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Keynote address

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"Old and new challenges for the insurance sector, its regulators and supervisors"

Good morning to all of you, dear Presidents and members of ICMIF and AMICE,

I am very happy to be here with you today to exchange views on the stimulating and no less challenging developments that the insurance sector, and especially mutual insurers, as well as their regulators and supervisors, will have to face in the upcoming months and years.

After a few words on the economic and financial context and its related challenges for insurers, I will first focus on those brought by regulatory developments currently in the making, and will finish with the new risks that insurers, their regulators and supervisors will have to address, namely cyber-risks and climate change-related risks.

Overall, **the macroeconomic environment has been favourable**. The recovery of the global economy strengthened last year. Global GDP grew at 3.8% in 2017 and is expected to grow at a similar pace for the next two years. The European economy performed well and the inflation rate in Europe is in line with the European Central Bank's target (2%). Even if recent survey data have been somewhat weaker, the medium-term outlook for the euro area remains broadly positive.

However, **global and domestic uncertainties are growing**. The tightening of monetary policy in response to improved economic conditions may impact the growth of major advanced economies. The US Federal Reserve and the Bank of England have progressively raised interest rates; meanwhile, the European Central Bank has started phasing out its bond-buying programme (QE). **The impact of monetary policy normalisation on financial markets should be closely monitored**. The overall market sentiment is optimistic, but signs of possible repricing in financial markets are emerging. Market volatility has increased since the beginning of the year and price corrections were observed, most significantly in equity markets. Valuations remain stretched in equity, bond and certain real estate markets creating a high risk of asset repricing. Recent tensions in emerging markets, especially Turkey and Argentina, initiated some flight to safety mainly towards US investments. **In the near future, the threat to global trade created by protectionist tensions, and growing political uncertainties, also in Europe following the developments in Italy and a significant probability of a hard Brexit may weigh negatively on the global environment**.

In addition, the European insurance sector has been facing an unprecedented and challenging low interest rate environment for the past four years. The downward trend in bond yields had a direct impact on the return on investments, especially for life insurers who hold a substantial portion of their investments in bond securities. **The dilution of investment yields has reinforced risks for the industry** such as a serious lapse risk if interest rates were to rise abruptly, financial losses for insurers who guarantee high technical rates compared to financial returns, or risks related to insufficient cost coverage.

Among this quick review of the most salient characteristics of the environment in which insurers have been operating **I would like to add that climate change risk has now become a reality and** although insurers usually know how to deal with climate risks, including in extreme events, it is more than likely that further adjustments will be needed.

Against this backdrop, **French insurance companies have reacted in three main ways: lowering of paid interest rates in life insurance, development of alternative investment strategies and adaptation of their traditional business model including an increased business diversification.** As a result, for instance**,** unit-linked liabilities are increasing, and the profit-sharing payments for euro-denominated contracts are decreasing. However, I note that these payments remain significantly higher for mutual undertakings: they amounted to 2.3% last year while the French average is lower, and the reserves for deferred profit sharing have been strongly reinforced and amount to approximately 6% of mathematical reserves at YE 2017, which is 50% higher than the French average.

As a result, French insurance companies remain fairly solid, and the own funds held largely cover regulatory solvency capital requirements for both life and non-life insurance companies, which is an important asset in the challenging environment in which they are operating. This is notably the case for the mutual insurance sector. Its solvency coverage ratio significantly exceeds 300%, which is higher than the average in France, thanks in particular to their prudent and long-term approach, with less pressure from the financial markets.

However, adapting to a challenging environment does not come without new risks. For instance, it is necessary to closely monitor risks related to policyholder protection and advice, the excessive lengthening of bond maturities or the over aggressive search for yield.

Now, **I would like to focus on regulatory developments, which are numerous and may have an impact on the insurance business model going forward. The French insurance landscape has experienced major regulatory changes over recent years**: a modification of the taxation system of life/savings insurance contracts (Flat Tax), the possibility of changing credit insurance contracts annually (Loi Hamon/Amendement Bourquin), and the creation of a specific prudential status for French pension funds. The new Pacte Bill should bring about further changes that seek to promote long-term investment in equity, including a reform of the French life long-term insurance product (also known as Eurocroissance).

In addition, at international and European level significant regulatory developments are also in the making. At the international level, **the IAIS work on systemic insurers and the international capital standard (or ICS) has recently made significant strides**. As you know, as part of its post-crisis action plan, the IAIS developed in 2013 an identification method for systemic risks, reviewed in 2016. This led to the identification of nine global systemically important insurers, to which specific measures are applied (increased supervision, specific management plans, chiefly for liquidity, recovery and resolution, and a capital add-on measure, currently postponed to 2022). Given the recognised shortcomings of the methodology, including weak factual basis, **the FSB asked the IAIS to review it with three key focuses: developing an activities-based approach supplementing the entity-based approach, which itself will be reviewed in order to correct deficiencies. A new framework is hence being developed** which will make it possible to reconcile an activities-based and an entities-based approach, to better capture relevant risks and systemic undertakings. In the meantime, the list of global systemic insurers will remain frozen for 2019 and could be suspended beyond and until 2022, so that enough experience is gained with the new approach.

Regarding the International Capital Standard, which aims to develop an international capital standard in order to be able to establish a comparable basis in terms of prudential requirements for all international groups, **recent progress was made in Kuala Lumpur in November 2017 which should lead to, by the end of 2019, a version called "ICS 2.0" that will be used as a reference in international supervision Colleges, for a transitory period of five years**. During this timeframe, each internationally active insurance group will have to ensure a compulsory and confidential five-year monitoring period based on the ICS, after which this standard is expected to become effective.

Now, I will turn to IFRS17: **it would be unreasonable to apply the new IFRS17 accounting framework right now. Given the obvious issue of timing, it is quite welcome that the IASB reopened the discussion and that the application of this standard has now been postponed by one year.** This will primarily give us time to reach an agreement on identifying groups of loss-making contracts. **We also want to bring the discussion on the**

treatment of reinsurance contracts held to a satisfactory conclusion. At this point, there is too much room for interpretation in the standard, which could interfere with the comparability and consistent application across countries.

In Europe, the current "hot topic" is the forthcoming Solvency 2 review.

This review must include a full and objective assessment of the framework that has now been in place for three years.

Of course, **insurers have significantly improved their risk and capital management under Solvency 2, and the insurance market is now more resilient and better equipped to cope with financial crises**. The average SCR ratio in the European Union stood at 241% in the first quarter of 2018. It tends to be even higher for mutual insurers

But these positives must not be allowed to overshadow the questions that need to be asked after such a radical change, particularly about the impact on equity investment and the financing of the European economy, as well as issues relating to volatility and complexity.

Therefore I invite Insurers to play an active role in the discussions that should come with the so-called "Long Term Guarantee Package" or 2020 review. As was the case with the 2018 review, **the ACPR will call for further progress towards a significant simplification of the framework. We also expect the review to better take into account the impact of Solvency 2 on the financing of the economy**.

This said, and irrespective of the outcome of the forthcoming reviews, the proportionality principle and its harmonised application across the European Union will remain a major concern for EIOPA and of course for ACPR.

On a topical note, I would add that **it is crucial for supervisors to apply all prudential requirements with equal rigour**. The string of failures by insurers doing business on the French market under the freedom to provide services, particularly in construction insurance, is a reminder of the importance of this. The Freedom of Provisions of Services is sometimes at odds with the specific features of national markets. Complex and long-term products require improved skills on the part of both the insurers providing the products and the supervisory authorities, with EIOPA's support. **The requisite convergence of supervisory practices needs to become a reality very soon**. I know that EIOPA is making this a priority.

Incidentally, the three-year review of the European Supervisory Authorities (ESAs), is underway. Following a public consultation proposed by the European Commission, the draft legislation looks to strengthen the authorities' and chiefly EIOPA's role and powers without calling into question the existing architecture. This should support the goal of increased convergence in supervisory practices, which should in turn promote improved effectiveness.

Accordingly, the proposal represents a positive step forward for Europe. **However, a close eye should be kept on the place given to national supervisors, especially regarding the question of internal models and supervisory colleges. They should remain within the national supervisors' realm of competence, while EIOPA's mediation role is essential and should be reinforced, especially with regard to cross-border issues. However, this is incompatible with assuming responsibility for validating national internal models**. As for the EIOPA role on cross-border cases and its guidance for national supervisors that some Member States would favour, such exchanges could take place within dedicated coordination platforms.

Beyond regulatory adaptation, the challenges ahead relate to technological and environmental changes, which are new and yet crucial matters for attention for insurers, regulators and supervisors.

Insurance players, of all sizes and risk exposures, are facing the digital revolution, which is inescapable as the developments in other business sectors such as travel, tourism or catering show. To remain competitive in terms of customer relationships, insurers will need to raise their customer experience to the highest levels. This will require them to fundamentally review their processes, tools and information systems. It also calls for an upgrade of their human resources policies. **The risks associated with the digital revolution are numerous, but I would like to stress the bigger risk associated with procrastination. This risk seems particularly important to me and it will be an essential focus of attention for supervisors**.

The digital revolution has other ramifications that require the attention of supervisors.

One of them is the increasing inclusion of insurance products within package deals. This is particularly the case for affinity insurance products. These often involve the multiplication of intermediaries in the value chain. This phenomenon can blur responsibilities and the intrinsic economic value of these products, and we are therefore vigilant as consumer protection is especially important in a strengthened European regulatory framework for product governance (via the Insurance Distribution Directive in particular).

Another one is the access and use of data. To remain competitive in the customer relationship and risk management, access to data and the ability to efficiently use them will be essential. These developments will involve further cooperation between the personal data protection authorities and the insurance supervisory authorities. This cooperation has already become a reality thanks to the CNIL's (National Commission for Information Technology and Civil Liberties) presence in the Artificial Intelligence Task Force led by the ACPR, which will publish a report in the coming months. I hope that this cooperation will deepen further in the coming years.

As a result, data are more than ever a strategic asset. In these circumstances, faced with the risks of cybercrime, it is imperative to ensure security.

The digital revolution has been accompanied by the emergence of IT attacks, which have been increasingly publicised. The insurance industry, where information systems play a major operational role, has not been immune to such cyber-attacks. **Insurers now need to manage and guard against this risk, which, in their case, is increased by the criticality of data (medical, personal, financial, etc.) handled and stored in their information systems**.

Public authorities are seeking to address these challenges and have undertaken major initiatives to raise awareness among insurers as to this new type of operational risk**,** as the **IT systems of the insurance sector are still too vulnerable.**

It is primarily up to **the market to design efficient security schemes compatible with the opening-up of information systems and innovation**. This is a huge challenge, but it is in this spirit that the ACPR works. Cyber security remains one of our supervisory priorities for the coming years and it is important to actively maintain or engage our dialogue in this regard, facilitate the emergence and dissemination of best practices, and strengthen the resilience of the insurance sector.

In this decisive transition phase, I would like to draw your attention to the ACPR's paper on IT risk, which discusses best practices regarding IT risks and more specifically cyber risk.

While the digital revolution creates new risks for insurers as targets, it also offers new opportunities for growth in the industry to cover the cyber risk of their policyholders. The ACPR will therefore be particularly vigilant in the development of cyber insurance, which again requires insurers to adapt, manage a ”new” risk in terms of selection and underwriting, pricing, and portfolio oversight.

The last supervision priority I would like to mention is related to **climate change**. Although losses from natural disasters in the world during the first half of 2018 were half of those observed during the same period in 2017[1], this is not good news. The long-term impact of

[1] Losses amounted in USD 33 billion in the first half of 2018 and USD 65 billion in the first half of 2017

climate change remains a key area of vigilance for insurers, as climatologists foresee a long-term increase in natural disasters. **Such changes impact both sides of the insurers' balance sheet, via the increase in physical risks and transition risks to a low carbon economy, and more work is obviously needed to address them properly**.

For instance, no common methodology has been developed yet to properly assess the impact of the foreseen increase in the frequency of natural catastrophes. Regarding the exposure to transition risks to a lower carbon economy, the exposures of the French insurers to such a risk have been assessed. At the end of 2017, EUR 250 billion, or around 10% of the total portfolio of the French insurers, was invested in sectors defined as sensitive to transition risk, which can be seen as a significant exposure. This figure is only a ballpark figure, though, as definitions of and methodologies to measure the carbon footprint of assets portfolios are still under construction.

These examples show that there is still not sufficient recognition of the need to act rapidly in order to reach the objectives of the Paris agreement in terms of climate change. Regulators' actions have to give the right incentives for players to act more quickly. In this respect, the Banque de France and the ACPR have set up and are actively coordinating the network of central banks and supervisors for Greening the Financial system (NGFS).

Let me conclude by saying that mutual insurers are of course exposed to all the challenges I have mentioned. I trust that they are willing and well equipped to live up to them. Over the last years and in order to face new challenges, the mutual sector, which historically comprised a large number of entities, has adapted and has successfully achieved the necessary concentrations. It is important that it continues to adapt, including at an international level, especially since the values of mutual insurance are essential to the stability of the insurance model based on risk-sharing.

Thank you all for your attention.