

**Commissioner McCreevy's Speech at
The European House – Ambrosetti
Workshop " *Intelligence on the World,
on Europe, on Italy*"**

Cernobbio, 8th September 2007

Steer

THE EUROPEAN HOUSE is a European management consulting group, under the partnership between AMBROSETTI (Italy), NORMANN PARTNERS (Sweden), STERN STEWART & CO. (Germany) and SYNOCUS (Finland).

The mission of THE EUROPEAN HOUSE is to provide consultancy services to the top management of public and private institutions in the following domains:

- governance systems;
- framework for strategic management (mission, business identification, business strategy, corporate/portfolio strategy, etc.);
- reconfiguration of the business and value creation system vis-à-vis discontinuity;
- leadership development;
- knowledge management;
- criteria for value creation and measurement.

Since 1975, during the first week of September, Ambrosetti has been running a workshop called "**Intelligence on the World, on Europe, on Italy**" at Villa d'Este in Cernobbio on the shores of Lake Como. Heads of State, top representatives of European institutions, ministers in office, Nobel laureates, and experts from around the world come together every year to discuss the issues of greatest impact for the global economy and society as a whole. In addition to forecasts about the worldwide, European and Italian economic and political situation, participants analyze key technological and scientific advances and their effects on the future of business and society.

**Commissioner McCreevy's Speech at
The European House – Ambrosetti
Workshop " *Intelligence on the World,
on Europe, on Italy*"
Cernobbio, 8th September 2007
Speech**

Ladies and gentlemen,

First of all I want to thank the European House Ambrosetti for its invitation today. Events like this are very useful. A comprehensive debate between key players that is based upon high quality research and facts can contribute meaningfully to fostering economic growth in Europe and Italy.

I particularly welcome the opportunity to talk to you about the important role of the insurance sector in the economy. If we are to succeed in our task of sustaining and increasing the growth of the European economy, a strong financial services sector and an integrated, sound and efficient financial system is critical. A competitive and efficient insurance sector must be an essential component of that.

Economic growth doesn't happen if people don't take risks. Of course if the risks are too high or too concentrated, people will shy away from them. By reducing, mitigating and spreading risks, the insurance sector plays a crucial role in the economy. The excellent report prepared for today's conference, by the Italian Insurance Association (the ANIA report) makes that point well. If European policymakers want a flourishing economy, a healthy and well-performing insurance sector that inspires the confidence of all economic actors is an indispensable condition precedent.

The insurance industry is one of the most significant institutional investors.

The industry – aside from enhancing financial intermediation, creating liquidity and mobilizing savings - is also a *longer term* provider of capital than banks. Therefore the insurance industry is - and always will be – key to the development of strong, more diversified, and more innovative capital markets.

This in turn helps drive higher and more sustainable growth.

But the contribution of the insurance industry to the economy doesn't stop at enhancing the quality, strength and diversity of Europe's capital markets and the provision of long-term finance for industry. It also helps address the most daunting, long-term challenges that our societies face: in particular the challenges created by an ageing population. We all know that the pensions' time-bomb is ticking and has been ticking for some time now. However, few Member States have to date taken the measures that are needed to handle the potentially devastating but inevitable combined effect of increased pension and health-care spending that will face Member State governments in the decades ahead.

The report prepared by ANIA reminds us that insurance companies can be part of the solution by galvanising the private sector and private individuals to complement the State as a provider of social protection. It is no secret that I have been a strong advocate of the need for Member State governments – in conjunction with private industry and individuals - to address the pension fund time bomb for some time now. As Minister of Finance in Ireland, I did what I could to ensure that the future of social protection does not just depend on future tax revenues to fund State benefits.

I believe that the "one-off" proceeds of privatization should be used not to artificially deflate short term deficits and create a sense of complacency but to start funding the building of independently managed State pension funds to meet future demographic needs. Side by side with that the further development of privately funded pension schemes for employees must be encouraged. This will not only reduce future burdens on society. It will also provide fresh capital to boost economic growth and encourage people to take their future into their own hands.

But perhaps most important of all is the need to develop third-pillar individual portable pension schemes which I stimulated in Ireland through tax incentives and by introducing greater flexibilities into the system. This is not just about people providing for their own future with the help, perhaps, of their employer. It is much more immediately and more urgently about avoiding the pitfalls of defined benefit schemes which massively penalise mobility and, by definition therefore, massively penalise flexibility, change, and therefore risks hampering long-term growth. Of course, there is nothing more attractive than the defined benefit pension scheme if you are about to retire with one. And it has been a common form of pension provision in both the public and private sector for many decades. But its continued appropriateness and relevance in modern economies -where business is constantly pressured to change and adapt to the forces of globalization, innovation and competition is highly questionable. At a time when globalization and technological change is forcing the pace, and at a time when it is making the need for labour market mobility and flexibility greater than ever, the in-built penalties for mobility that are embedded in defined benefit schemes too often render such schemes unfit for purpose.

They either leave employers with workers they don't want or workers with employers they don't want, or both. They not only stultify the growth of the individual. Where they are an obstacle to restructuring they can even threaten the survival of the business.

In many European countries, including Italy, a well-developed private pension system will be critical to guarantee that future pensioners have an adequate standard of living, as the replacement rate afforded by the public pension is set to decrease as the population ages. I acknowledge that Italy has already taken some steps in the right direction. But as with many other Member States, action needs to be intensified.

Fortunately, things are starting to move in different corners of the EU. In health care, we all know the positive steps that have been taken for example in the Netherlands. But we can look also towards Germany whose private insurance plays a fundamental role for significant segments of the population.

I would like however to stress that, as Commissioner for the Internal Market, I have no direct influence on these matters. Nor has the Commission as a whole. The design of pension and health-care systems is a responsibility that is firmly in the hands of Member States. It is also Member States who are responsible for taxation, and we know that it is only through tax incentives that you can develop new, private and individual funded pension schemes. I only hope that all Member States learn from each other and that they allow market operators to take full advantage of the single financial market that is emerging. As stated in the ANIA report, it is largely cultural changes that are required if Italy is to allow for a new partnership between the private and the public sector for the management of the main risks faced by society.

I was interested to read that the development of the Italian insurance sector, and in particular of the non-life part of it, is lagging behind in comparison to other EU Member States. This issue needs to be addressed and the creation of a single European insurance market will help by stimulating cross-border competition which in turn should stimulate Italian companies to be more creative in the design of products that are needed by businesses and households.

More particularly, I am convinced that the recent legislative proposal adopted by the Commission on the solvency of insurance companies will be a major stimulus for the modernisation and growth of this sector in Italy and in the rest of Europe.

Indeed, one way in which the European Commission can stimulate the positive role of insurance in promoting growth is by ensuring that the insurance market is properly regulated.

Since I took up office as European Commissioner, I have been striving to apply at EU level the philosophy of regulation that engenders trust in investors and consumers - at the least possible cost in terms of procedures and norms.

This means three things in practice: (1) fewer, and where they already exist, better targeted rules; (2) improved procedures before rules are adopted - open consultation, economic impact analysis, early participation of market professionals and national regulators; and (3) better implementation and enforcement.

Europe needs an insurance regulatory regime that is fit-for-purpose to face the challenges of the future. We learnt from the old system of regulating insurance that capital is not enough to ensure the soundness of companies. What is needed is a system that encourages and rewards good risk management.

The new system will be based on sound economic principles. The new quantitative requirements will mean that the true risk position of an insurer is reflected in the amount of capital he needs to hold, giving full recognition to the impact of modern risk mitigation techniques, such as securitization and derivatives.

The new qualitative requirements will strengthen the governance of insurers. Reporting and public disclosure will become more intelligent. Market discipline will be harnessed to support supervisory goals.

The responsibility for the sound running of the company will be firmly on the shoulders of the management. Supervision should be designed to be flexible enough to take account of the individual characteristics of firms, and it should not unduly restrict business decisions.

In the end, Solvency II will let insurers do what they should do best - the quantification and pricing of risk. Their own risk in this case.

The new system also acknowledges the changes in the landscape of the European financial services industry and particularly the appearance of large, multinational groups.

The supervisory view of groups has become increasingly detached from the integrated way in which groups are actually structured. Groups are faced with unnecessary administrative burdens and supervisory effort is being duplicated.

Under the Commission's Proposal groups will be allowed to organise themselves in the most economically efficient way. A dedicated group supervisor will have to be appointed for each group, with real decision-taking powers and coordination responsibilities. Groups will need to demonstrate robust systems and controls and effective group-wide risk-management before being allowed to take advantage of group-wide diversification benefits, a lower capital burden and streamlined supervisory and reporting requirements.

In brief, our proposal on group supervision aims at adapting our supervisory arrangements to the reality of the Single Market.

We expect considerable benefits from the Solvency II project for all interested parties.

The direct beneficiaries will be insurers. The new regime will promote sound risk management, linking supervisory requirements with market practices and rewarding well managed companies. This should lead to improved efficiency, establish a level playing field and contribute to a further integration of the EU insurance market. Most importantly, the international competitiveness of the EU insurers and reinsurers will be improved.

The main indirect beneficiaries will be policyholders. The new regime will ensure a uniform and enhanced level of policyholder protection across the EU. The introduction of an economic risk based approach should give policyholders greater confidence in the products offered by insurers, or at least greater ground for confidence, because of the better risk management and sounder pricing that Solvency II will promote.

We expect Solvency II to increase competition, especially for mass retail lines of business, such as motor and household insurance, putting downward pressure on many insurance prices and increasing choice by encouraging product innovation.

Overall, the economy as a whole should benefit. The alignment of regulatory requirements with economic reality will provide for a better allocation of capital at firm level, at industry level, and within the EU economy. This will result in a decrease in the cost of raising capital for the insurance sector, and possibly also for the EU as a whole, through the role of the insurance industry as an institutional investor. More efficient allocation of risk and capital within the economy should also promote medium and long-term financial stability.

Conclusion

In concluding, I would like to come back to the main message of the report which was prepared for today's discussion: Yes, the insurance industry can contribute more to economic growth both in Italy and Europe. And I believe that it will do so if the markets are more open, if capital moves more freely and if the new legislation that we have recently put forward is endorsed by Member States and the Parliament. The sooner the better for Europe.

It will then be up to governments, social partners and insurers in all Member States to see whether the new European legislative framework for insurance should be used as an opportunity to increase the role insurance companies play in society; whether a new balance can be found between private sector and public sector solutions.

I personally believe that all Member States would benefit from an in-depth, collective reflection of this kind.

I look forward, in any event, to taking an active part in these discussions.

ENDS.