

François Villeroy de Galhau: Insurance and pensions – institutional innovation, economic innovation, technological innovation

Speech by Mr François Villeroy de Galhau, Governor of the Bank of France, at the 7th annual EIOPA Conference, Frankfurt am Main, 22 November 2017.

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Ladies and Gentlemen,

It is a pleasure to be in Frankfurt today for this 7th Annual EIOPA Conference and I wish to warmly thank EIOPA's Chairman Gabriel Bernardino for his kind invitation. I must say that

I feel at home, since we are not far away from the ECB building where I take part in the meetings of the Governing Council at least every two weeks. But today I will speak in my capacity as President of the French supervisory authority, the *Autorité de Contrôle Prudentiel et de Résolution* (ACPR), which belongs to the board of supervisors of EIOPA, and which is in charge of the supervision of both insurance companies and banks in France. This is an important responsibility as the French insurance market is the second largest in the European Union, just behind the United Kingdom, with an aggregated balance sheet of approximately EUR 2,600 bn.

Given that I am speaking before the panel dedicated to innovation, I will take this opportunity to focus on three kinds of innovation, which in my view can lead us to rethink insurance and pensions: institutional innovation, economic innovation and technological innovation.

1. Institutional innovation

Let me start with institutional innovation. On this issue, I would like first of all to **pay tribute to EIOPA** which has done remarkable work to promote sound and consistent European regulation and harmonised supervisory practices within the European Union, since it was established in January 2011. The creation of EIOPA, following the Larosière report, reflected the need to move towards more integrated European supervision following the 2007–08 financial crisis, and I believe that it has been a success. In a context of increasing financial market integration, EIOPA has contributed to ensuring a true level playing field for all actors in the insurance and occupational pensions sector at the EU level, in coordination with national authorities and the other European Supervisory Authorities (ESAs). This well-balanced supervisory framework helps us deal with the “institutional” innovation – this is my first point – that we are starting to see as a consequence of the Brexit vote. Some British entities are indeed considering the possibility of simply setting up empty shell corporations in the European Union, mere company nameplates, while keeping their resources in the United Kingdom. I fully agree with EIOPA that vigilance is called for in this respect. Moreover, Brexit brings with it certain risks, and consequently the need for contingency plans. I am thinking in particular of the European policyholders who took out insurance directly with British undertakings and who should continue to benefit from the same protection. EIOPA, in liaison with the British authority, has rightly made British insurance undertakings aware of the necessity to draw up plans to deal with Brexit, irrespective of the fact that negotiations are still underway. This is particularly important to ensure that Brexit takes place as smoothly as possible, with limited effects for policyholders.

For the future however, it is worth considering the **need to adjust the European institutional framework**, so that it remains as efficient as possible. The review of the ESAs should prompt us to strengthen EIOPA missions. There are two areas in particular where enhanced convergence is needed, so that all European consumers are protected wherever the insurer is located in the European Union: construction and medical liability insurance. EIOPA has already launched cooperation platforms in order to facilitate information exchanges regarding construction liability insurance. We are strongly in favour of pursuing these initiatives and adopting measures to

harmonise supervisory practices in this regard. At the same time we should maintain a clear distinction between the day-to-day supervision entrusted to National Competent Authorities (NCA) and the regulatory harmonisation role that has to be played by EIOPA. In line with this principle, the validation of internal models, for instance, should preferably remain the responsibility of the NCA in order to reflect the close link between this decision and the on-going dialogue that takes place between the insurer and its national supervisor; EIOPA for its part could concentrate more efficiently on the essential task of enhancing the harmonisation between national practices.

In addition to these desirable adjustments of the European institutional framework, there is a need to make concrete progress towards a **European resolution mechanism**, which would provide more adequate tools to limit the impact of an insurer failure and increase trust and confidence. France has been working along these lines at national level and such a mechanism will be in place in our country before December.¹ The French resolution insurance regime requires insurers of a certain size to set up preventive recovery plans, which will form the basis for preventive resolution plans. Moreover, the ACPR is entrusted with several powers to be used in a resolution context, such as the possibility of appointing a resolution administrator in the insurance undertaking, limiting the distribution of dividends, or organising portfolio transfers to another insurer.

2. Economic innovation

Let me now turn to my second point: economic innovation. As Europe's economy is close to the "technological frontier", businesses need to innovate more. As such, they need to be able to take more risks, which requires more **equity** financing, over the long term, rather than debt financing. In this regard, the euro area is seriously lagging behind: equity capital amounted to only 68% of GDP at end-2016, compared with 128% in the United States. And yet, resources are abundant: the excess of savings relative to investment is around EUR 350 billion per year, which is more than 3% of GDP. It is therefore crucial for the euro area's economy to better steer these savings towards productive investment across borders, notably by shoring up equity which is the key to an innovation economy. Startups are well aware of this, but our European scale-ups, midcaps and SMEs also need greater access to equity leverage. The insurance sector has a key role to play since it is the largest institutional investor in the euro area, with total assets of close to EUR 7,800 billion in the second quarter of 2017.

In practice, what is the way forward? A large part of the solution lies at the European level. The efforts so far are going in the right direction, but work should now be accelerated with what I call a "**Financing Union for Investment and Innovation**". This Financing Union is the microeconomic accelerator that we need to make concrete progress towards a genuine Economic Union in the euro area. The building blocks for such a Financing Union for Investment and Innovation already exist: (i) the Capital Markets Union, which promotes the diversification of private financing; (ii) the Juncker Investment Plan, which channels a mix of public and private investment towards the real economy; and (iii) the Banking Union, which addresses persistent financial fragmentation. These initiatives, however, lack the unified governance of a Financing Union, which would help circumvent bureaucratic barriers and foster synergies. In addition, for this Financing Union to be effective, progress is still needed in four key areas: first, providing incentives for cross-border investments, mainly in equity, through accounting, taxes and insolvency laws; second, developing pan-European long-term saving products and investment vehicles like European venture capital funds – I will focus on this area of progress which is of particular interest to the insurance sector; third, completing the Banking Union; and fourth, controlling financial activities and risks that are of vital importance for the euro area, such as supersystemic CCPs.

In this context, insurers have an essential role to play by **taking the lead on new forms of life insurance** that are compatible with the low interest rate environment, with the euro area's need

for equity financing and with the expectations of euro area households – old age provision is now the second most important motive for saving. This means insurers should pursue reflections to develop new long-term pan-European savings products. These products should offer, over time, the higher returns provided by equity, and they can be less liquid, while also featuring a form of capital protection. However it remains crucial that product innovation continues to be carried out carefully, without undermining the protection of policyholders. In this respect, specific attention should be paid to the pan-European personal pension product (PEPP). The PEPP is an avenue to develop pan-European products and responds to the need for insurers to break away from the dual capital-liquidity guarantee. Yet it also raises several concerns: information on the risks incurred under the different types of guarantee may not be clear enough to consumers; in addition, the guarantee may ultimately depend on the financial company that is offering the PEPP, as there is a difference for instance between insurance companies abiding by Solvency II and asset managers, which have lower capital requirements.

This brings me to the issue of regulation. Here too, insurers have to play their part, by actively contributing to **the review of the Solvency II Directive's new regulatory framework**. In many respects, Solvency II represents a very significant step forward for the insurance sector. But this does not mean that it's perfect: we must analyse its impacts closely, particularly its effects on investment behaviour and the financing of the economy, in order to propose the adjustments that prove necessary. Progress has already been made on the financing of infrastructure projects and businesses, thanks to two amendments that came into effect in April 2016 and September 2017, respectively, which adapted the calibration of capital requirements. More generally though, the reviews of the standard formula and long-term guarantee package measures planned for 2018 and 2020 respectively, are important opportunities to make essential improvements. The work is already underway and I welcome the proposal published by EIOPA early in November to reduce the capital requirement for unrated debts and unlisted equities under certain conditions.

The Commission specifically requested that it look at those unlisted or unrated investments. But we may want to look more widely and encompass other types of long-term investments with innovative proposals for amending Solvency II, with the aim of striking the right balance between effective supervision and the financing of the real economy. It is now up to the industry to seize this opportunity to share its views and experience: tomorrow's regulation should benefit from your ideas. Looking at the overall picture of solvency calculation, the correlation between assets classes, for example, to fully recognise the benefits of the diversification of long-term investments, could be an innovative way forward.

3. Technological innovation

Let me now elaborate on my third and last point: technological innovation. The digital revolution is creating many opportunities for both financial players and consumers, including an increasing number of more accessible financial services, and more complete customer satisfaction. In France, the ACPR is mobilised to support innovation, as demonstrated by the creation of the Fintech Innovation Unit and the Fintech Forum with the French financial markets authority. Within this Fintech Forum, we work closely with other public authorities to promote the development of Fintechs and Insurtechs in France. A year ago, the ACPR authorised the first fully digital insurance company in the health sector, the Insurtech "Alan".

In the case of insurers, the digital revolution starts with a complete overhaul of customer relationships and user habits. But it goes further than that. In the digital revolution, the insurance sector can bring stability and protection – it is this that has always been the *raison d'être* of insurance. I'd like to underline two topics that I think are essential: cyber-insurance and big data.

Coverage against cyber-risk, first, is a very real concern that affects all companies – both small and large – as cyber-attacks are becoming increasingly frequent and costly: in 2016, cyber-attacks were estimated to cost businesses about USD 450 billion a year at the global level,

according to a report by Lloyd's and Cyence. Despite these threats, the cyber-insurance market is still underdeveloped. Insurers can and should take inspiration from their own experiences in tackling cyber-risk, and use it to develop a more mature European cyber-insurance offering.

The second subject I'd like to focus on is **personal data and big data**. Naturally, the spread of connected objects that is triggering an exponential rise in the amount of data available on insurance policyholders represents an opportunity for the business of insurance, which consists precisely in collecting and exploiting data in order to quantify and put a price on risk. Nonetheless, insurers should take a responsible approach: we need to strike the right balance between segmentation and the sharing of risk between policyholders. The basic principles of solidarity and risk-pooling that are intrinsic to insurance are at stake. And we must not lose sight of our collective values regarding individuals' right to privacy.

To conclude, I wish to stress that all these innovations require some creativity, on the part of both supervisors and insurers. John Maynard Keynes, who profoundly renewed economic thinking, was well aware of this need to think "out of the box". He wrote in the preface of *The General Theory*: "The difficulty lies, not in the new ideas, but in escaping from the old ones, which ramify, for those brought up as most of us have been, into every corner of our minds."² Let's have the courage to think differently. In this respect, as insurers, it's up to you to shape the insurance of the future and, as I said, a lot has to be done. As supervisors, we also have to demonstrate enough flexibility so as to foster your innovations, while ensuring that the key principles that I mentioned earlier are respected. I am very happy that this very issue will be developed in the next panel discussion this afternoon. I wish you a fruitful reflection. Thank you for your attention.

¹ "Loi Sapin", 9 December 2016; definitive framework adopted before December 2017 via "ordonnances"

² J.M. Keynes (1935), *The General Theory of Employment, Interest and Money*.