



Insurers were the ugly duckling of the sector

In Solvency II, a solvency ratio of 200% is seen as superior to 150%. But that is not always true.

Carlos Montalvo was the first executive director of the European Insurance and Occupational Pensions Authority (EIOPA) in 2011. It was the height of the euro crisis following the credit crunch. Montalvo is now the global insurance regulatory leader at PwC. Insurance supervision is still the specialty of the Spanish lawyer. We spoke to him during a recent visit to Amsterdam.

“Banking, banking, banking.” When Carlos Montalvo took up his post at the newly established European supervisory authority for pension funds and insurers, banks were at the centre of financial supervision. “Insurers were the ugly duckling of the sector”, he says now. “ECB’s policy of quantitative easing, which brought interest rates down to 0%, was mainly aimed at banks. It helped them navigate the storm. However, the extremely low rates were killing for pension funds and insurers, but zero attention was paid to that.”

Because of the low interest rates, guarantees offered by insurers and pension funds – often based on 4% interest – became very expensive. “Insurers discovered that under Solvency I their liabilities had been undercalculated. Guarantees aren’t necessarily a bad thing, they were simply mispriced at the time. One of the primary reasons Solvency II was a good idea is that it compelled the insurance market to accurately price guarantees. That lesson has been learned, but the distrust of guarantees remains. Many customers, however, appreciate guarantees, particularly long-term ones, precisely the type of products that insurers are best placed to provide.”

As a supervisor, Montalvo saw the financial sector struggling for years with low interest rates. Despite their unsustainability, no one dared to cut the guarantees. “What the Netherlands did with pensions was unique and impressive. The government showed courage and actually forced haircuts on pension benefits. The only other countries that did this were Greece and Portugal. But that was because of the pressure from Brussels.”

WHAT THE NETHERLANDS DID WITH PENSIONS WAS UNIQUE AND IMPRESSIVE

Since the credit crisis, insurers are perceived differently. Awareness has grown around the ‘protection gap’, the mismatch between financial risks and the portion covered by insurance, and how to narrow it. Also, insurers are now appreciated as institutional investors who can help drive progress through strategic investments.

With this increased attention comes a greater societal role for insurers, according to Montalvo. “There are two main purposes for investments by insurers. To serve policy holders and to deliver to shareholders. It is nice to facilitate the public agenda, but that should never be the priority. Having said that, insurance companies can help transform society. Traditionally, insurers compensate for losses by replacing what was lost. But bringing back the same doesn’t reduce the underlying risks. So, it’s smarter to look at how risks can be minimized, especially when many risks are actually increasing. If you don’t do that, they become uninsurable.”

A prime example is climate change and the resulting natural disasters. Extreme weather events are becoming more frequent and severe. ➔





Carlos Montalvo Rebuelta (1972) has a degree in law and a degree in business administration. He worked as insurance supervisor for the Spanish regulator DGSFP from 2000 to 2007. In 2007 he became secretary general of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) in Frankfurt. In 2011 he was involved in the setting up of EIOPA, of which he was the first executive president until 2016. Since then he is with PwC in Madrid. He is at present a partner, leading the global PwC insurance regulatory practice.

"If you rebuild homes and infrastructure the same way after a disaster, you're guaranteed that some climate risks will become uninsurable. So, after a loss, it's essential to consider how to avoid future risks. Insurers must not only react to damage, they should be part of the solution."

Insurers don't need to lead the change; there must be a viable business case. "There is the political temptation: insurers have trillions of assets, but investments should be in line with liabilities, not with political goals. Insurers are simply better at calculating and managing risks. That's not a core competency for most companies."

THERE IS A MUCH BROADER, LARGELY UNTAPPED FIELD OF OPPORTUNITIES FOR INSURERS

Montalvo sees a much broader, largely untapped field of opportunities for insurers. "The goal is to take over risks that individuals or companies can't bear across their entire lifespan. Managing capital accumulation and decumulation, healthcare, climate change, business support—you're seeing more of that. It's not entirely new, of course. Spain had a great example 20 years ago: corporate pension obligations became a burden for companies. But what does a construction or telecom company know about longevity risk? So early in the century, these obligations were transferred to insurers. The same trend has emerged in the UK over the past five years. Transferring risk doesn't eliminate it, but insurers can assess and manage it more effectively."

In the consumer market, Montalvo sees major potential. Even in countries like the Netherlands, that already have a high insurance coverage, there is still room for improvement to reach an optimal level of transferring risk. Pension systems are often outdated, based on old ideas about aging. "People live longer and want to maintain their affluent lifestyles. Dutch retirees want to play golf in Spain at 75. But that requires capital. This is where insurance companies can step in."

If insurers want to play a greater role and attract more business, they must improve their poor reputation. Montalvo shows a slide of a recent presentation he gave to a company. Banks, internet providers, and insurers are ranked lowest in public trust. "Distrust is the default for many consumers and businesses. How did we get there? The financial crisis played a key role. Banks took the biggest hit, but the distrust spread to the whole financial sector. Insurers often offer complex products and face an 'expectation gap.' I recently held a lecture on risk management course in Frankfurt. One student complained that her dental insurance – a policy with a €200 franchise – only reimbursed €1000 of €1200 in costs. The focus was on the €200 not covered, not the €1000 she did receive. That shows insurers aren't telling the right story. The sector needs to do better. Products must be simpler and more transparent, so customers understand what they're entitled to."

AI and the growing data stream can help tailor better products. "Data is the new gold. It has always been, but now there's so much more of it. We're better at using it, too. AI is mainly used for claims processing right now—making it faster and more transparent. But I believe AI can also help design new, more transparent products and better serve customers. The question is whether people have enough faith in insurers."

Montalvo emphasizes that the 'human touch' remains key in rebuilding trust in insurers. He shares a personal anecdote: his mother twice left the key in the inside of the front door. "A locksmith would cost hundreds of euros. I called my insurer. They resolved it for €50. Twice. But the best part was that they later called to ask how my mother was doing. That's what makes service valuable."



Montalvo sees insurance companies changing. "Little by little they are heading in the right direction, and that's good news to all of us."

As EIOPA director, Montalvo was deeply involved in developing the Solvency II directive, now under review. "Solvency II remains too complex," he admits. "Yes, I'm partly responsible for that. I wish we had managed a simpler regime."

MY CRITICISM IS THE EXCESSIVE FOCUS ON SOLVENCY RATIOS

His main criticism is the excessive focus on solvency ratios. The review doesn't address that properly, he feels. "In Solvency II, a solvency ratio of 200% is seen as superior to 150%. But that's not always true. You're comparing apples and oranges. One type of Tier 1 capital isn't the same as another. Insurers also deal with different national approaches to taxation, with transitionals, future profits etc. These factors all influence the ratio. "You need to understand how the number is calculated. Analysts, investors, and regulators need to be more aware of that. It's not the number that matters, but how you get there, the underlying calculations."

Montalvo doesn't expect this weakness of the regulation to be resolved quickly. National differences between governing laws for insurers as well as a supervisory approaches remain too great. That's also why he doesn't foresee rapid harmonization of the European insurance market. "A harmonized market is always better, because it's also bigger. But I don't see it happening anytime soon. The differences are too vast, even culturally. Germans prefer guarantees, while the French prioritize liquidity. That leads to differences in products and regulations." ■

REINSURERS

Carlos Montalvo expects reinsurers to gain in importance the coming years. That's why he welcomes new entrants alongside traditional players like Swiss Re and Munich Re, especially those bringing American capital. "There is room for both."

He foresees growth in climate-related and life reinsurance markets. But the ease with which risks have been reinsured in recent years isn't guaranteed. "To effectively manage risks, insurers and reinsurers need to work together more closely to mitigate them, for example in the development of climate-resilient infrastructure and housing.."

Government behaviour is also crucial in the insurance market for climate risks. "With major disasters, governments are quick to open their wallets. But if citizens and businesses come to rely on that, there's no viable business case for insurers and reinsurers. Governments need the courage not to help. Maybe regulators should point this out too."