance business model is based on diversifying risks as widely as possible across lines of business and geographical locations. Consequently, a loss in one line or location will have a more limited impact on the solvency position of a reinsurer than on more locally focused insurers. It is very difficult to capture the effects of this risk exposure appropriately and accurately with a standard model.

Models with multiple uses

Appropriately designed and calibrated internal models are the most appropriate way to carry out a proper economic capital assessment of global reinsurance groups. Using proprietary and public data, reinsurers can comprehensively and holistically model their economic balance sheets and risk profiles and measure their capital adequacy in particular loss scenarios. Reinsurers have therefore

Reinsurers are exposed to a wide variety of risks



been using their internal models for performance management and business steering for many years — well before their use was permitted for regulatory purposes.

Core uses of internal models include:

- business and capital planning
- capital and capacity allocation
- stress and scenario testing
- setting economic capital levels
- monitoring risk appetite
- understanding risk aggregations
- business pricing
- capital cost allocation
- optimising risk mitigation
- investment decisions
- setting remuneration
- complying with regulation

Advantages for all

The benefits to reinsurers of internal models are thus clear: they are crucial for sound risk management and business steering and thereby improve the resilience to risk.

Perhaps less widely understood are the "external" benefits: internal models make the risk profile of reinsurers more transparent and this not only enriches the dialogue between reinsurers and their supervisors, but also makes internal models the most appropriate basis for comparisons with other reinsurers.

As reinsurer boards and senior management need to understand the internal model and its limitations in a great level of detail to be able to apply it responsibly to their business, the "use test" requirement for internal model approval is part of a standard process. Supervisors require from senior management not only in-depth knowledge of the use of the model, but also awareness of areas such as the key modelling assumptions, limitations, simplifications and diversification methodologies applied in the model.

However, the use test is much more than a requirement placed on the board and senior management. Experience has shown that the biggest challenges to an internal model do not come from the supervisors approving it but from internal stakeholders using it. Use of the model for capital allocation or pricing provides the best incentive to appropriately quantify risk and forces companies to improve and refine their model of anticipated growth areas. This way, the internal model stays appropriate for a changed risk profile in a way that a standard model never could.

"It is very difficult to capture a reinsurer's risk exposure appropriately and accurately with a standard model."

Models and modern regulations

Depending on the size, nature and complexity of an insurer and its risks, different approaches to risk measurement are needed. A "one-size-fits-all" approach is unworkable, as it is either too complex for an insurer with smaller and simpler risks or it produces results that are misleading or wrong for those with larger and more complex ones. The danger is then that the solvency positions of companies derived using a standard formula are not comparable, as the risks of some are understated and the risks of others overstated.

Recognising this, modern insurance regulatory regimes — such as the EU's Solvency II, the Swiss Solvency Test or South Africa's Solvency Assessment and Management (SAM) framework — allow the use of internal models to calculate regulatory solvency capital requirements, subject to supervisory approval.

Worrying regulatory developments

There continue to be regulatory developments in this area that concern the Reinsurance Advisory Board (RAB). In 2018, EU supervisor EIOPA announced that firms using internal models that have significant exposures should take part in an annual market and credit-risk benchmarking survey and launched a similar exercise for non-life underwriting risk.

The RAB has significant conceptual concerns about benchmarking exercises, which start from the erroneous assumption that risk profiles in the (re)insurance sector are sufficiently homogenous for them to be easily compared. Usually, internal models are targeted to the company's risk profile, meaning that areas with greater exposure will have more sophisticated models, while areas with little exposure are modelled in a simpler manner. This can lead to comparison of benchmark portfolios providing distorted results. Likewise, looking at certain risks in isolation fails to provide a holistic view of a firm's risk profile and risk interdependencies.

EIOPA's 2019 work programme includes an assessment of how internal model ongoing appropriateness indicators (IMOGAPIs) could be integrated into reporting requirements. The RAB has concerns over the IMOGAPI work. EIOPA's initial indicators are understood to be based on comparisons with the Solvency II standard formula, which is not a good measure of reinsurers' complex risks. Moreover, efforts to make reporting for internal models more standardised will not cater for different modelling approaches and will exacerbate the risk of inappropriate comparisons between companies. And increased reporting requirements will lead to increased costs.

Solvency II has strict requirements about minor and major model changes, which are intended to guard against model drift over time. It is not clear why EIOPA views these as insufficient to ensure ongoing model appropriateness.

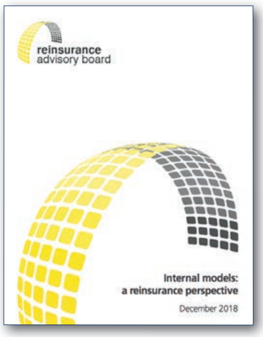
The EU's recently finalised review of its financial supervisory authorities proposed moderate changes to the oversight of internal models. While national authorities rightfully retain a primary role in internal model approval, EIOPA will now formally be able to offer technical support should national supervisors require and request it.

No shortcuts

While the resource demands of internal models are considerable, for large reinsurers these are significantly outweighed by the benefits they bring in terms of companies' and supervisors' understanding of risks.

There are no shortcuts in the process of reviewing and approving an internal model. Supervisory overlays, including benchmarks and indicators, will not give supervisors the information they need to understand a company's risks, nor will they improve the transparency or accountability of the insurance sector.

The RAB instead urges supervisors to share with each other their experiences of internal model approval in order to document and encourage best practice.



For more on the benefits of internal models see the recent RAB publication, "Internal models: a reinsurance perspective", in its section of Insurance Europe's website.

Recaredo Arias
President, Global Federation of Insurance Associations (GFIA)
Director general, Mexican Association of Insurance Companies (AMIS)

INSURERS & THE G20

Tangos & Tokyo

The Global Federation of Insurance Associations relishes its interactions with the Argentinian and Japanese G20 presidencies

One of the key drivers for the creation of GFIA in 2012 was to set up an appropriate global insurance industry counterpart with which other global bodies could engage. Measured by the success of our growing interaction with successive presidencies of the G20 — the global forum for financial and political collaboration that comprises 19 countries and the EU — GFIA's establishment seven years ago was both timely and needed.

GFIA has had constructive discussions with the successive G20 presidencies of Mexico, Russia, Australia, Turkey, China and Germany. And, in the last year, it has been our pleasure to engage with the first South American presidency, Argentina, and with the current presidency, Japan.

Building bridges in Argentina

Argentina's people-centred G20 agenda focused on development, fairness and sustainability, concentrating on the issues of the future of work, a sustainable food future and infrastructure for development.

It is the last of these three — infrastructure investment — that featured most highly in GFIA's discussions with the Argentinian presidency on how to help achieve the G20 goals. With well over €3.5trn to invest annually and with mostly long-term liabilities that require long-term, sustainable assets to match, the global insurance industry is ideally placed to support investment in infrastructure. This corresponds to the needs of governments around the world, which are increasingly seeking to attract private infrastructure investment to relieve the pressure on public resources. Indeed, according to the OECD, $95trn (€82trn) is needed globally between 2016 and 2030 to upgrade infrastructure.

Argentina warmly welcomed the industry's engagement, as demonstrated by its organisation of a G20 event entirely dedicated to insurance in September 2018, which GFIA was proud to sponsor.

Writing in GFIA's Annual Report afterwards, Juan Pazo, Argentina's superintendent of insurance, said: "Discussions related to sustainable development, barriers to long-term investment in infrastructure, technological innovation and financial stability cannot be fully addressed without the voice of the insurance sector." He went on to say that he believed that insurance could provide creative responses to many of the challenges faced by G20 leaders.

Superintendent Pazo stressed the need to create a favourable environment for insurers' investment in infrastructure, not only because of the positive impact on the real economy, but also because such opportunities for diverse asset allocation promote policyholder protection and safe and stable financial markets. He recognised, however, the need to improve the supply of projects that are suitable and attractive for investment and to improve the quality of the data-tracking of infrastructure projects so that investors can make sound financial evaluations.

Tokyo story

After Argentina, it is Japan that has taken over the G20 presidency. In December 2018, a GFIA Executive Committee delegation met senior Japanese G20 — and B20 business — representatives in the very first week of the presidency.

We had very constructive meetings with Japanese Minister of Finance Taro Aso and his team, with Haruhiko Kuroda, governor of the Bank of Japan, and with Toshihide Endo and Hiroshi Ota, the commissioner and deputy commissioner for international affairs at the Financial Services Agency. The Minister of Finance made clear that the G20 priorities put our industry at the centre of Japan's G20 agenda.

> **"It was a pleasure to witness the Japanese presidency's interest in the issue of long-term investment in infrastructure in both developed and developing economies."**

About GFIA

Established in October 2012, the Global Federation of Insurance Companies now comprises 41 member associations and one observer association. It represents the interests of insurers and reinsurers in 61 countries that account for well over €3.5trn of insurance premiums or around 89% of the global total. GFIA's secretariat is headquartered at Insurance Europe.

It was a pleasure to witness the Japanese presidency's interest in the issue of long-term investment in infrastructure in both developed and developing economies.

Recovery from natural catastrophes, financial innovation and digitalisation are likewise welcome topics on its list, from our industry's perspective, and ones in which GFIA's working groups are actively engaged. Japan is also the first presidency to put the issue of ageing high on its agenda and it is keen to promote dialogue between public and private entities and to ensure that ageing remains a theme for future presidencies.

The global issue of retirement security — as ageing populations widen the gap between social security contributions collected and the pension payments made — is one in which GFIA has been particularly active.

Last year, GFIA published a report entitled "Older and wiser: Solutions to the global pension challenge" (available at www.gfiainsurance.org), urging policymakers to promote funded pensions alongside pay-as-you-go systems to increase the sustainability of provision. It makes policy recommendations in three areas: stimulating the uptake of private pensions; empowering consumers through the promotion of financial literacy; and fostering the efficiency of pension saving.

Plans in Japan

Looking ahead to the remainder of the Japanese G20 presidency, GFIA is pleased to support the Insurance Forum that is being organised by one of our GFIA members, the Life Insurance Association of Japan (LIAJ), under the auspices of the G20 presidency. The event will be on 5 June 2019 in Tokyo, ahead of the G20 Osaka Summit at the end of that month, and will also mark the 110th anniversary of the LIAJ.

The Forum will follow on from the one in Argentina, discussing the role of insurance in achieving the G20's goals, particularly in relation to adapting to ageing societies, creating resilient economies and managing digital innovation. GFIA will be speaking at the Forum: I will have the honour of closing the event, while GFIA vice-president Don Forgeron will speak about insurers' role in resilient economies and our secretary general, Michaela Koller, will address the industry's role in pension provision.

GFIA
GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

Insurance Europe

Member associations

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Greece	Hellenic Association of Insurance Companies President: Alexandros Sarrigeorgiou www.eaee.gr tel: +30 2103 33 41 00
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Poland	Polska Izba Ubezpieczeń (PIU) President: Jan Grzegorz Prądzyński www.piu.org.pl tel: +48 22 42 05 105
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Romania	Uniunea Naţională a Societăţilor de Asigurare şi Reasigurare din Romania (UNSAR) President: Adrian Marin www.unsar.ro tel: +40 31 130 0605
Slovakia	Slovenská asociácia poisťovní (SLASPO) President: Vladimír Bakeš www.slaspo.sk tel: +421 24 34 29 985
Slovenia	Slovensko Zavarovalno Združenje (SZZ) Director: Maja Krumberger www.zav-zdruzenje.si tel: +386 1 300 93 81
Spain	Unión Española de Entidades Aseguradoras y Reaseguradoras (UNESPA) President: Pilar González de Frutos www.unespa.es tel: +34 917 45 15 30
Sweden	Svensk Försäkring President: Bengt-Åke Fagerman www.svenskforsakring.se tel: +46 85 22 78 500
Switzerland	Schweizerischer Versicherungsverband (ASA/SVV) President: Rolf Dörig www.svv.ch tel: +41 442 08 28 28
Turkey	Türkiye Sigorta, Reasürans ve Emeklilik Şirketleri Birliği President: Can Akın Çağlar www.tsb.org.tr tel: +90 212 32 41 950

United Kingdom	The British Insurers' European Committee (BIEC), comprising:	
	ABI	Association of British Insurers (ABI) Chairman: Amanda Blanc www.abi.org.uk tel: +44 20 7600 3333
	IUA of London International Underwriting Association	International Underwriting Association of London (IUA) Chairman: Malcolm Newman www.iua.co.uk tel: +44 20 7617 4444
	LLOYD'S	Lloyd's Chairman: Bruce Carnegie-Brown www.lloyds.com tel: +44 20 7327 1000

Associate member

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

10th International Conference: "Overcoming underinsurance"
Madrid, Spain, May 2018

"Minding the gaps: underinsurance problems and how to solve them", debated by (L to R) Alison Martin of Zurich Group, Cécile Wendling of Axa, Monique Goyens of BEUC, the EC's Paulina Dejmek Hack and Pilar del Castillo MEP, moderated by Insurance Europe's Michaela Koller.

Keynote speaker Antonio Huertas, chairman & CEO of MAPFRE.

"Cyber risks — needed by many, bought by few", debated by (L to R) Andries Smit of Aviva, the EC's Nathalie Berger, Mamiko Yokoi-Arai of the OECD, Norma Rosas of Mexico's Insurance & Surety National Commission and Eduardo Dávila of Aon.

The EC's Nathalie Berger moderated "Grey matters — tackling the pension timebomb" with (L to R) Javier Valle, VidaCaixa; Ricardo Rodríguez Marengo, ProVida AFP; Dirk Kempthorne, GFIA; Lard Friese, NN Group; and EIOPA's Gabriel Bernardino.

Left: Andreas Brandstetter of UNIQA, Insurance Europe's incoming president, gave his inaugural speech.

Solvency II Conference: "Two years on and two reviews"
Brussels, Belgium, June 2018

Andreas Brandstetter, Insurance Europe president, outlined what insurers hoped for from the EC's two reviews of Solvency II.

EC vice-president Valdis Dombrovskis set out the Commission's plans.

EIOPA's Gabriel Bernardino explained the supervisor's position.

Smiles on solvency: (L to R) moderator Olav Jones of Insurance Europe, Ismael Moreno of VidaCaixa, Alberto Corinti of IVASS, Hans De Cuyper of AG Insurance and Frank Grund of BaFin.

Andreas Brandstetter (R) greeted keynote speaker EC vice-president Dombrovskis.

Debating how to achieve the potential of Solvency II: (L to R) moderator Olav Jones, Gabriel Bernardino of EIOPA, Luigi Lubelli of Generali, the EC's Nathalie Berger, Immo Querner of Talanx and Lionel Corre of the French Treasury.

Publications

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

Annual Report 2017–2018
(May 2018)

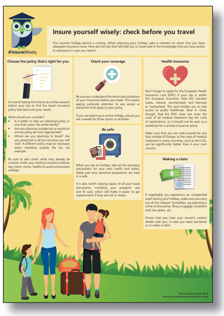
Articles on current insurance topics and details of Insurance Europe's structure and organisation

GDPR is around the corner: Time for final checks by insurers
(May 2018)

A one-pager of insurers' main obligations under the EU General Data Protection Regulation of May 2018

GDPR: What are your rights as a consumer?
(July 2018)

An overview of consumer rights under the EU General Data Protection Regulation of May 2018



InsureWisely: Check before you travel
(July 2018)

Five tips for consumers to ensure trouble-free travel

Preparing for cyber insurance
(October 2018)

A guide to buying cyber insurance, jointly produced by Insurance Europe, FERMA and BIPAR

European Insurance — Key Facts
(October 2018)

Key preliminary data for 2017, including information on European insurers' role in the economy, premiums, claims and investments

InsureWisely: Motor insurance
(October 2018)

Five motor insurance tips for consumers plus a step-by-step guide to what to do in the event of a road accident abroad

Insight Briefing: Big data and its big benefits for insurance consumers
(January 2019)

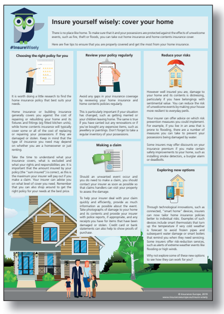
Why regulation must allow for innovation if consumers are to reap the benefits of big data-use in insurance

European Motor Insurance Markets
(February 2019)

Statistical trends and developments in Europe's national motor markets

European Insurance in Figures: 2017 data
(February 2019)

Detailed 2017 statistics showing European insurers' life and non-life premiums, claims paid and investments, plus market structure information



InsureWisely: Cover your home
(March 2019)

Five tips for consumers to get the most out of home insurance

Indirect taxation on insurance contracts in Europe
(April 2019)

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

Executive Committee

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Chairman & CEO
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Austria

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Association des Compagnies d'Assurances et de Réassurances (ACA)

Insurance Europe treasurer

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Malta Insurance Association (MIA)

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Verbond van Verzekeraars

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Managing director
Finans Norge

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President
Polska Izba Ubezpieczeń (PIU)

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Associação Portuguesa de Seguradores (APS)

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Uniunea Națională a Societăților de Asigurare și Reasigurare din Romania (UNSAR)

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Director general
Slovenská asociácia poisťovní (SLASPO)

Slovenia

Maja Krumberger
Director
Slovensko Zavarovalno Združenje (SZZ)

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Unión Española de Entidades Aseguradoras y Reaseguradoras (UNESPA)

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Managing director
Svensk Försäkring

Switzerland

Thomas Helbling
Director
Schweizerischer Versicherungsverband (ASA/SVV)

Turkey

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Secretary general
Türkiye Sigorta, Reasürans ve Emeklilik Şirketleri Birliği

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Director general
Association of British Insurers (ABI)

Insurance Europe

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Director general

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Vice-president 2016–19

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If P&C Insurance, Sweden

Vice-president 2019–22

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Association of Mutual Insurers and Insurance Cooperatives in Europe

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TUW SKOK, Poland

CFO Forum

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CFO Forum

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CRO Forum

Patrick Raaflaub
Chairman
CRO Forum

Group chief risk officer
Swiss Re, Switzerland

PEIF

Thomas Buberl
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Pan European Insurance Forum

CEO
Axa, France

RAB

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Reinsurance Advisory Board

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RAB

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Reinsurance Advisory Board

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FFA

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Chairman & CEO
Eurolife ERB Insurance Group

Italy

Maria Bianca Farina
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ANIA

Netherlands

Willem van Duin
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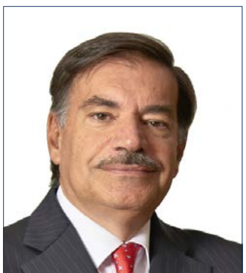
Achmea



Portugal

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President
APS

Spain

Pilar González de Frutos
President
UNESPA

Sweden

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President & CEO
Folksam

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(until February 2019)

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Aviva, UK

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Accounting policies &
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CaixaBank, Spain

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Scor, France

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IUA, UK

Solvency II Working Group (reports to Economics & Finance Committee)

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Net Insurance, Italy

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MAPFRE, Spain

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HUK Coburg, Germany

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Scor, France

Vice-chair
Holger Engelke
Head of group taxation
Munich Re, Germany

General Insurance Committee

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Generali, Italy

Vice-chair
Philippe Derieux
Head of P&C new business models
Axa Global, France

Vice-chair
Thomas Hlatky
Head of reinsurance
Grazer Wechselseitige, Austria

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HDI Global, Germany

Motor Working Group (reports to General Insurance Committee)

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HUK Coburg, Germany

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Claims management expert
Generali, Italy

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Head of reinsurance
Grazer Wechselseitige, Austria

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CEO
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Insurance Crime Platform (reports to General Insurance Committee)

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Deputy CEO
Larmtjänst, Sweden

Road Safety Platform (reports to General Insurance Committee)

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Head of insurance accident research
GDV, Germany

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CNP Assurances, France

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Juan Fernández Palacios
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Mapfre Vida, Spain

Vice-chair
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General counsel global life
Zurich Insurance Group, Switzerland

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Insurance Europe

Communications & PR Platform (reports to Public Affairs & Communications Committee)

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Communications & PR director
Assuralia, Belgium

Statistics Working Group (reports to Executive Committee)

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Head of global P&C retail
Generali, Italy

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George Veliotes
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Interamerican Group, Greece

Social Dialogue Platform (reports to Executive Committee)

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Deputy general manager
Arbeitgeberverband der Versicherungsunternehmen (AGV), Germany

Insurance Europe's Annual Report 2018–2019 is available on the Insurance Europe website: www.insuranceeurope.eu

Design: Insurance Europe

FSC logo

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