Report on the eighteenth Conference of European Insurance Supervisory Services

May 19-20, 2005, Prague, Czech Republic

Summary

The 18th Conference of European Insurance Supervisory Services, held in Prague on May 19-20, 2005, gathered over a hundred participants mainly from Central and Eastern Countries. Representatives from the participant jurisdictions as well as from international organisations developed their views on the changes of the European insurance market after accession of the new EU members, the risk based approach in prudential supervision, the role of the professional entities in the insurance sector, catastrophic risk management, the role of the external audit in the financial stability, the role of insurance contracts as financial instruments, the IAIS Framework and Corner Stones and solvency models and risk classification. An IAIS wordshop dealt with the valuation of assets and liabilities, the prudence requirements and the sensibility to risks. The next Conference will take place in Sofia on 7-8 June, 2007.

Introduction Opening of the Conference

The 18th Conference of European Insurance Supervisory Services has been held in Prague, Czech Republic on May 19-20, 2005, organized by the Czech Office of the State Supervision in Insurance and Pension Funds. The International Association of Insurance Supervisors (IAIS), the Organisation of Economic Cooperation and Development (OECD) and the International Insurance Foundation (IIF) gave an essential support to the success of this conference. The Standing Secretariat of the Conference (Swiss Federal Office of Private Insurance) assisted the organization when necessary.

The Conference was attended by over a hundred participants (see enclosure) mainly from Central and Eastern Countries. 9 of the 10 new members of The European Union (EU) were represented, the two future EU members, as well as other countries keen to exchange views about Insurance Supervision and markets, such as Croatia, Macedonia, Russia and Serbia. Participation of the private sector has also to be noted as a useful widening of discussions / exchanges / cooperation. This shows and confirms the important pan-European vocation of the Conference towards a very open and wide cooperation about Insurance markets and supervision.

In the opening speeches, **Bohuslav Sobotka**, Minister of Finance of the Czech Republic and **Vaclav Krivohlavek**, Head of the Office of the State Supervision in Insurance and Pension Funds of the Czech Republic emphasized the necessity to have a well working insurance system and good supervision, with the example of the catastrophic floods of 2002. Changes in the Insurance sector has been and will remain in the future a big challenge for their country. **Yoshihiro Kawai**, Secretary General of the IAIS stressed the importance of the convergence of the solvency regime and mentioned the liabilities as being the core issue of this convergence. **Kurt Schneiter**, Chair of the OECD's Insurance and Private Pensions Committee gave an overview of this Committee's activities.

Basic Changes of European Insurance Market after accession of new EU members

The representatives of the Czech, Slovakian and Polish Supervisory Authorities (resp. **Petr Svoboda**, **Dusan Katonak** and **Katarzyna Policha**) presented from their point of view the changes occurred in their jurisdiction from the establishment of an Insurance Market and an Insurance Supervision and in particular, after their accession to the EU.

All delegates reported that there has been no significant change in their respective domestic markets after their accession to the EU, on May 1st 2004. Companies standing under their supervision are mainly owned by foreign shareholders and were established in the market already before that date. And they all started implementing the EU directives years before this date, so that they were ready to apply them. The biggest change after the accession mentioned was the effective entry into force of the single license, allowing free circulation of insurance services. After only one year, those countries received between 150 and 200 notifications from foreign companies wishing to make insurance business in their jurisdiction. These countries have met so far and will go on meeting considerable challenges, especially in setting up and strengthen an efficient supervisory authority and adopting all the necessary legislation. The supervisory authority’s tasks are more complex, entail more responsibility, require more skilled staff and more intensive cooperation.

Karel van Hulle, Head of the Insurance and Pension Fund Unit of the European Commission, reported that the 10 new Member States had done extremely well in implementing the 22 insurance-related directives. As future new Member States, Bulgaria and Romania already participate in the Commission’s internal work. On May 3rd, 2005, the European Commission has issued for consultation a Green Paper defining its general Approach for the next 5 years. The main lines of this approach aim at “Better Regulation” are transparency, consolidation, effective transposition, impact assessment of all new legislation and ex-post evaluation. There are indeed few new initiatives apart from Solvency II. For this project, a second wave of calls for advice is under action. A third is still to come according to the “Road map”. Karen van Hulle also mentioned the debate for the next 10 years “How to develop a real retail insurance market ?” aiming at preventing anti-competition behaviour, enhancing supervisory convergence while maintaining a regulatory dialogue with the main third Countries. For the time being the main difficulties come from the application of the directives on intermediaries and pension funds.

Prudential Supervision : Risk Based Approach

Representatives of the Supervisory Authorities of United Kingdom (Financial Services Authority, FSA - UK), Hungary (Hungarian Financial Services Authority, HFSA) and Germany (Bundesanstalt für Finanzdienstleistungen, BAFin) presented their methods of Risk Supervision. These three Authorities are supervisory bodies for all financial sectors. Their approach join on a few basic points : both quantitative and qualitative elements must be taken into consideration, the processes aim at making the companies aware of their risks and responsible for them, the capital requirements are adequate to the level of risks, the need for supervision is proportionate to the risk level, combined with the quality of their control by the company.

Ashley : FSA UK's approach is based on a risk assessment process according to a specific framework (ARROW) whereby individual capital requirements are proportional to the risks identified. Especially through meetings with the companies at all levels, the aim of the assessment is to give incentives to companies to better see their risks, classified in 2 categories : Business Risks (e.g. Market, Credit, operational Risks, strategy, customers) and Control Risks (e.g. structure of the company, governance, business plan). Charges in term of Capital Adequacy are similar to those of Basle II : The bigger the risks, the bigger the Capital required ; the better the control, the lesser the capital required.

Judit Demjen-Gyöngy : Hungary has undergone very rapid changes in 7 years. HFSA was created in its present form in 2000. Before getting to the present risk based approach, there was an early warning system (1998) and then a rating system (2000). But these systems did not work properly because of lack of data, lack of electronic data processing systems and lack of qualified supervisors. These gaps have been compensated. The present system is based on the assessment of the risks, parted in 3 categories : Personnel risks (shareholders, strategy, management, staff), Operational Risks (corporate structure, information systems, internal controls) and Business Risks (solvency, liquidity, market and insurance risks). This assessment is integrated in the risk based supervision according to the so-called "circle of supervision". HFSA has undergone an FSAP Assessment in March 2005, where the very good progress were noted and recommendation issued for improvement, especially in setting guidelines or policies for companies about their risk management, internal controls and auditing.

Britta Heidemann: In Germany, Risk Management is considered by the BAFin as core function within an insurance company. It must be part of the company's strategy. The process should include identifying, measuring, controlling and monitoring the risks, as well as good internal control systems. The main risks categories are Underwriting Risks, Investments Risks and Operational Risks. The general and prudential legal environment have developed and is still developing towards these principles.

Role of Professional Entities in the Insurance Sector

The Czech Insurance Association, the Comité européen des assurances (CEA) and the International Insurance Foundation (IIF) had the opportunity to present their view in particular about their impact on Supervisory activities.

Ladislav Bartonicek of the Czech Insurance Association described the developments of the insurance industry. He reported that the local insurance industry would welcome a "simplification time" to swallow all the changes. But it won't come before Solvency II, which is the biggest change facing the industry. The Insurance Association cooperates with the CEA, but is still in a learning process and so are the regulators, with whom a deeper cooperation is wanted and needed.

Christian Pierotti of the CEA gave an overview of the CEA and its role. The CEA members, associate members and observers cover a geographically wide range of countries including Turkey and Russia. Its role is essentially to gather information and consolidate industry positions towards the Authorities. The quick changes of legislation should not be seen as a threat, but as a chance. The national Associations should however work closely with the Regulators. Solvency II in particular is a huge opportunity for the Insurance industry to improve competition. Mr. Pierotti strongly recommended the national associations to enhance national cooperation and especially the cooperation with Supervisors.

Robert Gibbons of the IIF presented a few headlines out of the latest US newspapers which showed the effectiveness of the supervision. There are a few abuses in the US insurance industry and the supervision does its job, but what about the consumer confidence ? Robert Gibbons stressed the importance of having a "collaborative supervision, including all actors : Supervisor, Consumers, Academics, Professionals, Insurers. A good Insurance market needs the collaboration of all to achieve its job.
"It is all about ethics" says Robert Gibbons, " we have to help each other to find Utopia, to find rules that all would accept if they were at the other's place."

Catastrophic Risk Management

Alberto Monti, of the OECD and Professor of the Bocconi University, Milan, parted the different types of catastrophic risks into three categories: natural (e.g. earthquakes), accidental man-made (e.g. industrial accidents), intentional man-made (e.g. terrorism). The insurability of these risks is an important issue, because they tend to become more frequent, to be more severe and to originate each more losses (Rising population densities, growing urbanization of exposed area). The 2004 Southeast Asia Tsunami was one of the worst natural disasters of the past 100 years, but the financial impact was very low, because insurance penetration is very low in the region. Solutions can be looked for on the financial market through securitization of catastrophic risks : the cat bonds. They allow immediate payment, transform the basis risk into a credit risk, but the market remains small compared to the needs of the Insurance Market. Governments as well have an important role to play in disaster prevention and compensation. There are also good examples of public/private partnerships. As a conclusion, the best solution is an integrated disaster risk management strategy.

External Audit : Role in the Financial Stability

Two representatives of auditing companies in Czech Republic report about their activity in the Insurance Sector.

Jana Kapralikova gave her point as Manager at Pricewaterhouse & Coopers about solvency. She is Member of a Commission with the Czech Professional Association which is working on Solvency II. She sees Solvency II as an opportunity for Insurers. The possibility of setting up an internal model in particular is an advantage for insurers. Solvency I is easy to monitor for insurers but only looks at the capital. She described the Basle II risk-based three-pillar approach. Not only quantitative but also qualitative risk approach is considered. For example the Assets-Liabilities Management is very good tool. Of course, Risk Management should result from the Insurer's business strategy, which in turn should be fixed considering all the risks.

Romana Benesova, Partner in KPMG, Czech Republic, works especially with insurance companies. She has presented her approach of International Financial Reporting Standards (IFRS), as introduced by the EU in Regulation 1606/2002 to be implemented as a reporting basis from 2005. The new IFRS are compulsory only for the consolidated accounts of the listed companies. In all other cases, the implementing jurisdiction has to decide whether IFRS will apply or not, or if the companies themselves will have the opportunity to choose their reporting system. Romana Benesova has noted that companies have a lack of knowledge and experience in IFRS, and not only in Central and Eastern Europe. Her auditing methodology does not cover only pure accounting but also other aspects, as for example the underwriting and claims handling. She stresses the necessity of cooperation between the companies' lawyers and the auditors.

Financial Instruments and Insurance Contracts

As an opening of the second day's workshop, two approaches opened the workshop on the important issue of prudential supervision and accounting approaches.

Sarah Bouquerel, Actuary at the French Insurance Supervisory Authority (CCAmip), has analyzed the benefits expected from and the yet unsolved questions raised by the new international accounting standards. Expected benefits are better comparability (also cross-sectorial), better transparency, better assessment of risks. She expressed nevertheless strong concerns about the standards applying to the Insurance Sector, IAS 39 and IFRS 4, because they only serve accounting purposes and very little the prudential purposes. IAS 39 applies to financial instruments (without risk transfer) and IFRS 4 (still provisional) to insurance contracts (with risk transfer). Delimitation between these two types of contracts is fundamental and not always easy. The new valuation methods (fair value) might not be as reliable as wanted, the assets/liabilities reporting could be inconsistent, comparability could be impaired by two many options in the standards, and excessive prudence in insurance liabilities (e.g. catastrophe provisions) is prohibited. The work is still in progress at the International Accounting Standards Board (IASB) and it is crucial that insurers and insurance controllers participate. IAIS has been attending the IASB Insurance working group since September 2004.

Douglas Barnert, Executive Director of the Group of North American Insurance Enterprises (GNAIE), noted as a start that the great activity in Europe about new accounting is not reflected in the USA. Therefore the GNAIE has elaborated a project report on "researching alternate accounting methodologies to be considered as a basis for international accounting standards". Douglas Barnert addressed a strong recommendation to those supervisors that have not yet chosen their system to read all possible literature produced on the topic. He described an alternative Life Model with an alternative methodology. He was rather critical about the definition problems : the word "significant" is mentioned 253 times in the current standards without proper definition ! For example, a contract is insurance, when there is a "significant" risk transfer.

IAIS Framework and Corner Stones

Ruud Pijpers, Member of the IAIS Solvency Sub-Committee and of the Working Group "Solvency II" of the Committee of the European Insurance and Operational Pension Supervision (CEIOPS) presented the "IAIS Framework" and the so-called "Cornerstones". The papers issued on these two subjects, the first in October 2004 and the second in February 2005, have received much support. The overall philosophy of developing a common structure for assessment of insurer solvency is accepted. Solvency should not only be based on finance matter, but also on governance and market conduct. The Cornerstones are limited to 8 “arrows” for further work. They are no rules to adhere to, but directions to be tended to in the long term.

Solvency models and Risk Classification

Thomas Luder, Member of the Swiss Solvency Test Team of the Swiss Insurance Supervision Authority, reviewed different solvency models, some being already applied and some still in project. He described the quantifiable risk types to be taken into account. He presented features of the new Solvency Systems for Supervisors to think about when choosing their own system : “How do I want to do my things ?”. Thomas Luder gave his tips as follows : unquantifiable aspects should not be part of solvency models; a one-year horizon is the best compromise between the asset's term (some days) and the liabilities' term (some decades); internal models do allow comparability if insurers don't cheat.

IAIS Workshop

The IAIS workshop aimed at finding solutions to make prudential supervisions compatible with new accounting standards. **Makoto Okubo**, Secretariat IAIS, introduced the workshop in saying a few words about solvency, and about ICP 23. The issues to be discussed in this workshop were three very important aspects of solvency.
a) **Valuation** : How to value assets and liabilities, and address mismatching ? If discounting, which discount rate should be used ?
b) **Prudence** : How to maintain prudence in capital adequacy requirements as general purpose reporting standards are changed ?
c) **Sensitivity to risks** : How to set capital adequacy requirements that are sensitive to risks ?

The working groups gave their conclusions in plenum to all the participants.

Closing, next 19th Conference

This very successful 18th Conference has been closed in announcing the 19th Conference, which will take place in Sofia on 7-8 June 2007 organized by the Bulgarian Financial Supervision Commission. This Conference will then officially be called the “Pan-European Conference”, to better express its orientation towards integrating emerging markets in the most up-to-date preoccupations of Insurance Supervisors.

For the Standing Secretariat of the Conference :
Federal Office of Private Insurance, Switzerland

Enclosures : - List of participants
- Programm